MINUTES OF THE MEETING
TAXATION COMMITTEE
MONTANA STATE SENATE

March 20, 1981

The 52nd meeting of the committee was called to order at 7:30 a.m. in room 415 of the State Capitol Building, Chairman Pat Goodover presiding.

ROLL CALL: Senator Towe absent, all other members present.

DISPOSITION OF HOUSE BILL 370:

Senator Goodover announced that he had told the sponsor that the committee was holding the bill because of the impact. The sponsor said there was no impact. Senator Goodover made a motion that the amendments be agreed to. The amendment language passed, Senator Norman dissenting.

Senator Elliott made a motion that HB 370 BE CONCURRED IN, as amended. The motion carried unanimously.

DISPOSITION OF SENATE JOINT RESOLUTION 26:

Senator Elliott moved that SJR 26 BE CONCURRED IN. The vote was 10 to 1 in favor of the motion, Senator Eck dissenting. Senators S. Brown and McCallum abstained.

CONSIDERATION OF HOUSE BILL 804:

> "AN ACT TO REVISE THE MILEAGE LIMITATIONS ON TELEPHONE COMMUNICATIONS EQUIPMENT THAT QUALIFIES FOR CLASS SEVEN TAXATION; AMENDING SECTION 15-6-137, MCA."

Representative Williams, District 70, explained the bill will allow small rural telephone companies to remain at lower tax rates. These are non-profit and co-op oriented for rural areas and will not affect the larger phone companies. He said the bill is changing the amended statute to overcome a serious problem. According to statute, there are two factors which determine whether you go into central assessment: 1) you have to serve in cities or towns of 800 persons or less and 2) stations have to be more than 1 1/4 miles apart. We amended the distance to one mile.

Representative Williams said when he started the bill through as HB 65, it was thoroughly researched. It was found it doesn't affect Mountain Bell or the cooperatives. The proposed legislation has no fiscal impact. Because it is in a locality where it is not likely there will be much growth, he thought the correction would handle the situation for some time.

PROPONENTS: Joyce Brooks, Montana Associated Utilities and Southern Telephone Company. There were no further proponents, no opponents, and Representative Williams closed by saying this bill merely keeps this company in the same class in which it has been paying taxes. It just lowers the distance between stations based on the average circuit line as measured.

The hearing was closed on HB 804.

CONSIDERATION OF HOUSE BILL 640:

"AN ACT PROVIDING FOR ASSISTANCE TO FARMERS, RANCHERS, AND BUSINESSMEN ENGAGED IN AGRICULTURAL ACTIVITIES BY ESTABLISHING THE MONTANA AGRICULTURAL DEVELOPMENT BOARD; AUTHORIZING THE ISSUANCE OF REVENUE BONDS FOR ACQUISITION OF AGRICULTURAL LAND, LIVESTOCK, BUILDINGS, OR IMPROVEMENTS; PROVIDING CERTAIN INCOME TAX INCENTIVES TO INDIVIDUALS WHO SELL OR RENT AGRICULTURAL LAND TO BEGINNING FARMERS; CREATING AN AGRICULTURAL ACCOUNT IN THE BOND PROCEEDS AND INSURANCE CLEARANCE FUND AND APPROPRIATING MONEY DEPOSITED IN THE ACCOUNT; AND AMENDING SECTION 15-30-121, MCA."

Representative Lund, District 2, said North Dakota has had a concept like this where they don't have to go into the bonding process because the banks finance loans to get into farming and for those that are there to stay there. On sale of tax-exempt bonds: There is a tax incentive to those who sell or rent to beginning farmers. The program does not use state funds except for start up money. Representative Lund said the amendments were self explanatory.

PROPONENTS: George Bosliman, GT Murray and Stearns Brokerage Firms, felt probably the most troublesome part of a revenue bonding bill is security. This bill is premised on the fact that FHA will have money available to back up the bonds. We think it is workable; Ann Scott, Montana Farmers Union.

OPPONENTS: John Cadby, Montana Bankers Association. He had reviewed 4 loan authority bills before the legislature and had a dilemma about what to do today. Banks don't want to appear to be against economic development. For example, federal law last year passed arbitrage measure. A lending authority knows the borrower. If a state agency were to make loans it would not be very good. There is an inflationary effect with loan authorities, and we thought the committee should have the benefit of good thinking. He asked Mr. Terry Anderson to testify at this time.

