A COMMISSION REPORT

Industrial Development Bond Financing

THE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

JUNE 1963
A—18

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Washington 25, D. C.

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A COMMISSION REPORT

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BOND FINANCING

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June 1963

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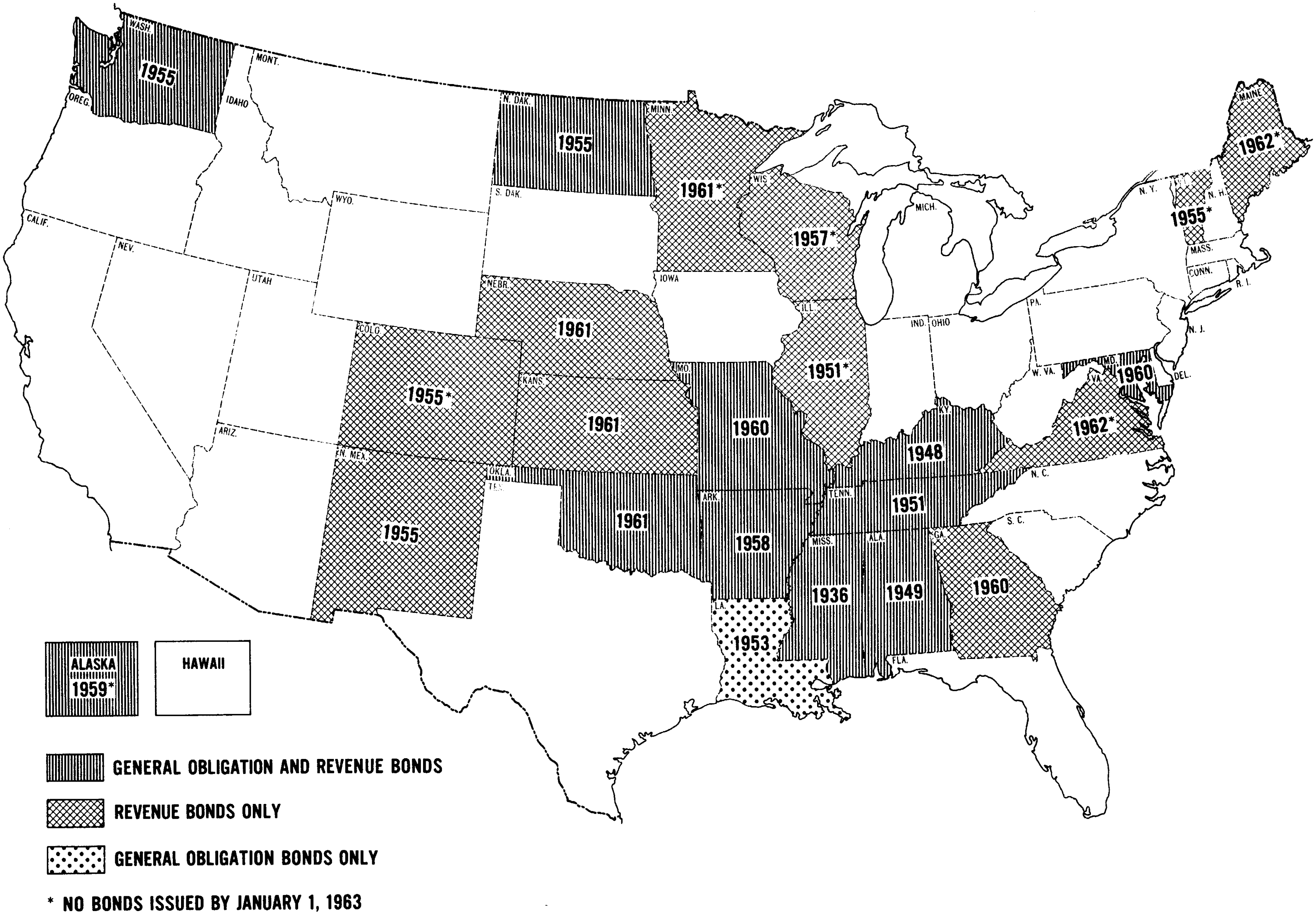
WHERE AND WHEN LOCAL INDUSTRIAL DEVELOPMENT BONDS HAVE BEEN AUTHORIZED

(AS OF JANUARY 1, 1963)



As set forth in Public Law 86-380, the Advisory Commission on Intergovernmental Relations has the responsibility, among others, to "encourage discussion and study at an early stage of emerging public problems that are likely to require intergovernmental cooperation."

The industrial development bond, employed in a number of States to finance industrial facilities for lease to private enterprise, is an emerging public problem with growing intergovernmental implications. Invented just a quarter of a century ago by one State seeking to complement its agriculture with industry, it has now spread to nearly half of the States and is under consideration in several others. While still a relatively minor source of industrial financing, it is capable of developing, in the opinion of some, into self-defeating competition for industry among the States. Its jeopardy to intergovernmental comity is aggravated by the circumstance that the advantage of the industrial development bond over conventional instruments of industrial financing stems in part from its immunity from Federal income taxation.

In this report, the Commission examines State and local bond financing of industrial development against the background of intergovernmental relations. It finds cause for concern in the unrestrained growth of this practice and offers a number of recommendations for State action and one recommendation for Federal action, all designed to eliminate the abuse of this practice for private advantage and to foreclose the development of destructive interstate competition for industry at the expense of Federal revenues and to the detriment of the public interest.

The report makes clear that if the States fail to regulate industrial development bond financing as recommended, interstate competition will inevitably dissipate their efforts to attract industry and may oblige the Congress to curb the practice through Federal legislation.

The use of tax exempt industrial development bonds is only one of several tools employed by State and local governments in their efforts to promote employment opportunities and attract industry. To some extent, interstate differences in the kinds of taxes imposed, in tax rates and exemption provisions, and in expenditure policies have similar motivations. The intergovernmental aspects of these practices will be considered by the Commission at a later date.

This report was adopted by the Commission at its meeting on June 27, 1963.

Frank Bane
Chairman

WORKING PROCEDURES OF THE COMMISSION

This statement of the procedures followed by the Advisory Commission on Intergovernmental Relations is intended to assist the reader's consideration of this report. The Commission, made up of busy public officials and private persons occupying positions of major responsibility, must deal with diverse and specialized subjects. It is important, therefore, in evaluating reports and recommendations of the Commission to know the processes of consultation, criticism, and review to which particular reports are subjected.

The duty of the Advisory Commission, under Public Law 86-380, is to give continuing attention to intergovernmental problems in Federal-State, Federal-local, and State-local, as well as interstate and inter-local relations. The Commission's approach to this broad area of responsibility is to select specific, discrete intergovernmental problems for analysis and policy recommendation. In some cases, matters proposed for study are introduced by individual members of the Commission; in other cases, public officials, professional organizations, or scholars propose projects. In still others, possible subjects are suggested by the staff. Frequently, two or more subjects compete for a single "slot" on the Commission's work program. In such instances selection is by majority vote.

Once a subject is placed on the work program, a staff member is assigned to it. In limited instances the study is contracted for with an expert in the field or a research organization. The staff's job is to assemble and analyze the facts, identify the differing points of view involved, and develop a range of possible, frequently alternative, policy considerations and recommendations which the Commission might wish to consider. This is all developed and set forth in a preliminary draft report containing (a) historical and factual background, (b) analysis of the issues, and (c) alternative solutions.

The preliminary draft is reviewed within the staff of the Commission and after revision is placed before an informal group of "critics" for searching review and criticism. In assembling these reviewers, care is taken to provide (a) expert knowledge and (b) a diversity of substantive and philosophical viewpoints. Additionally, representatives of the American Municipal Association, Council of State Governments, National Association of Counties, U. S. Conference of Mayors, U. S. Bureau of the Budget and any Federal agencies directly concerned with the subject matter participate, along with the other "critics" in reviewing the draft. It should be emphasized that participation by an individual or organization in the review process does not imply in any way endorsement of the draft report. Criticisms and suggestions are presented; some may be adopted, others rejected by the Commission staff.

The draft report is then revised by the staff in light of criticisms and comments received and transmitted to the members of the Commission at least two weeks in advance of the meeting at which it is to be considered.

In its formal consideration of the draft report, the Commission registers any general opinion it may have as to further staff work or other considerations which it believes warranted. However, most of the time available is devoted to a specific and detailed examination of conclusions and possible recommendations. Differences of opinion are aired, suggested revisions discussed, amendments considered and voted upon, and finally a recommendation adopted (or modified or diluted as the case may be) with individual dissents registered. The report is then revised in the light of Commission decisions and sent to the printer, with footnotes of dissent by individual members, if any, recorded as appropriate in the copy.

ACKNOWLEDGMENTS

The staff work for this report was conducted under contract with the Commission by Mr. H. Clyde Reeves of Louisville, Kentucky. During the course of his investigation, which included field interviews, group conferences and correspondence, Mr. Reeves received information and comment from numerous public officials, economists, representatives of finance, industry and labor, and private citizens. The cooperation of these individuals is gratefully acknowledged.

Wm. G. Colman
Executive Director

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Assistant Director

C O N T E N T S

I

FINDINGS AND RECOMMENDATIONS

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Introduction

This report examines one facet of State and local government efforts to attract industry -- the practice of using the credit of the governmental unit to finance the acquisition or construction of an industrial facility for lease to private enterprise. In the public mind, this activity has come to be associated with the financing of the acquisition of industrial facilities through so-called industrial development bonds -- the sale of municipal securities which, because of the Federal income tax exemption of the interest received from them, command more favorable terms in the money market than comparable corporate risks. Actually the sale of bonds is only one of several ways government credit is used to assist the financing of industrial facilities. State governments may appropriate current revenues or draw upon reserve or revolving funds for investment in industrial facilities or in the mortgages they support. They may also guarantee the credits extended by private lenders. Moreover, credit activities to finance the acquisition of industrial plants are typically only part of a multi-pronged public program of varying scope and magnitude to attract industry into a particular State or community.

This is an installment on our undertaking to examine the intergovernmental aspects of the relationship between State and local fiscal practices and the industrial location decisions of private enterprise. A subsequent report will deal with the other aspects of this larger question, including such issues as the differential impact of various kinds of taxes, differentials in tax rates, tax exemptions, and preferential tax provisions and practices.

Although the history of State and local use of public resources to promote economic development and create employment is as old as this Union itself,[1/] the techniques here under study have a relatively recent origin. The first to come to national attention had its beginnings in the late 1930's when Mississippi undertook to balance its lagging agriculture with industry. Local and State financing of industrial plant construction, however, did not become a multi-state practice until the 1950's and the volume of borrowing for this purpose reached a $20 million annual level only in 1957. Until relatively recently, also, this was primarily a local community activity. State financed programs are a development of the last few years.

1/ Local government debt was employed to finance a manufacturing plant in New Jersey, for example, as early as 1791. See Joseph Dorfman, The Economic Mind in American Civilization, 1606-1865, New York, 1946, p. 256.

By the beginning of this year (1963), authority for local governments to finance these activities through the sale of industrial development bonds was available in at least 23 States. In all but three of these, the enabling legislation has been enacted since 1950. By the end of 1962 only 15 had actually used their authority and in some of these the amounts involved to date are inconsequential. Local governments in some States have not implemented their authority because of policy or legal considerations; in several because the legislation is of too recent origin (1960-1962) for initial judicial testing to have run its course.

Programs for State financing of industrial development have been enacted in 13 States, including six of the above mentioned 23 with local government authority. At least three of the State government programs remain inactive. Some of these State programs provide for second mortgage loans, some for loan guarantees. Only one State engages directly in the construction of industrial facilities.

The combined contribution of State and local governments to the financing of industrial plant construction for private enterprise is still very small in relation to the volume of either business investment or State and local borrowing. The aggregate amount of all local industrial development bonds believed to have been sold from the beginnings of the program in 1938 to the close of 1962 is less than a half billion dollars.

This is a cumulative total. The aggregate financing provided and guaranteed by the State programs was still well below $100 million by the end of 1962. In comparison, the annual volume of securities issued by local governments alone has been above the $5 billion level and business expenditures for new manufacturing plant and equipment around the $14 billion level for some years.

As has been indicated, in several of the 30 States with legislative authorization to engage in these activities at the local or State or at both levels, implementation is not yet under way. Moreover, economic development program proposals calculated to attract industry by the use of public credit are under discussion in a number of additional States. Some new programs have already been enacted by State legislatures this year (1963). While there is as yet no solid basis for predicting that State and local financing of plant construction is destined to acquire major proportions, that possibility has to be reckoned with if the practice continues unrestrained.

That local and State government participation in the financing of industrial plants for private account is receiving nationwide attention bordering on notoriety at a time when it is still quantitatively unimportant, is explained by several factors. One is the pervasive fear that as the practice spreads, self-defense will drive local governments everywhere into participation. A second is that this will sap the fiscal strength of local governments and disrupt conventional financing procedures without contributing appreciably to the total volume of business activity. The experience associated with competitive State inheritance tax reductions in the early 1920's to attract wealthy residents and the competition associated with local and State efforts to influence the location of railroad routes during the past century are still fresh in many minds. Involved also is the deeply rooted public aversion to the intrusion of government -- local, State or National -- into activities traditionally reserved for private enterprise.