Terry Anderson, Associate Professor of Economics, Montana State University said his views don't represent those of the University and are just thoughts on the situation. His testimony is incorporated as Attachment #1.

Questions were called from the committee.

CRIPPEN: Testimony was given by a young farmer during a bill heard by the committee on Senator Towe's young farmer bill. The young farmer had been able to buy some land from his parents at \$850 an acre receiving 50% of the financing from FHA at 5% and a contract for deed for the remainder at 5% interest. He testified in favor of the bill but testified he was still unable to make it. He said if he were to buy the land now the land would be $2,000 an acre and interest would be 10%. If he is just making it now, is he going to make it under far worse conditions?

LUND: It makes a difference as to where the farmer is. You have to look at the unit.

SEVERSON: I would like to ask Ann Scott--I think it relates to what you were talking about where the beginning farmer needs to make more than half of his income from another source. Some farmers are dedicated people that are willing to work that hard.

SCOTT: The problem with $2,000/acre land, it's division land, not representing farm land value. This bill won't work in an area where land prices have been bid up to double what their value is. There are many cases where people will go out and work very hard with a full time job to subsidize themselves into agriculture. I felt that particular provision should be taken out.

CRIPPEN: Even if my $2,000 figure were cut in half, I still have problems with it.

McCALLUM: The land Crippen is talking about is different that what you and Ann were talking about. But when you figure the interest on the land, you can't even make interest.

LUND: On land purchased in the last few years they can't make it.

McCALLUM: My biggest concern, as Senator Manley said, you are making serfs out of young people who have nothing going except inflation on the land. How are you going to finance this?

LUND: Revenue bonds. They are guaranteed by FHA.

CRIPPEN: You still have missed the point. We have a problem in Montana where we are losing valuable ground to development or outside influences. As a raionale, this is something we ought to avoid. If this method is not the way to go about doing it, how do we go about it? What role should the state take?

ANDERSON: It is a myth that we are losing agricultural land. More land is being put into production than taken out. I admit that corporate farms and large farms have been more successful than the small farm---really more efficient. If our goal is that we would like to have small farmers then I think we should be up front and not cover it up with bunk in terms of losing agricultural land. Say let's just subsidize them. You really are talking about an institution that is not extremely efficient--people are getting into it who can't manage. If you want to subsidize them all, go ahead. Do it on that basis. Clearly dry land will differ with irrigated.

Senator Goodover said Bob Berglund issued a statement widely publicized that the large farms were much more efficient. Problem is whether to maintain small farming which is not cost efficient.

SCOTT: I recently read the report Senator Goodover related. They found that 100% of efficiencies of scale were reached at the point of 1,400 acres cropped. They noted in Montana average cropland acre charge is 1,800 acres and we are already beyond farm efficiency. They noted efficiencies declined, as well as ability of farm to deal with soil and water conservation, as you increase this 1,400 acres. One of the reasons we see an influx into agriculture is that there are so many false economies for outside investors (long term capital gains, averaging out, etc.)

CONSIDERATION OF HOUSE BILL 654:

> "AN ACT TO REVISE THE LAW PERTAINING TO RAILROAD BONDS; TO PROVIDE THE NECESSARY BACKING FOR RAILROAD REHABILITATION REVENUE BONDS AND RAILROAD ROLLING STOCK REVENUE BONDS; ~~INCREASING~~ ELIMINATING LIMIT ON INTEREST RATES ON THE BONDS; INCLUDING CARRIERS USED TO TRANSPORT PRODUCTS OTHER THAN GRAIN IN THE DEFINITION OF ROLLING STOCK; AND AMENDING VARIOUS SECTIONS, MCA."

Representative Menahan, District 90, said this is an act to revise the law pertaining to railroad bonds to provide railroad rehabilitation bonds. There is no liability to the state on these bonds.

PROPONENTS: Mike Fitzgerald, President Montana Trade Commission, passed out a summary, Attachment #2. He said this legislation would amend to provide that interest rates will be established by the department. It provides for the repeal of rolling stock as well as manufactured stock. Legislation will require a transfer to the Department of Commerce.