The industrial development bond issue is attracting widespread attention also because it impinges on some deeply held viewpoints on basic public policy issues.

Those opposed to the income tax exemption of interest from municipal securities on grounds of tax fairness use the industrial development bond as a prime exhibit of inequity, particularly in those instances where the lessee of the industrial facility himself purchases the tax exempt municipal obligations and becomes the recipient of tax free interest income. The offense is particularly deeply felt if the lessee chances to be, as is the case in a relatively few well publicized cases, a financially strong national corporation. Spokesmen for tax equity feel aggrieved also because the replacement of private with public ownership of industrial facilities results not only in income tax exemption of the rental income but generally also in property tax exemption of the industrial plant.

The defenders of the tax exemption of municipal bonds, on the other hand, appear fearful that public and political antipathy to tax exempt financing of industrial facilities will strengthen the case for terminating the exemption of municipal securities generally. The leaders in corporate finance with an eye on the future also have reason to be concerned. The trend toward the decentralization of manufacturing activities out of the industrialized urban centers, coupled with access to financing economies through the utilization of the tax free status of the activities and facilities of State and local governments, could conceivably divert significant portions of corporate financing from conventional channels, without necessarily producing compensating public benefits.

Friends of organized labor also claim a stake. They believe that the device contributes to the flight of industry into areas abounding in unorganized workers and right-to-work laws and to chronic unemployment in industrial centers. Northern and New England States, confronted with the out-migration of large segments of particular industries are similarly motivated, partly because the companies which stay behind may feel themselves victimized by unfair competition from other areas.

As pointed out below, local industrial development bond projects have in the main been small and orderly. We have not uncovered many examples of conspicuous abuse. Such examples, however, need not be numerous to generate public concern and produce sensational news copy, particularly because they typically involve multi-million dollar financing for a financially strong, nationally known corporation.

If at times the volume of news stories, reports, and speeches about industrial development bond financing appears to be out of proportion to the intrinsic present significance of the practice, it has at least succeeded in directing attention to a potential trouble spot. In the process, a sufficient number of intergovernmental issues has become the focus of public debate to make this type of financing a concern of this Commission. Interstate competition for plants, the possibilities for disrupting community economies and fiscal systems, the kinship between State and local subsidies to attract industry and the Federal programs for the economic rehabilitation of depressed areas, and the freedom of State and local governments to dispense subsidies to private industry partly at the expense of the U. S. Treasury (by tax exempt financing) illustrate the intergovernmental aspects of the problem and the focus of our primary emphasis. We concern ourselves with such questions as: Is the use of public credit for the acquisition of industrial plants for lease to private enterprise a constructive State and local government activity? Is it compatible with the division of governmental responsibilities under the Federal form of organization? If these questions are answered in the affirmative, how can the attendant friction points between governments and levels of government be minimized?

Governments in the United States since the beginnings of the Republic have freely intervened in and assisted the private economy to enable it better to achieve popular ends. This has occurred typically in the sweep of new patterns of growth and expansion, some national, others more limited. State and local government financing of privately owned canals, turnpikes, and railroads during expansion to the west is the conspicuous illustration. Less conspicuously, but quite commonly, governments financed banks, drainage areas, irrigation projects, and other internal improvements associated with the development of private interests. More recently, government ownership of utilities to foster the expansion of urbanization has become a common phenomenon.

The practice of State and local governments using their credit to help finance industrial facilities for private enterprise to further economic development and employment within their area bears some resemblance also to the investment of public funds (sometimes obtained through tax exempt financing) in baseball stadiums, sport arenas or recreation facilities to attract trade and commerce, particularly tourists.

In considering the propriety of State and local governments to engage in the stimulation of industrial development note should be taken also of the fact that the Federal Government is so engaged, with similar objectives, through such agencies as the Area Redevelopment Administration and the Small Business Administration.

Indeed, the phenomenon of two or three levels of government focusing on a common problem is the rule rather than the exception under our governmental system. If there be a preference for one particular pattern in the allocation of responsibilities among governments, it is biased toward relying in the first instance on local initiative.

Industrial development financing by State and local governments, as now practiced, appears typically to be associated with surplus labor problems. This conspicuously is the case with the hundreds of community programs scattered across a half dozen southern States where its objective is finding jobs for displaced agricultural workers. This appears also to be the case with the newer State programs concentrated in a few industrial States, where the motivation and statutory justification is the provision of jobs for chronically unemployed industrial workers.

Inherent in areas of substantial unemployment is the absence of property investment through which people can be productively employed. Rural areas are frequently deficient in credit facilities and in leasable industrial structures of substantial size. In both rural and industrial areas, the capital required by small, new innovating enterprises is often not readily available from conventional credit sources. In these kinds of situations, government can help to provide capital. Indeed, evidence suggests that public credit financing loosens and has a bellwether influence on private credit.

The communities in which employment has been generated with benefit of State and local financing assistance now number in the hundreds. Most are small places with small projects. From the viewpoint of some of these communities, particularly the smaller ones hitherto without industrial plants, the operations have succeeded. They have created some jobs, as was their objective. This at least appeared to be the consensus of those interviewed in the 17 communities with some 60 plants visited in the course of this project. Evidence of this kind, to be sure, casts insufficient light on the net effect of these activities on total national employment. The data required to illuminate that question are not available because the impact of these activities on the familiar economic indicators is indiscernible in the interplay of the legion of variables which shape nationwide and statewide business activity. While conclusive evaluation of the net contribution of industrial development bond financing to the national economy would be informative, it is not indispensable to the consideration of its intergovernmental aspects.

As we have already noted, there is nothing radically new or revolutionary in a local government's effort to use its fiscal powers in behalf of its economic objectives. However, the more notable earlier excursions of local governments into development financing, it should be observed, occurred at a time when the tax exemption of the interest on their securities was not a factor. The Federal income tax did not come into existence on a permanent basis until 1913 and a level of tax rates high enough to cloak tax exemption with major significance is an even more recent development. The advent of the Federal income tax, and more particularly the increased value of an exemption from its high rates, has necessarily introduced a new factor into the situation. However, our primary concern here is not with the broad issue of tax exempt securities. Little would be gained by fanning those fires here and now. That question, too, has to be faced and squarely, but this can be done only in the context of the appropriate role of the total apparatus of intergovernmental immunities -- local, State, and Federal -- in our system of government. Our concern with tax exemption is here limited to the consideration that in all cases of industrial development bond financing, one of the costs incurred is a loss of Federal revenue by virtue of the exemption of interest income from Federal taxation.[2/]

Industrial development bond arrangements are vulnerable to misuse and examples of malpractice can be found. We can identify at least three categories of abuse. One of these occurs

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2/ The government's revenue loss from the issuance of tax exempt industrial development bonds is partially offset, it should be noted, by the revenue gain resulting from the fact that the private business enterprise which receives the benefits of the tax exempt borrowing through lower rental charges is a taxable entity. To the extent that tax exempt financing (and other subsidies provided by State or local government) increases the business firm's taxable net income, its Federal tax liability is increased. In this respect the revenue effect of the industrial development bond differs from that of municipal bonds generally.

when the firm for whom the facility is constructed has access to adequate financing through conventional channels. The abuse is particularly glaring when the benefited enterprise itself acquires the tax exempt bonds issued to finance the structure it occupies, thus becoming also the beneficiary of tax exempt income.

Another kind of abuse results in instances where projects far beyond the community's employment needs are undertaken. When this occurs labor is imported, the local economy is disturbed, and community facilities are strained. In addition, the community may saddle itself with excessive contingent liabilities in the form of debt service on the bonds.

A third kind of abuse occurs where tax exempt financing of an industrial facility enables a community (perhaps with benefit of its other advantages, such as availability of cheap labor, raw materials or a market) to pirate a going concern from an established location.

The evidence we have been able to muster indicates that examples of pirating or run-away businesses associated with industrial development bonds are exceptions, not the rule. However, the use of public tax exempt financing for the benefit of nationally known firms well able to finance their expansion from private sources is increasing. We have noted instances of this in small communities subject to the kind of dangers just enumerated. An expansion of these practices could readily jeopardize the usefulness of State and local development programs.

New local and State programs to attract industry are being planned in many parts of the country and the industrial development bond device is frequently involved. If competition for industry is allowed to spread unrestrained, State and local governments will neutralize one another's efforts and the public investment will have been largely wasted. In this sense, the entire development is potentially self-defeating, unless confined to economically justifiable proportions and circumstances. However, so long as some communities engage in the practice, others will feel themselves obliged in self-defense to follow suit. This underscores the urgent need for appropriate safeguards to cleanse the practice of its more objectionable features.

We conclude that the industrial development bond tends to impair tax equities, competitive business relationships and conventional financing institutions out of proportion to its contribution to economic development and employment. It is therefore a device which the Commission does not endorse or recommend. However, the Commission recognizes the widespread and growing nature of this practice and the unlikelihood of its early cessation. Therefore, we conclude that if the practice is to continue, a number of safeguards are absolutely essential. These safeguards are required to minimize intergovernmental friction, to insure that the governmental resources deployed for this purpose bear a reasonable relationship to the public purpose served and that the governmental powers employed are not diverted for private advantage. We believe that the need for these safeguards is urgent.*

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* Senator Muskie expresses the following separate views in which Speaker Lowman concurs: I do not concur in the negative conclusions expressed about industrial development bond financing expressed above. (1) States and their local governments should be encouraged--not discouraged--to attack problems of economic stagnation and underemployment; (2) abuses have not been prevalent, and although present to some extent do not constitute a basis for condemning the self-help efforts of State and local governments; and (3) providing opportunity and incentive for industry and employment, through a free enterprise economy is a proper and legitimate concern of local government which does not materially differ from the provision of water, sewage disposal, roads, parks, swimming pools and the other facilities provided by governments to encourage economic activity and frequently financed through public borrowing. I do not find evidence in the accompanying text to justify the conclusion that "the industrial development bond tends to impair tax equities, competitive business relationships and conventional financing institutions out of proportion to its contribution to economic development and employment."

If ours were a unitary government, the appropriate safeguards could be readily provided by central government. In this governmental system, however, neither the National Government nor one of the States prescribes unilaterally for the others. Each is required to show compassion for the interests of the others and intrude upon them for its own advantage only when considerations of public welfare are compelling.

Costs, benefits, and equities are important criteria for the evaluation of any governmental program. They acquire special political importance where, as is here the case, the distribution of these costs and benefits has intergovernmental attributes. In these circumstances, moreover, the provision of the necessary safeguards is logically the cooperative responsibility of all the levels of government involved.

The provision of safeguards against the abuse of industrial development bond financing is appropriately the joint concern of the States and the National Government. The National Government is concerned because the financing method employed usually involves the dispensation of a Federal subsidy to private interests by a third party, in this case a local or a State government. It may be justified, therefore, in taking such steps as it deems necessary to insure that subsidies dispensed at its expense are not dissipated or exploited for private advantage. The National Government is logically concerned also with the relationship of State and local activities in the cause of industrial development to its own programs in behalf of economic growth and development.

Other national considerations are involved as well. The effect of these State and local activities on the fairness of the Federal tax system, the efficient operation of the money markets, the dispersal of industry, employment and unemployment, and the condition of the national economy generally illustrate the range of the national interest.

Scope for State Action

The State governments' interest in preventing abuse is several fold. They anticipate that the National Government might stop the abuse by designing a legislative remedy to curb the exploitation of the industrial development bond's tax exemption for private gain and will want to avoid the Congress being driven to this extremity. This would not only defeat the ends sought by the States which rely upon these arrangements to facilitate industrial development, but would also thwart those who seek a greater role for State government in an effective, cooperative federalism.

The States have other motivations as well for cooperating in the imposition of selective and qualitative restrictions upon the use of industrial development bonds. The plant acquisitions they finance are exempt also from State and local taxation since they are typically publicly owned. Also, where one jurisdiction over-extends itself, the maladjustments tend to spill over to other jurisdictions to the detriment of the State's total economy.

Unsound financing in individual cases ending in failure may initially embarrass only the one jurisdiction, but ultimately will impair the credit standing of other jurisdictions and indeed, of the State itself. In those cases where special governmental units or districts have to be created to gerrymander the required political support, the rationality of the State's local governmental structure is impaired. Finally, mention should be made also of the State's custodial responsibility for all the activities of its local governments because it is the depository of residual powers and all powers of local government stem from it. Clearly, the States' interests in monitoring the supply of industrial development bond financing, both quantitatively and geographically, to accord with the distribution of capital and employment needs and the requirements of a rational structure of local government, parallel and complement the interests of the National Government.

Since conditions vary from project to project, the control of industrial development bond financing can best be approached on a case by case basis. Qualitative rules and standards for the distribution of financial aid can more successfully be developed at the State than the national level because they can be tailored to the specialized needs and conditions prevailing in the particular area. In short, if the practice of issuing industrial development bonds is to be subjected to qualitative tests, the States will have to impose and enforce them. For the reasons stated, it is to their self-interest to do so. Moreover, States have an obligation to discharge this responsibility as part of their responsibility to oversee the activities of their local governments. It is their obligation to the Federal Government as well, if for no other reason, because they are dispensing a subsidy at Federal expense.

Recommendation No. 1. This Commission recommends, therefore, that if States elect to permit the acquisition or construction of industrial facilities with public funds for lease to private enterprise they define by legislation the precise conditions and requirements under which such activities may be undertaken.

A question requiring resolution in developing legislation to control public industrial development financing is whether the operation of the program should be decentralized among local governments or retained at the State level. Current practice provides examples of locally operated programs, State operated programs, and of both existing simultaneously. The State alone can and should determine the pattern of administration appropriate for its requirements and circumstances. Evidence developed in the course of our investigation suggests that (a) local programs are best adapted to rural areas with a surplus of farm labor and a dearth of capital and property leasing resources, while (b) State programs lend themselves most effectively to the needs of urban and industrial areas with surplus labor, interested in the small, new, and innovating businesses which do not normally have ready access to capital from conventional sources.

To insure compliance with prescribed standards, the State government should vest the authority to approve the issuance of industrial development bonds in a State agency experienced in the administration of local government problems. Complicated findings of fact and questions of law such as may be involved in industrial bond questions where private advantage and public policy may conflict are most expeditiously handled by administrative bodies subject to judicial appeal. In the absence of compelling reasons to the contrary the approval of these bonds should be vested in the State agency, if any, which has supervisory jurisdiction over local government financial administration. The agency charged with the approval or disapproval of proposed bond issues should be required to give the State development authority or planning agency advance notice of contemplated proceedings and afford it an opportunity to be heard.

Recommendation No. 2. This Commission recommends, therefore, that if States elect to permit their political subdivisions to issue industrial development bonds they require that all such bonds be approved by an appropriate State agency as a condition of issuance.

Special local government districts and authorities are often unresponsive to popular control. The aid they dispense to industry through industrial development bond financing may easily lose its relationship to the public benefit. This is evidenced by some of the large issues recently sold or proposed in two or three States. In the negotiations incident to the decision of business enterprise to locate in a community, general units of government are in a superior position to determine and be concerned with the burdens the new enterprise may place upon a community for additional public services. For this reason, the advantages and disadvantages of an industrial development of a new character are more likely to be properly evaluated by a unit of general government than by a special purpose district. This Commission has already stated its misgivings about the proliferation of local governments through the creation of special districts and agencies.[3/]

Recommendation No. 3. This Commission recommends, therefore, that if States elect to permit their political subdivisions to issue industrial development bonds they restrict such authority to general units of government, i.e., counties, municipalities and organized townships.

Local government industrial development bonds have been used primarily in surplus agricultural labor areas with limited capital and property leasing facilities. When local bonds are used to finance industry in other areas, the special districts and satellite municipalities are usually the sponsoring unit of government and the corporations aided are most often well established financially and interested primarily in the subsidy. In such cases the public benefit generated is not likely to be commensurate with the government's contribution. If urbanized and industrialized areas need assistance in financing industrial development, other devices, such as second mortgage loans and programs for guaranteeing private industrial loans, would be more appropriate.

3/ State Constitutional and Statutory Restrictions upon the Structural, Functional and Personnel Powers of Local Government, pp. 74-75, October, 1962.

Recommendation No. 4. This Commission recommends, therefore, that if States elect to permit their general units of local government to issue industrial development bonds, they give priority to those governmental units which have surplus labor and are outside the area of the regular and effective operation for existing conventional credit and property leasing facilities. 4/ (Urban areas are covered in Recommendation No. 8.)

Because general obligation industrial development bonds are a direct contingent liability of the issuing local government and because in the case of revenue bonds the issuing unit of local government may belatedly discover that it needs to assume responsibility for debt service, the aggregate volume of such liabilities incurred should bear a reasonable relationship to the economic resources of the area and more specifically to the ability of citizenry of that area to assume them. Other considerations also counsel a limitation on the volume of this kind of financing. Industrial projects out of proportion to the size of the community in which they are located result in labor importation with attendant disturbance of local economies and the necessity for increasing public expenditures to provide required services. A limitation on the magnitude of operations will buttress efforts to confine this practice to units of general government and to limit exploitation of the practice in behalf of financially strong corporations.

4/ In considering what constitutes a proper definition of a surplus labor area, the standard employed by the Area Redevelopment Administration may be helpful. See Public Law 87-27, sec. 5.(a) and 5.(b). Generally the rules laid down (sec. 5(b)) for determining redevelopment areas have applicability in the context of Recommendation No. 4. However, some States may find simpler definitions more useable. In defining areas outside the regular and effective operation of existing conventional credit and property leasing facilities, States may find the "standard metropolitan statistical area," as that term is employed by the U. S. Bureau of the Census, useful.

Our conclusion in favor of a quantitative limitation on the aggregate volume of this kind of borrowing is not at variance with our recommendation elsewhere[5/] that States leave the determination of the volume of local borrowing to duly elected governing bodies, because the industrial development bond entails special considerations not present in borrowing for the established general functions of government which the people logically entrust to their elected officials.

In light of the variations prevailing in the economies of the different States and more particularly their varying stages of economic development, the selection of a yardstick for governing quantitative limitations on industrial development bond financing necessarily presents difficulties. Since one of the objectives is to limit these activities to magnitudes consistent with the fiscal resources of the community, the aggregate amount of the population's personal income (compiled annually by Department of Commerce on a State-by-State basis) suggests itself as a criterion. For example, a limitation of the general magnitude of 10 percent of the aggregate annual personal income of a State's population would not only accommodate all present programs but leave them substantial scope for growth in the coming years. A limitation in terms of personal income, to be sure, would allocate a smaller volume of industrial development bonds to low income than to high income States, which

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5/ State Constitutional and Statutory Restrictions on Local Government Debt, pp. 71-75, September, 1961.

probably should not employ them at all. Nevertheless, it is an appropriate measure in low income States for keeping bond financed community development projects within reasonable limits. A percentage of the residents' aggregate personal income is closely related to their capacity to assume the risks involved in this kind of financing and to their ability to provide the additional public facility and service requirements generated by new industrial plants.

A limitation in terms of personal income may not be practicable on a jurisdiction by jurisdiction basis, partly because data for individual communities are not readily available and partly because one community's project might very well serve a larger area; therefore, a legislative limitation in these general terms is likely to be most useful on an areawide basis. Utilized in this way, it would assist and govern the State administrative agency in fixing the magnitude of the amount of borrowing to be apportioned among all eligible units of government.

<u>Recommendation No. 5.</u> <u>This Commission recommends, therefore, that if States elect to permit their general units of local government to issue industrial development bonds, they place a limitation on the total volume of such bonds which may be outstanding at any one time and to the extent practicable, relate such limitation to meaningful criteria, such as the personal income of the population.</u>

Few if any industrial projects are now financed through the issuance of local government development bonds on a speculative basis. The general practice is to undertake the construction of a facility for an identified lessee to meet his particular specifications. Always in the case of revenue bonds and normally in the case of general obligation bonds, a contract governing the construction and occupancy through rental payment is concluded before the bonds are issued. Communities frequently find the assistance of the representatives of State government helpful in evaluating the terms of these contracts. To facilitate the provision of this help and to provide adequate safeguards for participating communities, a contract with an occupant providing for rental payments reasonably calculated to amortize the bonds during the useful life of the facility should be required as a condition for approval of issuance of bonds.

A question inevitably involved in the terms of the contract concerns the ownership of the facility upon expiration of the contract. Where the government retains title to the property,the likelihood is reduced that the arrangement between the lessee and the community is little more than the transfer of the community's tax exemption to the corporation. On the other hand, ultimate private ownership of the facility will eventually release the property and the income it produces for tax purposes and liquidate the community's activity in real estate operations, albeit with the attendant loss of rental income.

Recommendation No. 6. This Commission recommends, therefore, that if States authorize their local units of government to issue industrial development bonds, they condition the approval of such bonds upon the existence of a contract with a responsible tenant with necessary provisions to safeguard the interests of the community, including the question of the disposition of the property at the termination of the lease and its contribution to local tax revenue. Provisions should be included to restrict the "pirating" of industrial operations by one community from another.

In our earlier report on the borrowing powers of local governments, we counseled against requiring individual bond issues to be submitted to electoral approval. We concluded in favor of vesting that responsibility with the elected local governing body, always reserving for the local electorate, however, the right to initiate a referendum on the question. We believe these complementary principles to be controlling. The electorate's right to initiate an election is especially important in the borrowing here under scrutiny. Community investments in industrial facilities should concern the citizens for a variety of reasons, including the contingent obligation they assume by issuing bonds. The prospective industrial resident should himself be interested in the electorate's attitude, as reflected in a referendum. To make the electorate's privilege to voice its views on the proposed borrowing operation meaningful, provision should be made for full disclosure of the contemplated operation through public posting or advertising.

Recommendation No. 7. Accordingly, this Commission recommends that if States elect to permit their general units of local government to issue industrial development bonds, they make adequate provisions to insure that the public has an opportunity to understand the proposal and that citizens have the right to initiate a referendum on the proposal.

We have reached no firm conclusion on the question of general obligation vs. revenue bonds for industrial financing. In our earlier report on the borrowing powers of local governments we expressed a preference for general obligation financing. In the context of the problem here under consideration, each type has advantages and disadvantages. These are discussed in Part II.

State Programs

Our foregoing recommendations concern the use of industrial development bonds by local governments. We have previously noted that they are best adapted for use in rural areas with surplus agricultural labor and a deficiency of credit and property leasing facilities. Their use is less evident and more subject to abuse in urban and industrialized areas where conventional facilities for large volume of credit are not generally lacking. Until very recently, industrial development bond issues tied to individual projects have not been used for financing development in such areas. Moreover, large units of general government in urban centers have seldom found it feasible to issue industrial development bonds.

Some States may see a need for facilitating industrial expansion by easing the availability of credit, particularly for small, new, and innovating industries in urban and industrialized areas. Indeed, a number of States, including Michigan, New York, Pennsylvania, and Rhode Island, have taken steps in this direction. State programs acquire the funds used for financing industrial facilities by bond issues, treasury loans, and appropriations.

State programs are dominantly of two types -- loans secured by a second mortgage to supplement local civic and conventional financing and State guarantee of conventional mortgage loans. Though the second mortgage loan type program rates preference because it disturbs the conventional money market least and does not involve a contingent liability which may be called most inopportunely, under certain circumstances the guaranteed loan type programs may be more practicably employed as an investment stimulant.

Some existing State programs for second mortgage loans may offer industrial loans at interest rates below the cost of money to the State and below conventional rates for other prime credit risks. This places State governments in competition with conventional financial institutions in a manner which the recommendations herein are designed to deny local governments and might lead to interstate competition in lowering rates to a level that would prejudice private capital accumulations and economical allocation of industry.

<u>Recommendation No. 8.</u> <u>Accordingly, this Commission recommends that if a State deems it desirable to assist in the financing of industrial development to stimulate employment in urban and industrialized areas, it adopt a State program or empower its principal units of general government in urban centers to adopt programs restricted to such areas and designed to minimize competition with conventional financial institutions.</u>

Scope for Federal Action

The foregoing recommendations place primary responsibility for regulating industrial development bond financing upon the States. This reflects our view that they have a compelling obligation to do so, especially where the immunity of their securities from Federal taxation may be misused for private advantage without corresponding public benefit. We are mindful of the likelihood that our recommendations may encounter resistance, particularly in those States where established programs operate with inadequate standards and safeguards. We recognize also that the adherence of States to the standards and restrictions here proposed may not be forthcoming with sufficient alacrity to relieve the concern of the National Government over the abuse of the tax exemption privilege. In these circumstances it might serve the interests of the States and the National Government equally if the Congress conditioned the future use of tax free bonds for industrial development financing upon (1) the enactment of State programs of control along the lines recommended above and (2) the certification of the adequacy of the State's regulatory program by an appropriate agency of the Federal Government, such as the Department of Commerce's Area Redevelopment Administration or the Treasury Department.

Under the present circumstances we are not prepared to make firm recommendations for subjecting the adequacy of State programs to such Federal approval because self-policing by the States better accords with intergovernmental comity. However, we do not foreclose the possibility that the States' failure to confine competition for industry within reasonable limits, and more particularly their failure to safeguard the National Government against the further abuse of tax exemption within a reasonable period of time may oblige the Congress to prescribe it.

We have already noted that perhaps the clearest case of abuse of the industrial development bond device occurs when the corporation which leases the industrial facility itself buys the tax exempt bonds which financed the acquisition of the facility. Such a corporation is obviously able to do its own financing without governmental aid. The absence of conventional sources of financing, a consideration to which we attach substantial importance in justifying the intercession of local governments in rural areas, is not present here. When a financially strong corporation itself buys the municipal bonds issued to finance its plant, it not only enjoys a rental reduction reflecting the interest savings derived from the tax exemption of the bonds but a tax exempt interest income as well, despite the fact that its investment in the bonds is subject only to the risk inherent in its own business. This is a different risk than that assumed by other investors in tax exempt bonds. In these situations the misuse of the tax immunity of municipal bonds for private advantage is too glaring to permit the remedy to be delayed until State legislatures provide it. Prompt Congressional legislation to eliminate this kind of abuse is required. The remedy could take either of two forms: (a) denying tax exemption to the interest income or (b) denying deductibility to the rental payments for Federal income tax purposes. In a broader context, both approaches have been considered by Congressional committees in past years. Alternative (b) is less likely to provoke a question of constitutionality than alternative (a) and therefore may be preferable.