Kenneth Clark, United Transportation Union; Ann Scott, Farmers Union; Clark Pyfer, self.

OPPONENTS: John Cadby, Montana Bankers Association.

McCALLUM: Do they have car manufacturing in Great Falls?

MENAHAN: Not at the present time. There are repair facilities in Miles City and Havre. This legislation would provide an incentive for someone to build cars.

ELLIOTT: Who is taking advantage of this act at the present time and why isn't industry purchasing their own rail cars?

FITZGERALD: I know of no company taking advantage at this time because it doesn't work the way it is now. No company is purchasing cars in Montana because none are manufactured here.

NORMAN: There is a provision in here that this will not become an obligation or not become a liability of the state. We have it for the rolling stock but not for the manufacturer of the cars. Is there anything that says this will not be made an obligation of the State of Montana?

MENAHAN: The fiscal note says to sell bonds.

NORMAN: He asked someone to look up the fact that the state will not be picking up the tab.

The hearing was closed on HB 654.

CONSIDERATION OF HOUSE BILL 798:

"AN ACT TO CREATE AN ECONOMIC DEVELOPMENT AUTHORITY; PROVIDING FOR THE ISSUANCE OF BONDS TO FINANCE PROJECTS; DESIGNATING TYPES OF PROJECTS TO BE FUNDED; CREATING ACCOUNTS NECESSARY FOR CARRYING OUT THE PROGRAM; AND PROVIDING RULEMAKING AUTHORITY."

Representative Hannah said HB 798 has been called the Montana Economic Development Act of 1981. The purpose of the MEDA is to allow tax exempt financing for jobs. Authority: 7 persons would be empowered to issue 200 million dollars in tax exempt bonds and loan to self-sustaining projects at low interest rates. Before loaning any money, the authority would be required to determine the project will be self-sufficient and capable of paying principal, interest, operating expense and taxes. Financial institutions would be engaged to review loan applications. They will be allowed to charge 1% service fee and carry 10% of the amount loaned. Except for starter costs no state funds would be needed. The authority is required to maintain a minimum reserve account. Any amount borrowed would be repaid by the authority and the sale of the bonds would not affect the credit of the State of Montana.

Representative Lund said the first amendment corrects a drafting error; 2 calls for per diem for board members; 3 allows board to set terms and conditions for loans; 4 makes sure that the 1% service fee allowed doesn't conflict with IRS regulation; 5 taken from Senator Towe's bill to set up criteria for the loans, and 6 says if Department of Commerce does become Department of Commerce, this program will be under their authority and, if it doesn't, it will be under the Department of Administration. Representative Lund said he had more amendments to take care of any troubles the committee had with the bill. He introduced John Oitsinger, a lawyer from Helena.

Mr. Oitsinger was appearing at the request of Representative Hannah. He said they discussed the credit provisions of the original bill and suggested an alternative to create a co-insurance pool backed by limited appropriations from the state. This is a mechanism which would comply with federal arbitrage regulations. This insurance fund mechanism is being suggested because there is an arbitrage, or split, limitation on the bonds that would limit spread to 1/8 or 1/2%, depending upon administration. This is different from the Board of Housing who would operate off 1 1/2%, now limited to 1/2%. The insurance fund is suggested as means of providing co-insurance backup for these bonds that would be implemented through insurance fees from the companies that are borrowers.

PROPONENTS: George Bosliman; Forrest Boles, Montana Chamber of Commerce; Mike Fitzgerald; Clark Pyfer, Montana Chamber of Commerce.

OPPONENTS: John Cadby, Montana Bankers Association, says some of our problems with the bill are that a borrower can borrow 2 million dollars. A banker would be irresponsible not to make his customer aware of this money at a better rate of interest. Who decides who gets the money? If you have two candidates, who is going to be the recipient? There is no way any commercial bank can compete with a state loan authority. Why isn't the Board of Housing here? They will have the task of administering these bills. How about the authority in the bill where the state may own land and property, lease, manage? It sounds like a state-owned bank.