Recommendation No. 9. Accordingly, this Commission recommends that the Congress amend Subchapter B of Chapter 1 of the Internal Revenue Code of 1954 to terminate the financing of industrial facilities with tax exempt securities in situations where all or part of the industrial development bonds are directly or indirectly held by the lessee of the facility by denying the deduction of amounts paid for the use of the industrial plant in the determination of taxable income.

Our information about the ultimate placement of industrial development bonds is fragmentary. The identity of the purchasers of these securities is not a matter of public record and details gleaned from secondary sources cannot be confirmed. It is believed that parts of several large issues have been subscribed by the leasing corporations themselves and there may be a trend in this direction.

Obviously, Recommendation No. 9, standing alone, would not deny tax exempt financing to large corporations with adequate access to conventional financing sources since they would be left free to place "their" bond issues with investors other than themselves.

Implementation of our recommendations for State action would prevent the use of industrial development bonds for large projects on behalf of companies able to do their own financing directly or through conventional credit sources. Hopefully, these recommendations can be effective and operational within a few years. Speedier termination of the use of this device on behalf of these larger corporate projects could perhaps be achieved by denying the rental deduction contemplated by Recommendation No. 9 to all leased industrial facilities representing large industrial development bond issues (say those of \$5 million or larger). While this limitation would have affected only two projects in 1961 and four in 1962, they account for more than 50 percent of the dollar volume of industrial development bond financing in each of those years. It would have left undisturbed the typical industrial development efforts in the small non-urbanized areas where, as we have already noted, the case for this kind of governmental activity is strongest.

Whether a legislative remedy along these lines is technically practicable can be evaluated best by the tax writing committees of the Congress with benefit of the technical skills at their disposal.

II

HISTORICAL DEVELOPMENT AND GENERAL BACKGROUND

1. The Nature of Local Industrial Development Bonds
2. The Use of Local Industrial Development Bonds
3. State Aid in Financing Industrial Development
4. Citations to the Constitutional and Statutory Provisions Authorizing Industrial Development Financing
5. Inventory of Leading Court Cases
6. Source of Data on the Volume of Local Government Industrial Bonds Issued

1. THE NATURE OF LOCAL INDUSTRIAL DEVELOPMENT BONDS

Local industrial development bonds, simply defined, are obligations of local governments or their instrumentalities sold to obtain funds for acquiring or improving facilities, plant sites and buildings, sometimes machinery and equipment as well, which in turn are made available (for a consideration) to private industrial enterprise for the conduct of its business. The bonds are either (1) general obligations, secured by the taxing power of the issuing government or (2) revenue bonds, secured only by the property acquired with the proceeds of the bond sale and the income the property produces under the terms of the lease contract.

In the public mind, governmental programs to stimulate the economy and provide employment are usually associated with the National Government. These national programs necessarily affect various communities and areas differently. The differential impact is in part explained by the geographic distribution of the activity on which the program is focused. In part, however, it is locally influenced through private and public decisions. Where the focus of the national program is business activity, the distribution of that activity among States and communities, through the location decisions of private enterprise, is necessarily influenced by local conditions, including the availability of labor, capital, markets, raw materials, entrepreneurial talent, and public services. Since local governments necessarily influence the supply and quality of some of these ingredients, they inevitably play a role in influencing industrial location decisions.

Direct efforts by local government to influence industrial location by distributing subsidies of one kind or another have a substantial history. Helping to locate sites, building roadways, offering tax exemptions, or assuming certain moving and personnel training costs are examples. Such activities in behalf of industrial development are in the nature of gifts. They often arise out of bargaining situations and have no bearing on the basic economic factors in private location decisions. Undoubtedly early civic and governmental offerings of buildings were in the nature of inducements. As the programs involving the sale of local government bonds to finance the construction of buildings for lease to private industrial tenants have developed, a pattern has emerged indicating that in certain rural areas the availability of credit and property leasing facilities are sometimes as essential as transportation or water resources in order to take advantage of the economic factors of labor, raw materials, and markets.

A Rural Area Phenomenon

The incomplete inventory of projects financed with local industrial development bonds now lists substantially in excess of 500 separate issues. Most are located in areas of surplus farm labor, usually designated as redevelopment areas for Federal assistance. 1/ The list does not appear to include a single pre-1960 bond issue for the construction of a plant in the immediate vicinity of a large city. The first such case appears to be a 1960 issue by the Industrial Development Corporation of Davidson County (Nashville), Tennessee. In 1961 North Little Rock, Arkansas, and Florence (near Covington and Newport), Kentucky, issued industrial development bonds. Substantial issues were announced in 1962 in behalf of nationally known companies in Lewisport (near Owensboro), Kentucky, in Shrevesport, Louisiana, and in Mobile, Alabama. Municipal industrial development bonds are conspiciously absent from the immediate areas of such urban centers as Birmingham and Montgomery, Alabama; Louisville and Lexington, Kentucky; New Orleans and Baton Rouge, Louisiana; Jackson, Mississippi; and Memphis and Knoxville, Tennessee.

The absence until recently of local government industrial development bond financing near large urban centers is attributed to (1) the political problems local governments encounter in furnishing aid to a new industry in a community where substantial established industry has developed without comparable aid, and (2) the fact that urban centers have adequate commercial credit and property leasing facilities for servicing industry. It is significant that the recent bond issues in urban areas were sponsored in Tennessee by a special district and in Arkansas and Kentucky by satellite municipalities.

The small and medium sized industrial concern thinking of starting manufacturing operations or expanding them into a rural community seldom has accumulated cash for construction; and such capital accumulations and credits as it is able to take to the new seat of operation

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1/ Cf. the Redevelopment Areas Map of the U. S. Department of Commerce, Area Redevelopment Administration, October 1, 1962.

are usually needed for sales promotion, research, and operating capital required in the new location. It is often impracticable for such industries to sell stock publicly because of the expense involved and the threat to ownership's control. In short, many concerns, particularly small, new, and growth-industry firms, wanting to initiate or enlarge operations require external financing from within the area into which development is proposed.

Economic considerations have operated to make it advantageous for many businesses to lease rather than own the real estate necessarily used in the conduct of their affairs. The practice of Sears, Roebuck and Company and various chain store organizations illustrates this point.

A study of the factors influencing industrial location is revealing about the role of the availability of buildings for lease in the decision process. On the basis of 1180 replies received from a survey of 5000 companies that had expanded or relocated in seven southern States during a five year period, the "availability of buildings or other property" ranked near the top in importance and "financial aid" near the bottom. 2/

Typically, rental space available in small towns is inadequate for industrial needs. The capital available for investment in commercial and industrial property in rural areas gravitates to the less risky multiple-tenant buildings rather than to the single-tenant rambling industrial plant. The good rental space that local money is equipped to finance in the community is pre-empted by local tenants and national retail chains. Large accumulations of capital interested in industrial plant investment restrict investments to areas of particular interest and to areas where there is multiple opportunity for lease. 3/

Banks are the principal source of credit for industry and large banks are able to lend all of their resources allocated to industrial bonds and mortgages to prime borrowers and within select areas. Banks in most of those cities and counties which have issued industrial development bonds are small -- seldom with more than $10 million in deposits -- and pursue a conservative investment policy. Some State laws restrict banks territorially. This further handicaps banks in providing capital for the construction of industrial buildings in rural areas. Banks in large

2/ Thomas P. Bergin and William F. Egan, "Economic Growth and Community Facilities," Municipal Finance, May 1961, p. 148.

3/ An officer of a large national concern engaged in this type of business suggested that Cincinnati, Ohio, represents the minimum sized metropolitan area in which speculative industrial building can be reasonably undertaken.

commercial centers often make industrial loans at interest rates higher than allowed by some States where local industrial development bonds are issued. 4/ This impedes the flow of capital to some areas. When capital is available to relatively under developed areas interest rates tend to be higher than in financial centers. 5/

Together these conditions lead to the conclusion that in rural areas conventional credit facilities do not adequately provide financing for industrial buildings, and the machinery for using credit to provide industrial buildings on a lease-back arrangement is lacking. In many areas local government is the only entity that has the motivation and power to command capital for this use. The use of industrial development bonds to bridge "credit gaps" is consistent with the role recognized as appropriate for Federal credit programs by a committee that recently reported to the President on this subject. 6/ Certainly, the income tax exemption of the interest on local industrial development bonds has made their use more attractive. The _ad valorem_ tax exemption of the property for which industrial development bonds are issued may be of equal or greater significance.

Tax Considerations

The use of local government bonds to build and perhaps equip an industrial building for lease to a private operator incorporates a number of tax advantages that are usually passed on to private business. These tax advantages take at least the following forms:

(1) The interest on such bonds is exempt from income taxes.

4/ The maximum legal rate of interest is six percent in Kentucky and Tennessee.

5/ George Maceisch, "Interest Rates on the Periphery and in the Center of Economic Development," _Southern Economic Journal_, Vol. 28, p. 140, July, 1961

6/ Committee on Federal Credit Programs, _Report to the President of the United States_, G.P.O., February 11, 1963, pp. 7-9.

(2) When the lessee owns the bonds, tax free income is received from what may be tantamount to investment in his own business.

(3) The amortization of the bonds during the term of the lease contract may often result in an advantage to the occupant equivalent to a write off for income tax purposes at a rate faster than would be allowed if the property were owned by the occupant. 7/

(4) The industrial property leased by the occupant and owned by the local government and the bonds themselves may be exempt from State and local *ad valorem* taxes.

These tax advantages are a governmental subsidy to private enterprise. But governmental subsidies are a familiar institution in organized society and take diverse forms such as accelerated depreciation, protective tariffs, pegged prices, and preferential tax provisions. 8/ Federal subsidy in various forms

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7/ Some existing arrangements may give rise to income tax problems in determining the base for depreciation and problems in determining the value for *ad valorem* taxation upon expiration of the lease.

8/ Recently, a voice has been raised in favor of unimpaired local subsidies to industry, John E. Moes, *Local Subsidies for Industry*, Chapel Hill, N. C., 1962, 252 pp. and "The Subsidization of Industry by Local Communities in the South", *The Southern Economic Journal*, October, 1961, pp. 187-193. Moes appears to base his case on the classical proposition that full employment will occur in a free labor market: Minimum wage laws and labor unions will not permit wages to drop so as to increase the number that can be profitably employed; therefore, local government should subsidize industry in surplus labor areas enabling it to hire more, produce more and sell the finished product at less per unit without loss of profit position. For a critical analysis of this thesis see Irving J. Goffman and James H. Thompson, in *The Southern Economic Journal*, October 1962, pp. 111-119.

is broadly claimed by many industries. The subsidy in local industrial development bonds from the Federal Government is substantial, but it is triggered by a third party, local government. Herein lies a source of dissension. It may be argued that local government officials might dispense a Federal subsidy less carefully than a subsidy of local money or less carefully than Federal officials. The use of Federal subsidy to foster inter-area competition and particularly when its use may disadvantage established private enterprise is obviously objectionable. However, Federal subsidies to enable an essential enterprise to operate though some competition may result (as in the transportation industries) or to assist in the rehabilitation of a depressed area, are accepted policies. Subsidy to industry arising from the fact that local industrial development bonds confer certain Federal tax favors, acts economically very much like Federal loans for small business and industrial loans under the Area Redevelopment Program. In another sense this subsidy is akin to accelerating depreciation and direct income tax reduction to encourage general economic expansion. However, the Federal subsidy represented by the income tax exemption on local industrial development bonds is directly and specifically related to industrial investment, while the impact of other Federal tax adjustments designed to stimulate economic growth is not so pinpointed.

The income tax exemption of the interest on local industrial development bonds makes investment in the bonds more attractive and tends to increase the availability and reduce the cost of capital for such investment. Industrial bonds of responsible local governments may be an effective vehicle for the dissemination of a Federal subsidy via the tax exemption route, to stimulate economic growth and to create employment in chronically distressed rural areas. Helping small business and chronically distressed areas are matters of substantial Federal legislation. The case for local participation in the decision making processes of Federal programs is often pushed. There is a general inclination to favor keeping decision making as localized as practicable. The local industrial development bond route minimizes administrative costs and automatically directs the Federal subsidy to those communities that are trying to help themselves by facing up to their problems and making decisions about them.

The amount of Federal subsidy represented by the loss of tax revenue from the exemption of interest on local industrial development bonds is now relatively small. Assuming a 6 percent interest rate on $500 million of bonds (issued through 1962) and a 30 percent marginal tax rate, the annual revenue loss is in the neighborhood of $9 million. Moreover, part of this loss is recaptured because it is reflected in increased taxable income for the lessee, through reduced rental cost deductions. However, the revenue loss will increase as the practice spreads. On the other hand, if the use of local industrial development bonds is restricted to assisting small, new, and venturesome firms in areas with surplus labor which lack adequate resources for financing and leasing industrial property, the amount of such financing is likely to remain small.