Representative Hannah closed saying there is no intention of setting up a state bank. All loans must be made through the bank, otherwise amend to say that. Three points in closing: 1) this bill is fair--no special interest; 2) it is a safer program--it must be administered by private lenders; and 3) it is needed.

CRIPPEN: Will you respond?

CADBY: Pages 7, 8 and 9 state the authority can participate in making loans. In 1975 we opposed creation of the Board of Housing because of direct loans. They said they were not going to make loans but we have authority to make direct loans. Today, on multi-family projects, they are making loans; they are not running it through local banks; and they are serviceing the escrow payments. These are all end runs around the private sector. I cannot approve of that, nor can the people I represent.

ECK: Someone said there are only 1/2 dozen banks who will lend more than $150,000.

CADBY: Banks have corresponding relationships with city banks and can accommodate almost any amount borrowed through those relationships.

The Chairman announced the meeting tomorrow morning would start at 7:30 a.m.

Metting adjourned at 10:00 a.m.

PAT M. GOODOVER, Chairman

ROLL CALL

TAXATION COMMITTEE

47th LEGISLATIVE SESSION - - 1981 Date 3/20/81

NAME	PRESENT	ABSENT	EXCUSED
Goodover, Pat M., Chairman	✓		
McCallum, George, Vice			
Brown, Bob	✓		
Brown, Steve	✓		
Crippen, Bruce D.	✓		
Eck, Dorothy	✓		
Elliott, Roger H.	✓		
Hager, Tom	✓		
Healy, John E. "Jack"	✓		
Manley, John E.	✓		
Norman, Bill	✓		
Ochsner, J. Donald	✓		
Severson, Elmer D.	✓		
Towe, Thomas E.		✓	

Each day attach to minutes.

SENATE Taxation COMMITTEE

BILLS 640, 654, 798, 804 VISITORS' REGISTER DATE 3/20/81

Please note bill no. (check one)

NAME	REPRESENTING	BILL #	SUPPORT	OPPOSE
Ed. Boles	Montana Chamber	HB 798	✓	
G. L. Bousliman	G T Murphy Co & Bear-Stearns	HB 798 & HB 640	✓	
Kenneth D. Clark	United Transportation Union	HB 654	✓	
Michael W. Gullickson	" " "	"	✓	
Ern				
Terry L. Anderson	MT Bankers Assc.	HB 640 798		✓
John Cadby	" " "	HB 640 [illegible]		✓

PLEASE LEAVE PREPARED STATEMENT WITH SECRETARY

Attachment #1

March 19, 1981

TO: Senate Taxation Committee

FROM: Terry L. Anderson

RE: General thoughts on "Loan Authority" bills.

Let me begin by reminding you of the general mood in the United States regarding the role of government. This century has witnessed a rapid expansion of government relative to the private sector. While some of this expansion has come at the federal level, the majority of it has come at state and local levels. In part this expansion has been necessary to meet the demands of the growing and complex economy. At the same time, however, a significant portion of it has been stimulated by special interest groups pressuring governmental agencies to provide concentrated benefits to them while difusing the costs of those benefits over the general population. One of the consequences of this expansion has been a decline in productivity. This in turn has contributed to the double digit inflation which we face today. It seems to me that our task for the 1980s is to reverse these trends by pursuing policies which stimulate productivity and reduce inflation.

The loan authority bills which are currently before this committee on the surface appear to be a step in this direction. As an economist, however, I have some reservations about this conclusion which I would like to share with you. At the end of my remarks it will be clear that these loan authority bills, in fact, may serve to retard productivity and efficiency and that they are, ~~at least in part~~, a part of our "transfer society" which enhances special interests at the expense of the general taxpayer.

Expand

A favorite story of mine tells of the Roman messenger who returned to Rome bearing bad tidings. Upon informing the emperor of the bad news he was immediately beheaded by the emperor who did not want to hear such news. In any society and under almost any conditions it is not uncommon for the receiver of bad news to be upset with the messenger rather than to confront the bad news itself.