One of the considerations in favor of terminating the tax exemption of municipal bonds is that they divert investment from private enterprise. 9/ From the viewpoint of that objective, the industrial development bond would appear to have a strong claim on tax exemption since its purpose is to provide capital to private enterprise. By the same token, however, the industrial development bond loses any justification if it is issued for corporations that do not need assistance in financing expansion and in areas where commercial credit and property leasing facilities are readily available.

When the lessee of a municipally financed building purchases the bonds which financed the building, additional tax advantages may accrue. If by contract or pursuant to a stipulated or negotiated price the building becomes outright the property of the lessee upon retirement of the bonds, a part of the lessee's interest income from the bond investment is in effect equivalent to tax free return on an investment in a depreciable asset. When a lessee owns the tax exempt bonds issued to finance his own building, his risk is of a different order than that of other owners of tax exempt securities because the element of risk present is only that involved in his own business. If the term of the bonds is shorter than the useful life of the building, the rental reduction calculated to repay the bonds on maturity is the equivalent of accelerated depreciation, where the building becomes the property of the lessee. In the end, however, income tax adjustments may be forthcoming; tax questions are involved which have not been ruled upon.

The effect of exempting the leased property from *ad valorem* taxation because it is municipally owned is in principle the same as several States' practices to exempt new industries from property

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9/ Harold Groves, *Post War Taxation and Economic Progress*, N. Y., 1946, pp. 200-206.

taxation and will be considered in another report. Suffice it here to observe that such exemption is not a necessary complement of municipal industrial development bond financing. Some firms operating in municipally financed buildings make payments in lieu of taxes or property taxes on lease holds. The *ad valorem* exemption can also be disassociated from the development bond financing simply by selling the building under a conditional sales contract instead of leasing it. This, however, might affect depreciation deductions or their equivalent. It should be further noted that some sentiment is developing for *ad valorem* tax exemption of industrial property on the ground that the governmental costs associated with the presence of an industrial establishment often are less than the tax revenues that the facility provides. 10/ Also, it is of such significance as to merit repeating that *ad valorem* tax exemption of the property may be more significant than income tax exemption of the interest on the bonds sold to accumulate capital to provide the building.

Abuses

The literature on local industrial development bonds generally condemns the exemption of interest paid on them. The practice has been denounced in strong terms as leading to socialism, prejudicial to municipal credit, jeopardizing State and local sovereignty, and creating ill will among governments. 11/ It has been condemned by the Board of Governors of the Investment Bankers Association of America, the Municipal Finance Officers Association, and the AFL-CIO. In connection with the review of the Internal Revenue Act of 1954, the Ways and Means Committee considered with some sympathy proposals to disallow exemption of interest on local government industrial bonds or to exclude as a business deduction rental paid by the lessee of buildings financed by such bonds. However, remedial legislation was not enacted. Agitation for

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10/ Lynn A. Stiles and Lillian M. Rymarowicz, *State Government and the Economy*, unpublished memorandum, Chicago, 1962.

11/ Joseph F. Bradley and Oswald D. Bowlin, "Industrial Aid Bonds -- A Device for Attracting New Industry", *Municipal Finance*, May, 1961; address by Cushman McGee, before the Investment Bankers Association of America, May 9, 1962, White Sulphur Springs, W. Va., and Harry W. Wolkstein, "Problems of Tax-Exempt Financing of Industry", in *Commercial and Financial Chronicle*, September 21, 1961.

remedy, however, continues. Bills pending in the Eighty-Eighth Congress would tax the interest from municipal industrial revenue bonds 12/ and disallow the deduction for federal income tax purposes of rental payments for the use of buildings financed with tax exempt bonds. 13/ The latter remedy is urged by the Investment Bankers Association of America, among others.

If industrial expansion can be accomplished in either of two areas of otherwise comparable advantage, the community offering industrial development bond aid will be favored. This advantage may tend to spark inter-community and interstate competition for industry and may even lead to plant pirating. This can disadvantage communities that have become industrialized without local government aid and where general, areawide, politically responsible local government does not participate in the practice.

The case against municipal bond financing is strongest when a small community uses its governmental powers to enable an industrial giant to borrow large sums of money at less than prime commercial rates to construct plants that require the importation of labor which the community can not readily assimilate. The proposal of the small southeastern Missouri community of St. Genevieve to issue $500 million in industrial revenue bonds is a conspicuous illustration. The contemplated size of the operation is out of proportion to the employment needs of the area and the size of the community. The incorporation of the virtually unpopulated area of an industrial site in an urbanized region, apparently for the primary purpose of securing tax exempt financing, as in the case of Champ, Missouri, plainly endeavors to place other industrial property owners in the St. Louis area at a relative disadvantage.

The creation of municipal corporations and the use of municipal powers principally for the purpose of tax avoidance reflects on the institution of intergovernmental tax immunities and discredits the tax exemption of municipal securities. Financing the expansion of companies well able to command ample credit without governmental aid, as has been done in several States, disturbs the corporate money market and may result in mislocating

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12/ H. R. 517, by Congressman Abraham Multer, 13th Dist., N. Y.

13/ H. R. 6772, by Congressman Robert P. Griffin, 9th Dist., Mich.

industry without compensating public benefit.

A summation of the abuses highlighted in this section and inferred elsewhere suggests that if use of industrial development bonds is to be continued in areas finding them helpful in efforts to provide employment, safeguards are required to eliminate or at least mitigate particularly the following practices:

(1) The use of industrial development bonds to finance expansion of firms well able to obtain the required capital from conventional sources;

(2) The purchase by the lessee of bonds issued to finance the facility he occupies;

(3) The tendency of communities to over extend themselves and finance large industrial projects out of proportion to their employment needs, public service facilities and fiscal resources;

(4) The use of the device principally as an instrument for competitively attracting industry; and

(5) The formation of special districts solely for the purpose of issuing industrial development bonds to facilitate the perpetration of abuses.

Special District Financing

Comments in the following section, particularly those pertaining to Oklahoma, Tennessee and Washington, relate the story of industrial bonds issued by special districts. Not only are districts created for other purposes engaging in industrial development financing but increasingly special districts are being created for this purpose. This kind of financing by special districts facilitates the opportunity for abuse of the development bond device. Special districts are typically subject to little if any control by the electorate, their representatives or by State supervisory agencies. The evidence suggests that they aid the enterprise that does not need help and foster practices unfair to established firms and conventional financial facilities.

Announcement Value

A large industrial firm expanding into a city in Mississippi urged the city to initiate an industrial development bond issue to finance a new building on its behalf. The city took all the necessary steps, including electoral approval of the bonds, after which the firm declined to have the bonds issued and provided the financing itself. The company is reported to have done this to assure itself that it was wanted in the community. Local cooperativeness is a factor in industrial location. The willingness of the electorate to approve bonds to finance plant construction is a most convincing demonstration of community welcome.

The location of an industry frequently becomes a bargaining situation between the community and the firm. The bargaining may involve diverse elements, such as financial help in retraining the labor force, a free building site, tax concessions, construction of transportation and utility facilities, improvement of schools and recreation facilities, or the erection of a local hotel. The community and the local government officials may be unaware of what the area needs to attract industry; certainly, this may often be true as it applies to small communities in relation to specific industries. An offer of industrial development bond financing is an effective announcement on the part of the community that it is willing to negotiate.

General Obligation vs. Revenue Bonds

Local governments obtain funds to finance industrial buildings by issuing general obligation bonds, revenue bonds, or a combination of both. In the case of the general obligation bond, the issuing government pledges its tax resources (i.e., its "full faith and credit") to service the debt, while the revenue bond may tap only the rentals paid by the lessee and the building he occupies for debt service. Associated with this basic difference are the following characteristics peculiar to each:

General obligation industrial development bonds -- (1) The amount that may be issued is normally limited by statute or State constitution; (2) electorate or State approval is often required; (3) the financial strength of the issuing government affects their marketability; (4) they are a direct liability of the issuing unit of government; (5) they usually sell at lower interest rates than revenue bonds when issued in behalf of corporations enjoying less than a prime credit rating; and (6) they are a possible vehicle for industrial innovations and entrepreneurial ventures that could not support revenue bonds.

Revenue industrial development bonds -- The market's estimate of the prospects of the leasing corporation determines the limit of the amount of bonds a unit of government can issue and the rate of interest it pays. Because they are not direct tax obligations, electorate or State approval is usually not required.

Communities have often encountered difficulty in marketing revenue bonds to construct buildings for local or small and perhaps weak enterprises. Often the market for such revenue bonds is confined to the immediate area. The common failure of voluntary local development corporations to redeem and pay interest on outstanding subscriptions may have made local investors in some communities wary of industrial development revenue bonds. In other communities local purchases of initial issues have helped build a market for subsequent issues.

Communities, as in several cases in the western part of Tennessee when they first offered to issue industrial revenue bonds, were unable to locate the kind of lessee prospects who would command a ready market for revenue bonds. General obligation bonds, however, could be sold readily because the general taxing power of the local government was pledged, usually in addition to the lease revenues. Once the issuance of general obligation industrial bonds was established, it tended to encourage a market for revenue bonds. However, general obligation bonds were often sold on more favorable terms than revenue bonds. 14/ This caused prospective lessees to prefer general obligation bond financing unless they enjoyed a credit rating equal to that of the issuing government, unless they themselves purchased the bonds as sometimes happened, or unless the rental charges were fixed in excess of and without relation to amortization costs, which seldom happens. This explains the apparent tendency for States to authorize both revenue and general obligation bonds.

Comparison of developments in Mississippi, where only general obligation industrial development bonds were authorized until recently; in Tennessee, where both general obligation and revenue bonds are issued; and in Kentucky where practically only revenue

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14/ In 1960 the average yield of the 34 general obligation issues sold in Mississippi was 4.19 percent and the average yield of the six revenue issues sold in Kentucky was 4.67 percent.

industrials are issued, confirms the observation that general obligation bonds are better designed to disperse small industry throughout the State. This comparison also points to the conclusion that general obligation bonds are not normally employed in financing the more costly industrial expansions. Half the total dollar volume of local industrial development bonds issued in 1961 and 1962 consisted of six large revenue bond issues ranging from $5.8 million to $25 million while the largest general obligation issue was $6 million. The next largest general obligation issue found was $4.7 million in 1951 and most involved less than $500 thousand.

State statutes authorizing local governments to issue industrial development revenue bonds usually regulate interest rates and terms, prescribe that they shall never become an obligation of the issuing governmental unit, and stipulate that the bonds are conditioned upon benefiting the community and upon the feasibility of the project. Missouri, where the law has not been fully activated, is the only State requiring industrial revenue bonds to be approved by referendum and administratively by the State. The argument usually made against State supervision and approval of local industrial development revenue bonds is that such red tape is unnecessary because the market is the best judge of the feasibility of the project.

General obligation bonds for industrial development are necessarily related to local revenue resources and are usually statutorily related to the property tax base. Most States require voter approval of general obligation industrial bonds and Louisiana, Missouri, Mississippi, and Tennessee require approval by more than a simple majority of the electorate voting on the question. These same States require general obligation industrial development bonds to be approved by a State supervisory agency. Approval in Louisiana, Mississippi and Tennessee is conditioned upon showing the availability of labor, a satisfactory lease with a responsible lessee, and compliance with other statutory provisions. The administration in Mississippi has been criticized as being too conservative and rejecting issues for marginal enterprises that should have been aided. 15/ Many local officials and community leaders in Mississippi and Tennessee endorse the approval practices in their States. No local inquiries were made in Louisiana and no bonds had been issued in Missouri when the field survey for this report was done.

15/ Moes, *op. cit.*, p. 77.

Some investment bankers handling local industrial development bonds are unfavorably disposed to the general obligation type financing on the ground that the market is not afforded the opportunity to appraise the feasibility of the project, while public officials and local voters are not qualified to do so. They fear that general obligation financing may foist uneconomical enterprises upon the community under conditions requiring the taxpayers to assume the obligation for debt service. On the other hand there may be reason for concern that the limited liability of revenue bonds might be circumvented. 16/ In such event taxpayers might be burdened with obligations which neither they nor their representatives ever considered as contingent.

This Commission has on a previous occasion expressed its preference for general obligation bonds over revenue bonds for financing construction of regular governmental facilities. 17/ The disadvantages of revenue bonds -- the additional costs involved, their use in circumventing debt limits, the minimization of public accountability in connection with them -- are well known. However, revenue bonds for industrial development may be justified in some circumstances on the ground that they conserve the general credit of the issuing unit of government for other purposes. Revenue bonds supported by a strong though small company may be more attractive to certain investors than the general obligations of the small rural communities offering them. Certainly, revenue bond issues can be carried through more expeditiously than general obligation issues if less is required in the way of voter and State agency approval.

On the other hand, many of the small, new, and venturesome enterprises that have been aided by general obligation issues in Mississippi, for example, could not have been financed by revenue bonds. Private investors would not have been willing to take the

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16/ See "The Public Purpose of Municipal Financing for Industrial Development", 70 Yale Law Journal, 759-803, April 1961; Arthur O. Armstrong, "Municipal Inducements -- The New Mexico Commercial and Industrial Project Revenue Bond Act", 48 California Law Review, p. 58, March 1960; and Notes, "Legal Limitations on Public Inducements to Industrial Location," LIX Columbia Law Review, 618-647, April 1959.