This story is important when considering these loan authority bills since they are in part our effort to behead the messenger. In this case, the messenger is our private financial system. This system coordinates individuals and groups with funds available for loans with individuals and groups desiring to borrow those funds. The middle man in the transaction, usually the banker, is faced with the tasks of matching creditors with debtors. His profits depend upon his ability to find the most productive activities in which funds can be invested. This means that he is often the messenger who brings the bad news. He is the one who scrutinizes potential investments to determine which are the better ones. As this messenger, he serves as the "reality check" for our society. Since his profits depend upon finding the most productive investments, he has an incentive to be realistic in assessing all the opportunities. When he tells us as a society that the beginning farmer is not a good credit risk, it is not because the banker does not like young farmers. It is because on average the failure rate is high. When loans are made to these beginning farmers it is because they are likely to be the ones who will be more efficient.

It seems to me that these loan authority bills represent our effort to avoid the messenger. The fact that private capital markets are not making money available for the projects outlined in these bills is a signal that the reality check is bringing bad news to the borrowers. By avoiding this reality check, we can not eliminate the bad news.

Assuming that you pass these loan authority bills, let me ask three questions which must be confronted:

(1) Where will the loan authorities get the money;

(2) Will there be a sufficient reality check; and

(3) Is there any subsidy implicit in these loan authorities?

Since these loan authorities can create no new money, the money they get through the sale of bonds must come from private sources. Unless there is idle money in the economy, and this seems highly unlikely in these times of tight money, there is no way that these programs can be expansionary, i.e. no way that they can expand economic growth for the U.S. economy. If the sale of bonds is able to attract funds from sources outside Montana, it is conceivable that they can expand local economies. While this may make sense from our narrow self-interest as Montanans, it does not make sense for the economy in general. In fact, if these bonds attract money from more productive investments, they will only work against the goals I mentioned at the outset.

Will there be a sufficient reality check? Remember that in the private sector the person making the loan is rewarded for finding productive investments. He is, what we call in economics, a "residual claimant," i.e. when all other bills are paid, he receives the profits which are left over. In the public sector there is no such reality check. It is a simple fact that people act differently when their livelihood does not depend upon the outcome. I am not, and I repeat am not suggesting that you as legislators do not have good intentions and that board members will not have the same. But good intentions are no substitute for good results. When the reality check of the marketplace is lacking, red tape is often used as a proxy. Unfortunately, the number of people willing and able to fill out forms will likely ~~exceeed~~ exceed the amount of funds available. Since these forms cannot always help us separate the better investments, they do not provide the same reality check. The result will be that some investments which should have "received the bad news" will instead receive funding, and general productivity in the society will be reduced.

If these loan authorities will be providing funds for less productive investments, you might ask why would anybody buy the bonds in the first place? The answer, of course, is that the bonds are tax free. It is common place to refer to this tax exempt status as a "tax expenditure." A tax expenditure is a tax reduction or loophole designed to encourage certain types of private sector activities. Such tax expenditures certainly have their place in providing incentives for the private sector. However, a question which we must ask is how will government spending be financed if that spending is not cut by an amount equal to the tax expenditure. In the case of these tax exempt bonds, there is no provision for cutting government spending in accordance with the tax expenditure. The slack must be picked up somewhere else in the system. The result in this case is that the Montana taxpayer is subsidizing the investments by the loan authorities. If the funds are attracted from outside the state, the outside investors in the bonds are receiving the subsidy. Though the magnitude of this subsidy has not been estimated, such an implicit subsidy should not be overlooked.

Let me summarize with some general remarks about how these loan authority bills fit into the task of the 1980s. A current buzz word in my profession is "supply-side economics." To many people in the business community, this simply means that the government is finally undertaking policies which will stimulate supply as well as demand. To the economists, however, supply-side economics means more. It means pursuing policies which promote efficiency by providing the correct incentive. In many cases this means freeing up the private sector and the productivity which it holds. These loan authority bills do provide incentives for investment. I do not believe, however, that they guarantee any increase in efficiency. The intention of these bills is to provide funds where they are now lacking. Before jumping to the conclusion that this is the best way to get the funds, perhaps we should consider why the funds are lacking in the first place. Let me remind you that "regulation Q", which is now being phased out, has been responsible for channeling funds from savings accounts in local Montana banks to money market funds in the East. These money market funds are not in the business of loaning money to beginning farmers or small commercial establishments in Montana. The reason money has flowed to these money market funds was government regulation in the first place. As regulation Q is phased out, I would suspect that more local funds will become available to help solve the problems addressed by these bills. My point is not that eliminating regulation Q will solve all of our problems. Rather, it is that we should address the cause of the problems in a forthright manner. If we will stop tampering with the incentive structure of the market system, patchwork measures like these loan authority bills will be unnecessary.