17/ ACIR, State Constitutional and Statutory Restrictions on Local Government Debt, September 1961, pp. 54-57.

risk involved. By assuming this risk, the taxpayers of many small communities in Mississippi have been able to attract small industries and may have been instrumental in developing new and venturesome projects, into strong, responsible business enterprises. 18/

No case has been found of long term default in interest or principal of a municipal industrial development bond issue. There are a few instances, however, in which the lessee has abandoned the building and failed to pay the rental, so that the burden of avoiding default has fallen upon the issuing local government. The legality of this in the case of revenue bonds is uncertain and no record of the question having been adjudicated was found.

Normally industrial development general obligation bonds have been overwhelmingly approved by the electorate. 19/ In some areas of Tennessee, however, as cities have approached the limit of their debt for this purpose, counties or sub-county districts have moved into the gap and proceeded to hold elections for the issuance of industrial development bonds resulting in approval by very narrow margins. No county disapprovals were found, though some may have occurred. Local residents interviewed attributed the relative lack of enthusiasm on the part of farm voters to the influence of commercial farmers. These sources suggest that commercial farmers oppose industrial development because it tends to increase farm wage rates, though it may not affect the availability of farm labor.

18/ The fact that the risks of a general obligation issue are spread among all the taxpayers of a community may provide a stronger case for tax exemption of interest on general obligation industrial development bonds than on revenue bonds. See op. cit., LIX Columbia Law Review.

19/ For a record of the "yes" and "no" votes by issue in Mississippi, frequently 40 to 1, see Summary of Mississippi BAWI Plants, mimeographed, Mississippi Agricultural and Industrial Board.

2. THE USE OF LOCAL INDUSTRIAL DEVELOPMENT BONDS

Community efforts to promote industrial development by mobilizing local assistance in financing plant facilities began to make their appearance in the late 1800's under the leadership of chambers of commerce and other business-oriented local groups interested in providing employment and protecting property values. These private civic efforts originated and are still most active in small communities and labor surplus areas. Money is raised in various ways--by public subscription, the sale of stock and borrowing--to support programs calculated to promote community development. Forty percent of 1200 non-governmental community industrial development organizations surveyed in 1957 had each built at least one building for industrial prospects. 1/ All States, save Alaska, reported such local development organizations. In 1961 at least 3,147 were in existence. 2/

Mississippi was hard hit as the country was emerging from the Great Depression. The practical exhaustion of the timber supply and changes in cotton culture left the area with relatively little industry and much surplus farm labor. There were no large financial institutions or private resources for financing industrial facilities. Several communities in the State had raised money privately to build industrial buildings that were successfully occupied. Cities had tried to use public money for this purpose but had been judicially denied the right to engage in the activity. 3/ A constitutional provision prohibited the lending of public credit for a private purpose.

In 1936 Mississippi established its Balance Agriculture with Industry (BAWI) Program. Its legislature declared industrial employment to be in the public interest and authorized cities and counties to incur general obligation indebtedness to construct industrial buildings for lease to private enterprise.

1/ Moes, *op. cit.*, p. 121.

2/ "States Having Means to Assist Industrial Financing," Area Redevelopment Administration, Staff Memorandum, July 30, 1962.

3/ Carothers *v.* Booneville, 153 S. 670, 1934. The leading court cases are listed in Section 5.

The Mississippi legislation was validated in 1938;4/ and soon thereafter other States began to enact similarly patterned legislation along somewhat comparable lines and the now familiar "industrial development bond" came into being.

Extent of Local Industrial Bond Financing

Industrial development bonds were first authorized to be issued for at least some political subdivisions in the following States in the years indicated. 5/

Mississippi	1936	Arkansas	1958
Kentucky	1948	Alaska	1959
Alabama	1949	Georgia	1960
Illinois	1951	Maryland	1960
Tennessee	1951	Missouri	1960
Louisiana	1953	Kansas	1961
Colorado	1955	Minnesota	1961
New Mexico	1955	Nebraska	1961
North Dakota	1955	Oklahoma	1961
Vermont	1955	Maine	1962
Washington	1955	Virginia	1962
Wisconsin	1957		

The amounts of local industrial development bonds reported to have been sold, by years through 1962, are shown below. 6/ The volume, it will be noted, has been substantially higher in the more recent years than in earlier periods. Year to year fluctuations appear to be explained in part at least, by the timing of one or two unusually large issues, accidents of reporting, and to some degree conditions of the money market. Some small issues doubtless escaped notice in the preparation of this tabulation. The omissions in the aggregate should not exceed $20 million. On this basis, the total volume of local industrial development bonds issued by the end of 1962 is estimated at approximately $460 million.

4/ Albritton v. Winona, 178 S. 799, 1938; an appeal claiming a Federal issue to be involved was dismissed, 303 U. S. 627, 1938.

5/ The citations of State laws are listed in Section 4. In Washington the authority is restricted to special units of government. In Alaska and Maine the authority is by constitutional provision, not by statute. In North Carolina bonds were first issued in 1961 without specific State legislative authority.

6/ Sources of data for this and the following tabulation are listed in Section 6.

Year	Amount
Amount Before 1951	$ 7,248,000
1951	9,615,000
1952	7,605,000
1953	5,270,000
1954	5,015,000
1955	7,280,000
1956	8,231,000
1957	19,841,000
1958	17,495,000
1959	45,536,000
1960	103,023,000
1961	83,459,000
1962	87,840,000
Date uncertain	33,598,000
Total. . .	$441,056,000
Estimate for underreporting. . .	20,000,000
Grand Total. . .	$461,056,000

The volume of industrial development bond financing to date is small in terms of the size of local government financial operations. All industrial development bonds now outstanding represent less than one percent of the approximately $52 billion of local government bonds issued during the decade 1953-1962 and of the $56 billion local government long term debt outstanding on June 30, 1962. 7/ However, the volume of

7/ U. S. Bureau of the Census, Governmental Finances in the United States, (annual) 1953-1961, and Long-Term Debt of State and Local Governments (1962 Census of Governments, Preliminary Report Number 7).

these issues, particularly large ones, is increasing; 8/ their use is spreading, and in some jurisdictions the volume in relation to conventional criteria of debt load is high.

The volume of local industrial development bonds reported to have been issued through 1962 by States is as follows:

Alabama	$ 73,052,000
Arkansas	48,461,000
Georgia	2,198,000
Kansas	3,311,000
Kentucky	42,239,000
Louisiana	12,630,000
Maryland	100,000
Mississippi	102,748,000
Missouri	425,000
Nebraska	3,225,000
New Mexico	7,300,000
North Carolina	501,000
North Dakota	2,650,000
Oklahoma	500,000
Tennessee	125,716,000
Washington (estimate)	16,000,000
Total. . .	$441,056,000
Estimate for underreporting . . .	20,000,000
Grand Total. . .	$461,056,000

8/ Before 1961 the only issue to exceed $5 million was the Mayfield, Kentucky, $9.5 million revenue bond issue for General Tire and Rubber Company. In 1961 there were three issues of over $5 million. These were revenue bonds of $10 million by the Industrial Development Corporation of Davidson County, Tennessee, for Genosee Co.; $14.4 million by the Bradley County, Tennessee Industrial Development Board for Olin Mathieson, and $25 million of Cherokee County, Alabama, for Armour and Co. In 1962 Opelika, Alabama, issued $21 million in revenue bonds for the U. S. Rubber Co.; the Bradley County, Tennessee Industrial Development Board issued $5.85 million revenue bonds, and Shreveport, Louisiana, and the Mobile, Alabama, Industrial Development Board issued general obligation bonds in the amounts of $9.2 and $6 million, respectively. The 1962 data were supplied by the Investment Bankers Association of America and the companies for which the last three named issues were sold was not available.

By the end of 1962, at least 23 States had some type of specific authorization for local government industrial development bond programs. 9/ Eleven States authorized both general obligation and revenue bonds; 11, revenue bonds only, and one, general obligation bonds only (see frontispiece).

Three of the 23 States, Colorado,10/ Illinois,11/ and Vermont, 12/ have had enabling legislation since 1955 or earlier but the authorizations have not been used. The Wisconsin authorization is for city and village revenue bonds to develop industrial sites (not buildings) which are sold to industry; the extent to which the enabling legislation has been used is not centrally available. 13/ Under 1961 Wisconsin legislation counties may appropriate funds to non-profit agencies to promote industrial development.

9/ This excludes North Carolina where Rocky Mount issued $501,000 industrial development revenue bonds without specific legislative authority.

10/ Missouri Division of Commerce and Industrial Development, Industrial Development in the United States, Jefferson City, March, 1961.

11/ Letter from the Illinois Board of Economic Development, dated August 17, 1962, advising that bond attorneys have ruled unfavorably on the constitutionality of the enabling legislation.

12/ Letter from the Vermont Development Department dated August 22, 1962, advising that the law has not been validated judicially.

13/ Some of the chamber of commerce executives interviewed in Wisconsin were unaware that their cities were authorized to issue bonds to develop sites. This suggests that the authorization has probably been little used. A letter from the Wisconsin Department of Resource Development dated August 17, 1962, points out that there are 216 civic industrial development corporations throughout Wisconsin that have handled site developments and "these arrangements have been most satisfactory."

Authorization of revenue and general obligation industrial bonds is inherent in the home rule charters of local governments in Alaska, but none has been issued. 14/ By 1961 legislation, Minnesota permits municipalities having redevelopment agencies to issue industrial development revenue bonds. In 1962 Maine adopted a constitutional amendment enabling cities and towns to issue industrial development revenue bonds, and Virginia by special legislation permitted authorities in certain cities to issue such bonds.

In total, bond issuance has been initiated in at least 16 States. 15/ Developments in these States are summarized below.

Developments in Selected States

Alabama. Before 1951 several counties in Alabama had the power to issue general obligation securities for the purpose of acquiring and leasing industrial property. Because a majority of the registered voters in the community were required to approve such a plan, the results were insignificant. 16/ In 1949 municipalities were authorized to create public corporations empowered to finance manufacturing projects by issuing revenue bonds. In 1950 and 1953 a few cities were authorized by constitutional amendments to issue a variety of obligations for financing industrial development and in 1951 cities and towns were authorized by general law to issue revenue industrial development bonds. In 1958 and 1961 several counties were authorized by constitutional amendments to issue general obligation industrial development bonds. A law authorizing revenue industrial development bonds applicable to counties generally was enacted in 1961. A $25 million issue on behalf of Armour and Company was authorized in 1961 by the small rural county of Cherokee and a $21 million issue for the United States Rubber Company by Opelika in 1962. A minimum of $73 million in industrial development bonds has been issued in the State through 1962. 17/

14/ Letter from the Alaska Legislative Research Council dated August 27, 1962.

15/ Philadelphia, Pennsylvania issues tax exempt mortgage notes to finance the development of industrial property.

16/ Alabama Business Research Council, Alabama Goes Industry Hunting, University of Alabama, 1957, pp. 47-48.

17/ Letter from the Alabama Planning and Industrial Development Board dated May 1, 1963.

Arkansas.[18/] Between 1955 and 1958 local civic industrial development corporations issued industrial revenue bonds in Arkansas. These were not municipal bonds and the interest on them apparently was taxable under the Federal Internal Revenue Code. Of the $5 million plant construction aid by local industrial development corporations during these years, nearly $1 million was subscribed capital. The balance was raised from the marketing of bonds sold at par to yield not over six percent. The State Board of Finance purchased $2 million and private investors an equal amount. By 1958 the market for these industrial development corporation bonds seemed effectively closed and Arkansas amended its constitution to enable first and second class cities, towns, and counties to issue general obligation industrial development bonds at a maximum of six percent. The amendment prescribes that they must be amortized in not more than 30 years from property tax revenues and a special property tax levy not to exceed five mills per dollar of assessed valuation. Operating under this self-executing provision over $12 million in bonds were issued between 1959 and 1962. Legislation enacted in 1960 supplemented the constitutional amendment by permitting counties and municipalities to pledge the gross revenues from industrial projects and surplus revenues from public utilities and other assets "used and useful in securing and developing industry" as security for industrial development bonds. Over $30 million of these bonds were issued to aid 33 firms.

Georgia. In Georgia constitutional amendments proposed by the legislature may be adopted on a county basis by referendum. The first amendment authorizing the issuance of revenue bonds for industrial development was for Worth County in March, 1960. Since then 83 counties have adopted similar amendments. This authority has been used five times, once in Ware County (Waycross) and four times in Dougherty County (Albany). The total amount of financing aid for these five projects is over $2 million. House Bill No. 24 of the 1963 Georgia General Assembly enabled each city and county to create an Industrial Development Authority empowered to issue industrial development revenue bonds. At least three bond issues totaling $1 million have been sold pursuant to this Authority. 19/

18/ Kornelis Walraven "Financing New Industry" in The Arkansas Economist, Vol. 3, No. 2., p. 10, Winter 1961, and data through October 22, 1962, supplied by the Arkansas Industrial Development Commission.

19/ Letter from the Georgia Department of Commerce dated May 10, 1963.