I repeat that our task in the 80s is to release the energy and productivity of the private sector. This means rewarding efficiency. If we do not do this in the short run we can expect continued inflation and a continued decline in per capita incomes. In the long run we will have to face extreme changes in our political-economic system. Before passing these loan authority bills, I suggest that you carefully consider whether they contribute to the task of the 80s or to more of what we have had in the past.

Attachment #2

HOUSE BILL 654 IS THE RESULT OF LEGISLATION THAT WAS INTRODUCED BY REP. DENNIS IVERSON DURING THE 1979 SESSION.

THE INTENT WAS THREEOLD:

1. to alleviate the grain car shortage in Montana (shortage of railroad rolling stock)

2. to strengthen the rail transportation system in Montana

3. and to stimulate the state's economy by providing more jobs for more Montanans.

THIS WAS TO BE ACCOMPLISHED BY:

---authorizing the issuance of up to $25 million worth of revenue bonds for the rehabilitation of certain rail facilities

---and further authorizing the issuance of up to $75 million worth of revenue bonds for the manufacture, purchase or lease of certain railroad rolling stock.

THIS WAS PASSED DURING THE 79' SESSION AND HOUSE BILL 654 LEAVES ALL OF THIS IN PLACE AND IN ORDER FOR THE STATUTE TO BE WORKABLE DOES THE FOLLOWING:

—provides that the interest rate on the bonds be established by the department in order to sell them.

—provides for not only the manufacture, purchase or lease of rolling stock but the repair as well.

—provides that railroad rolling stock meaning railroad cargo carriers used to transport grain be expanded to transport lumber, ore, coal, freight and commodities as well.

—remedies the IRS objection that the rolling stock couldn't be used primarily in Montana by providing that the rolling stock is to be based in Montana.

—provides that the department may require the borrower to secure the loan with the project or other property of the borrower.

STANDING COMMITTEE REPORT

March 20 19 81

MR. PRESIDENT:

We, your committee on TAXATION

having had under consideration Senate Joint Resolution ~~Bill~~ No. 26

Respectfully report as follows: That Senate Joint Resolution ~~Bill~~ No. 26

DO PASS

JRF

PAT M. GOODOVER, Chairman.

STATE PUB. CO.
Helena, Mont.

SENATE COMMITTEE TAXATION

Date Mar. 20, 1981 SJR ~~Bill~~ No. 26 Time

NAME	YES	NO
SEN. McCALLUM (Vice-Chairman)	absent	
SEN. BOB BROWN	✓	
SEN. STEVE BROWN		abstain
SEN. CRIPPEN	✓	
SEN. ECK		✓
SEN. ELLIOTT	✓	
SEN. HAGER	✓	
SEN. HEALY	✓	
SEN. MANLEY	✓	
SEN. NORMAN	✓	
SEN. OCHSNER	✓	
SEN. SEVERSON	✓	
SEN. TOWE	absent	
SEN. GOODOVER (CHAIRMAN)	✓	
	10	1

Betty Dean
Secretary

Pat M. Goodover
Chairman

Motion: SJR

(include enough information on motion--put with yellow copy of committee report.)

STANDING COMMITTEE REPORT

March 20 19 81

MR. PRESIDENT:

We, your committee on TAXATION

having had under consideration House Bill No. 370

Underdal (Elliott)

Respectfully report as follows: That House Bill No. 370, third reading copy, be amended as follows:

1. Page 1, line 19.
Following: "thereof."
Insert: "The gross sales proceeds shall be determined by multiplying the units of production sold from the well times the royalty unit value of that production at the well."

And, as so amended,
BE CONCURRED IN

XXXXXX
~~DO PASS~~

JLf

PAT M. GOODOVER, Chairman.

STATE PUB. CO.
Helena, Mont.