Kansas. In 1961 Kansas authorized cities to issue revenue bonds for industrial development. A total of $3,311,000 was issued by five cities by the end of 1962. 20/

Kentucky. A bonding program for industrial development has existed in Kentucky since 1948 when the Commonwealth enacted its Industrial Building Statutes authorizing cities to issue industrial revenue bonds. Counties were given similar authority in 1962. Kentucky's highest court, the State Court of Appeals, has held that cities may issue general obligation bonds for industrial development under certain adverse economic conditions and pursuant to a referendum. Such general obligation bonds have been used in only three cases. 21/

In several small Kentucky cities local government industrial revenue bond issues have been disposed of in the community, in some cases to businesses and individuals who normally do not invest in securities. Since State approval is not required, the existence of these bonds is not generally reported outside the immediate area. The management employees imported into the community by the new industry often bring with them, from other communities, expectations of higher educational and public service standards than prevail in their new location. Kentucky's experience, however, as that of other States, is not unblemished. In some instances new plants have created various community problems. Very large plants in small communities, as the $40 million bond project announced in Lewisport, Kentucky for Harvey Aluminum, give rise to speculative property values in anticipation of labor importation and real estate development without adequate regard for public service facilities and fiscal limitations.

Louisiana. In 1953 Louisiana amended its constitution to enable communities to finance industry. Pursuant to this, parishes, cities and wards may contract to construct a plant for a new industry and issue general obligation bonds to finance it. Bonds are limited to 20 percent of assessed valuation of the borrowing unit's taxable property. The State Bond and Tax Board and the Louisiana Board of Commerce and Industry are required to review the financial soundness of the undertaking and approve the contract between the local government and the industrial enterprise.

20/ Letter from the League of Kansas Municipalities dated May 14, 1962.

21/ Industrial Financing in Kentucky, Kentucky Department of Commerce, Frankfort, 1962.

The Board of Commerce and Industry apparently pursues a conservative policy in approving industrial bonds--highly rated financial stability is prerequisite.

Maryland. In essence, the situation in Maryland is that permissive legislation exists which allows incorporated municipalities and counties to issue revenue bonds for industrial development purposes, and counties to issue general obligation bonds for such purposes if the county commissioners declare unemployment to constitute an emergency. Currently, cities and industry are exhibiting some interest in using the authorization. Only the city of Frostburg has issued industrial development bonds. Here the issue was for $100,000; the bonds were general obligation, and were issued without statutory authority, though judicially approved. 22/

Mississippi. Mississippi is credited with starting the issuing of municipal industrial development bonds in 1936, though no bonds were issued until after court approval in 1938 and the idea had been unsuccessfully attempted earlier in both Tennessee and Mississippi. Only general obligation bonds were issued prior to the 1960 legislation authorizing municipalities to issue revenue bonds. General obligation bonds outstanding may not exceed 20 percent of the assessed valuation of property subject to taxation by the issuing governmental unit. Both cities and counties are empowered to issue general obligation bonds. Before bonds are issued the Mississippi Agricultural and Industrial Board must issue a certificate of public convenience and necessity based upon several factors including a finding that unemployment exists. In addition, a two-thirds majority approval by at least 50 percent of the electors is required. The 1960 authorization to issue revenue bonds has been used in only a few instances.

Very few large plants have been financed by local government bonds in Mississippi, though many communities have each financed several small plants. Mississippi has constructed more individual plants with local industrial development bonds than all other States combined and has issued over $100 million in bonds. There are only a few instances of lessee failures among

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22/ Letter from the Maryland Department of Economic Development dated May 8, 1963. The Frostburg case was not an unqualified success. The company for which a $100,000 building was constructed under a lease-purchase agreement has ceased to use the building but has assured the city that rental payments will be continued in compliance with the agreement.

the hundreds of plants involved. Only two long term vacancies were found. In these cases the cities were using the buildings as community centers and meeting the debt payments. Filling station operators, waitresses, bankers, public officials and college professors interviewed evidenced some cognizance of the local government's role in bringing industrial plants to the community and voiced satisfaction with the result.

Missouri.[23/] Missouri amended its constitution in 1960 to permit cities and villages to issue industrial bonds. Under legislation implementing the constitutional authorization, revenue bonds have to be approved by the Missouri Commerce and Industrial Development Division of the State Department of Business and Administration and by four-sevenths of the voting electors. General obligation bonds require the same approval except the vote must be by two-thirds majority. Several Missouri municipalities have given electoral approval to bond proposals and one general obligation bond issue for $425,000 was sold in 1962.

Two illustrations of what is being attempted in Missouri may shed light on things to come. A small tract of potentially industrial land in St. Louis County was acquired by certain business interests and incorporated as the Village of Champ. It has about twelve residents. Application to annex over 3,000 additional acres of industrial land was approved and proceedings were started to issue revenue bonds. These are held up by litigation to determine if the area is entitled to incorporation. St. Genevieve, a small rural city in southeastern Missouri has proposed to issue $500 million in industrial revenue bonds. These would be sold as lessees actually materialized.

Nebraska. Nebraska in 1961 authorized cities, villages and counties to issue revenue bonds for industrial development. Early in 1962 the Nebraska Supreme Court upheld the constitutionality of the law and two issues totaling over $3 million were sold in 1962. Six issues totaling $5 million were sold in early 1963. 24/

23/ Interview with the personnel of the Chamber of Commerce of Metropolitan St. Louis, October 16, 1962; The Weekly Bond Buyer, January 15, 1962, p. 31, and letter from Missouri Commerce and Industrial Development Division, dated April 30, 1963.

24/ Letter from the Division of Nebraska Resources dated May 9, 1963.

New Mexico. The picture in New Mexico is different and more complex than that found elsewhere. The New Mexico legislation of 1955 is the brain child of a few men who had chosen to make Deming their home. Deming is a village of a few thousand population in desert range country where long staple cotton grows well under irrigation from a strictly controlled and quite limited deep well water supply. It is far removed from major markets. Farm mechanization had decreased migratory Mexican labor in harvest-time and local business was declining. Efforts to develop or attract industry were unsuccessful, except for Government contract business during the Korean War.

The concept of the legislation is based on three assumptions: (1) Only locally owned industry would locate in Deming; (2) industrial enterprise should be privately operated for private profit; and (3) the provisions of the Federal income tax could be used to advantage in fostering the accumulation of capital for purchasing the assets of business for removal to Deming. Accordingly, legislation has developed authorizing a municipality, by ordinance, to issue revenue bonds to buy all of the assets of a company, including, in addition to land, buildings and equipment, its inventory, cash, goodwill, etc., and to move all of its movable property into or near the municipality, provided that the property is leased to a private operation company subject to rental payments adequate to amortize the bonds.

Under these provisions the Auburn Rubber Company, two other companies, and several smaller subsidiaries have been moved to Deming. All are leased to the Hosdreg Company, a private operating company, or its subsidiaries, and 90 percent of the operating profits by contract are paid to Deming and set aside to meet bond obligations. All bond payments are reported to be current; some bond payment funds are reported to have accumulated a surplus. Employment has been provided to over a hundred people. When the bonds are retired, annual rental payments to Deming will be reduced radically for the duration of the original 30 year lease, which is renewable for another 30 years at the option of the lessee. First and second mortgage tax exempt bonds have been used, the former to purchase the assets of companies. Interest rates have been as high as nine percent of the face value and bonds have been exchanged for stock of purchased companies; other first mortgage bonds have been sold to disinterested parties for as low as six and one-half percent. Second mortgage bonds have sometimes been used to purchase ownership but usually have been issued to pay fees--finders, legal, accounting, etc. 25/

In Carlsbad a similar operation has been attempted less successfully. Revenue bonds of Clovis have been used to provide plants and equipment for two national corporations under arrangements similar to those conventionally employed in other States where local industrial development bond financing is authorized.

North Carolina. An industrial organization contracted in 1961 with the city of Rocky Mount for the issuance of $501,000 in revenue bonds to construct a factory. The bonds were issued by a non-profit corporation on behalf of the city. This was done without specific State legislative authority. This project was criticized by a committee established by the Governor to study industrial development financing. This committee, by a divided vote, recommended that the State should enact legislation authorizing special districts to issue industrial development bonds under a system controlled by the State. 26/ The committee also recommended that the North Carolina congressional delegation support Federal legislation to deny tax deduction of lease payments on buildings financed by local industrial development revenue bonds.

North Dakota. The 1955 North Dakota legislation enabled municipalities to issue industrial revenue bonds. This authority has been employed only three times and some difficulty has been encountered in distributing the bonds. In 1961 the previous authorization was amended, among other things, to enable "greater distribution of the bond holdings," 27/ by authorizing industrial

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25/ Interviews with village and operating company personnel in Deming, New Mexico, October 13 and 14, 1962. Those interviewed were cooperative although some reluctance was evidenced in revealing the specifics on operating profits and second mortgage bonds distributed in payment of fees. Such information is reportedly available in the records of the Internal Revenue Service and the Securities and Exchange Commission.

26/ "Report to the Governor of North Carolina from the Committee to Study Financing for Industrial Development" (mimeographed), Nov. 1962. The Committee has been discharged, and the 1963 legislature did not act on its industrial development bond recommendations.

27/ North Dakota Economic Development Commission, Opportunities in North Dakota Through the Use of the Municipal Industrial Development Act.

development bonds to be issued, subject to electoral approval. None has been authorized. 28/

Oklahoma. In 1961 Oklahoma authorized local subdivisions of government to issue both revenue and general obligation bonds for industrial development. The authorization for general obligation bonds was by constitutional amendment and issuance requires voter approval. No bonds have been issued nor does the use of either authority appear to be imminent. 29/ An interesting facet of the Oklahoma program enabling local units of government to lend credit for the accumulation of capital for industrial development by utilizing Federal income tax exemption is the authority of special agencies known as public trusts. 30/ In December 1962 Muskogee issued $500,000 industrial development bonds using the "trust" arrangement and it is reported that subsequently other cities have taken similar steps. 31/ The Oklahoma City Airport Trust issued bonds for the construction of the Aeronautical Center building which is leased to the Federal Aviation Agency. This may be only one step beyond the conventional leasing of airport facilities to carriers, but in Oklahoma, still another step has been taken. The Mid-America Industrial District, formed under the Trusts Law to take over the Army Ordnance complex near Pryor, Oklahoma, offers to "build on a basis designed for your company's own specifications. Because the yield on the financing obligations is tax exempt, your company can acquire a new plant in Mid-America Industrial District through lower monthly costs than in other competing areas." 32/ It was reported nearly a decade ago

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28/ Letters from the North Dakota Economic Development Commission dated August 21, 1962, and May 2, 1963.

29/ Interviews with personnel of the Oklahoma Department of Commerce and Industry, the office of the Attorney General of Oklahoma and the Oklahoma City Chamber of Commerce, October 15, 1962.

30/ Oklahoma Statutes, 1951 revised, Title 60, secs. 176-180.

31/ Letter, L. D. Milton, Oklahoma City, May 2, 1963.

32/ Mid-America Industrial District, Industrial Opportunity! Pryor, Oklahoma, (inside back cover).

that communities in Oklahoma issued revenue bonds for municipal buildings and then leased them in part or in their entirety to industry. 33/

Tennessee. The 1951 Act of Tennessee authorized cities to issue industrial development revenue bonds. Counties were given similar authority in 1953. Difficulty was encountered in distributing the bonds in some communities and the law was amended in 1955 to permit the issuance of general obligation industrial development bonds. These require three-fourths majority vote in a referendum on the issue and approval by the State. In approving general obligation industrial development bonds the Tennessee Industrial and Agricultural Development Commission must find that "the public welfare demands and sound State policy requires..." that the municipality be allowed to issue the bonds. 34/ In practice the Commission requires a finding that unemployed persons within a 30 mile radius of the project exceed the number to be employed at the project by 50 percent, a contract with a responsible occupant, and a showing that the proposed issue does not exceed the legal debt limit for this purpose. The limit is 10 percent of the assessed valuation of the property subject to tax by the issuing unit.

Legislation of 1955 also authorized the establishment of industrial development corporations in counties and cities which may be empowered to sell revenue bonds to accumulate capital to purchase and develop land and construct buildings to promote industry. Bonds were first issued under this authority in 1959.

In the five-year period 1957-1961 the political subdivisions of Tennessee issued, in dollar volume, over nine times as many revenue as general obligation industrial bonds. In 1960 and 1961, the activities of the industrial development corporations in Davidson (Nashville) and Cleveland (near Chattanooga) Counties in behalf of large national companies accounted for half of the total volume of Tennessee local industrial development revenue bonds. 35/ Small rural communities, however, are still using general obligation bonds. Some rural cities are approaching the legal limit on the amount of general obligation industrial development bonds they can issue. In these situations, sponsorship falls to counties.

33/ State of New York, Report of the Joint Legislative Committee, No. 28, 1954, p. 32.

34/ Tennessee Code Annotated, Chap. 29, sec. 6-2905.

35/ Data on volume from The Tennessee Taxpayer, Tennessee Taxpayers Association, Nashville, July, 1962.

Washington. In Washington State any county by referendum may establish a port district. Since 1955 any port district may establish an industrial development district to develop or redevelop the use of land, broadly defined as marginal, and may advance cash or credit for this purpose. 36/

Washington is unique in that only port authorities are empowered to issue bonds for industrial development. This may account for the absence of reference to this State in the literature on industrial development bond financing. Port authorities were first empowered to develop industrial and warehousing sites on the waterfront, ostensibly to attract sea shipping. Little was done until after World War II. As sea port authorities began to show results the concept was extended to river waterway communities and to "dry land ports." Some of these now offer bond financing for private industrial facilities. Walla Walla is reported to have provided facilities, by issuing port authority bonds, to seven industries--this includes a very large plant. Walla Walla is reported to offer to employ either general obligation or revenue bond financing at not over $4\frac{1}{2}$ percent interest to construct to specification a building for sale or lease to a qualified industrial tenant. 37/ Among Washington port authority officials, strong disagreement is evident about the legitimacy of financial aid to inland industry and an obvious reticence about it.

The extent to which port authorities generally may be issuing tax exempt bonds to finance industrial buildings not essentially associated with marine traffic operations is unknown. It was estimated for 1957 that all U. S. ports spent about $6.5 million for industrial development not including capital outlays for such things as piers, terminals, etc. 38/ The extent to which bonds were involved was not indicated. Port authorities in Virginia are reported to be offering to finance industrial buildings by issuing bonds and certain industrial developments in Georgia may have been financed by port authority revenue bonds. 39/

36/ Revised Code of Washington, sec. 53.25.

37/ Program and interviews with port authority officials at the Conference on Business Expansion, Olympic Hotel, Seattle, October 11, 1962.

38/ Donald R. Gilmore, Developing the "Little" Economics, C.E.D., New York, 1960, p. 86.

39/ Op. cit., Report to the Governor of North Carolina, p. 5. This has been confirmed for the Port Authority of Brunswick, Georgia, which has issued $4 million in bonds for a firm that uses imported raw material.

New Developments. Proposals to authorize local industrial development bonds financing are active issues in a number of other States. Four States (Iowa, Michigan, West Virginia, and Wyoming) enacted such authorizations during their 1963 legislative sessions. The Michigan law, which allows counties, cities, villages, townships, and port districts to issue industrial development revenue bonds, requires approval by a State agency, the Municipal Finance Commission, before such bonds can be sold. The new Iowa legislation permits cities and towns, and the West Virginia and Wyoming legislation authorizes counties and cities to sell revenue bonds for industrial development.

Indiana passed 1963 legislation permitting municipalities to acquire and improve industrial sites for lease to private enterprise. The Indiana law, however, does not include a bond feature; instead, municipalities are authorized an additional property tax levy to help finance such operations. Maryland and Georgia, which already had industrial development bond laws, expanded the local authority to issue such bonds.

Effects of Local Industrial Bond Financing

Local governments issue industrial development bonds to provide employment and if the firm which thereby is furnished a plant employs people under acceptable conditions, the ostensible objective of the local government is accomplished. To what extent the government's financial aid contributed to the location, however, is uncertain. Would the firm have provided equal employment elsewhere? Might the surplus labor have been employed in the general area by another employer without the government's assistance? Some industrialists who have used government financing are themselves uncertain about how much weight the financing had on their location decision. Others insist they could not or would not have grown or expanded into a new area without such aid. Objective evidence is scarce.

As has been demonstrated, to date the amount of plant investment using municipal industrial development bond financing has been small. The use of this device on a relatively substantial scale has been confined largely to a few southern States. To be sure, since the Depression there has been a highly publicized migration of plants, especially in the soft good industries, from the industrial northern States to the rural southern States. This migration has involved many factors--among them, labor costs, union activity, the quest for markets, and plant obsolence--which tend to obscure any contribution municipal bond financing may have made to this migration. In any event, by far the greater bulk of relocation and out-expansion to the South has been privately financed.

Even in Mississippi, which has had the longest experience with municipal industrial development bond financing, the evidence on the role of governmental financial aid in increasing manufacturing employment is inconclusive. The number of employees in operating manufacturing establishments increased by some 30,000 or about 40 percent between 1947 and 1960. However, the southern States in general, including those that did not provide government industrial financing, showed a larger relative increase in manufacturing employment than did the rest of the nation. Some of the New England and other industrial States, on the other hand, actually evidenced a relative decline as a result of the general migration already noted.

In nine years, 1953 to 1961, inclusive, Mississippi announced 1,060 new plants and expansions; 270 of these used local industrial development bond financing. What industrial growth might have occurred in Mississippi without industrial development bonds is conjectural. Public and chamber of commerce officials, however, generally endorse aid in financing industrial development as a catalyst and a factor in their community's industrial growth and over-all improvement. (They would be expected to do so in any event.) This was found also in the small towns of Kentucky and Tennessee. In Mississippi industrial operations assisted by local governments experienced less attrition and more average employment per unit than those not so aided. 40/

There is some evidence that industrial plants tend to improve the social and economic condition of plant workers in States which offer local government industrial financing. 41/ Yet, Mississippi's relative position in the per capita personal income ranking of the States has not increased, despite substantial population outmigration. It is still the lowest per capita income State in the nation. And rural sociologists do not look upon rural industrialization as a solution to the surplus agricultural labor problem. 42/

40/ From data supplied by the Mississippi Agricultural and Industrial Board, Jackson.

41/ Industrialization in Chickasaw County, Mississippi: A Study of Plant Workers, Agricultural Experiment Station, University of Mississippi, Bul. 566, 1958, p. 12 and Paul H. Price, Alvin L. Bertrand and Harold W. Osborne, The Effects of Industrialization on Rural Tennessee, Louisiana State University, p. 37 ff.

42/ See Rural Industrialization: A Summary of Five Studies, U. S. Department of Agriculture, Information Bulletin No. 252, 1961, p. 32.

Though industrial development bonds may help rural communities to provide employment for their population -- a national economic policy objective -- the effect on the areas from which industry migrated or out-expanded needs to be weighed in the balance.

Some community leaders where out-migration of industry has occurred disavow regretting the loss, at least with benefit of hindsight. Most of the displaced employees, with the exception of some of the older workers, appear to have been absorbed. New industries tend to fill the vacuum created by the out-migration, often resulting in a better balanced industrial situation. Muskegon and Plymouth, Michigan, and Manchester, New Hampshire are examples. 43/

Local industrial development bond financing of new buildings for out-expansion and sometimes for migration of industry is said to have accelerated the obsolescence of existing buildings and to have located new investment uneconomically. This may have happened but the entrepreneurial choice was free and most of the entrepreneurs have been satisfied with their choice. Most displaced buildings are old and often multi-story structures of a vintage not well adapted to economical use of modern equipment. The unemployment and hardships incident to such industrial relocation has spurred the replacement of old buildings with more efficient structures and the local quest for new development. Normally the total change results in industrial employment being provided in the new location and the displaced workers in the abandoned location being substantially absorbed.

Local industrial development bonds are alleged to appeal to the runaway and the footloose industry. Evidence does not support this in any substantial way. Runaway industries, like airplane accidents, occur relatively infrequently but make good copy. We have not been able to identify more than twenty firms that have moved lock, stock and barrel from the North or East

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43/ Manchester's adjustment to the closing of the Amoskeag textile mills in 1935 and to the loss of 11,000 jobs was facilitated to be sure, by an organized community effort. A local corporation, organized for this purpose bought the mill property with locally raised funds and mortgage financing and in one year refilled nearly half of the vacated space and recovered close to half of the lost jobs. By 1942 it had repaid all of its debt obligations and by 1949 could take credit for 12,000 jobs. See the "Industrial Development in New Hampshire" supplement to the New England Telephone and Telegraph Company's Business Conditions, reprinted in Congressional Record, January 25, 1963, pp. 1007-9.

into industrial development bond financed buildings in the South. 44/ Inquiry was made about several of these in the immediate area of their former location. They appear to have been prompted to move by a variety of factors unrelated to the lure of cheap financing, although industrial development bond financing may have made the move practicable, in the sense that it may not have materialized without it.

Municipal industrial development bonds are most frequently used to finance building construction and sometimes machinery acquisition for the expansion of established industries; occasionally to start new businesses. The principal reasons usually attributed to industrial expansion into new locations are improvement in the availability of labor and raw materials and better access to markets. At some stage of their growth industries serving large market areas find it advantageous to decentralize in the interest of more efficient marketing operations. Aid in financing plants may have implemented this process.

Revenue bonds by their nature require a long term rental contract with a responsible company as a condition precedent to saleability. This is the best assurance of the financial soundness of a revenue bond project. The care with which State approval agencies, investment bankers, and investors scrutinize general obligation bonds precludes in some measure their use to assist irresponsible and footloose operators. Community concern about the other State's program for attracting industry is normally temporary and exists only in areas stirred by an incident of migration or because it comes off second best in the competition for a particular firm. The loss is deeply felt if the gainer is a nearby community in an adjoining State. In our discussions with government and industry representatives in States that have lost industry to other parts of the country, we encountered none who could definitely attribute a firm's emigration to industrial development bond financing.

Where local industrial development bonds fill a gap in conventional credit facilities increased industrial investment should result. There are other considerations that point to the same conclusion. An unknown percentage of local government industrial development bonds has been sold locally. Some of this capital would not otherwise have been invested in industrial development. Many industrial bonds have been absorbed in the municipal market and in this sense have diverted capital to industrial investment. The fact that tax exemption reduces a

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44/ For reports naming several of these and highlighting relocation see the New York Times, July 24, 1961, AFL-CIO News, July 22, 1961, July 29, 1961, and the Detroit Free Press, February 15, 1961.

firm's cost of borrowing and enhances the economic feasibility of an investment undertaking works in the same direction. In the same way industrial development bonds may make it possible for firms to innovate and expand that otherwise would remain static. While it cannot be demonstrated statistically, the presumption is warranted that in at least some situations industrial development bonds contribute to the production of goods and services by increasing investment.

Public programs that offer credit under more favorable conditions than conventionally provided under market conditions inevitably involve some element of subsidy. Those who object to this type of subsidy argue that if left to its own devices the market will allocate productive resources in the most economical and efficient way and that in the long run this provides maximum production. Those contrary minded hold that reliance on the market place ignores the inertia of businesses and people. Inertia is most characteristic of industries with heavy fixed investment and more complex technologies. 45/ The less skilled industries normally have less fixed investment and tend to abandon skilled labor market areas. Less skilled and relatively unskilled workers are less mobile than skilled workers.

The substantial migration and out-expansion of textiles, furniture, apparel and light metals from the North and East to the South unaffected by any State or local aid support these inertia and mobility hypotheses. These hypotheses suggest, as indeed is otherwise apparent, that local government industrial bond financing accelerated and facilitated what was happening anyway. Perhaps, local industrial development bonds in southern States spurred credit expansion and other developments in the northeast to accelerate industrial growth to absorb displaced workers and provide employment opportunities for a growing population. Lowell, Massachusetts and Manchester, New Hampshire are illustrative of communities that have endeavored with some success to develop new industries and property values to provide employment to compensate for the out-migration of industry. 46/

45/ This was found to be the case in Michigan by Wilbur R. Thompson and John M. Mattila, An Econometric Model for Postwar State Industrial Development, Detroit, 1959, p. 26.

46/ For the story in Lowell, Massachusetts see J. T. Bonoit "Lowell Pushes Drive to Boost Its Local Economy," The American City, June, 1956, p. 146 ff., and in Manchester, New Hampshire, Douglas S. Powell, "A City's Part in Industrial Promotion," Alabama Municipal Journal, June, 1954, p. 7 ff.

State and local programs for financing industrial growth essentially relate to the existence of surplus labor, although exceptions to this generalization may be becoming more frequent. Governmental aid in financing industrial growth in surplus labor areas has humanitarian as well as economic aspects. When effective, it preserves or increases property values, increases economic activity in the area and may stimulate the creation of new markets; but its principal objective is to bring jobs to people rather than requiring people to migrate to jobs. This caters to the inertia of people--their family attachments and love of home, as well as their lack of knowledge of job opportunities elsewhere, their unfamiliarity with travel and their financial inability to move. These same human values are reflected also in such national policies as those embodied in the Area Redevelopment Program.

The availability of labor is obviously essential to industry and industry will not locate where labor is not available. There is no reliable evidence supporting conclusions of general application that State and local financing devices are used as guises to subsidize the employment of inferior labor while superior labor is idle. Some unemployment results from industrial mobility, including industrial out-expansion, assisted by State and local financing devices but from a national point of view compensating employment occurs. The fact that wage rates may be lower and unionization absent in the area of the new location are phenomena characteristic of differing degrees of industrial maturity.

Programs at all levels of government for stimulating economic growth have the fiscal objectives of reducing relief and unemployment rolls and thereby reducing public expenditures for these purposes and increasing public revenues from existing tax levies on increased property values and economic activities. Industrial growth, however, particularly at the local level, always entails increased public services beyond those directly related to the new industry. 47/

Economic imbalance stimulates the quest for ways to grow and contribute to growth. Whether State and local industrial development financing contributes or detracts from economic imbalance cannot now be ascertained. It is, in any event, still a modest force in the economy. Some would maintain, to be sure, that where governmental aid helps to start industrial activity

47/ Alan K. Campbell, Effect of Industrial Location on Revenues and Expenditures of Municipalities, Speech 1961 Conference, Municipal Finance Officers Association, Chicago.

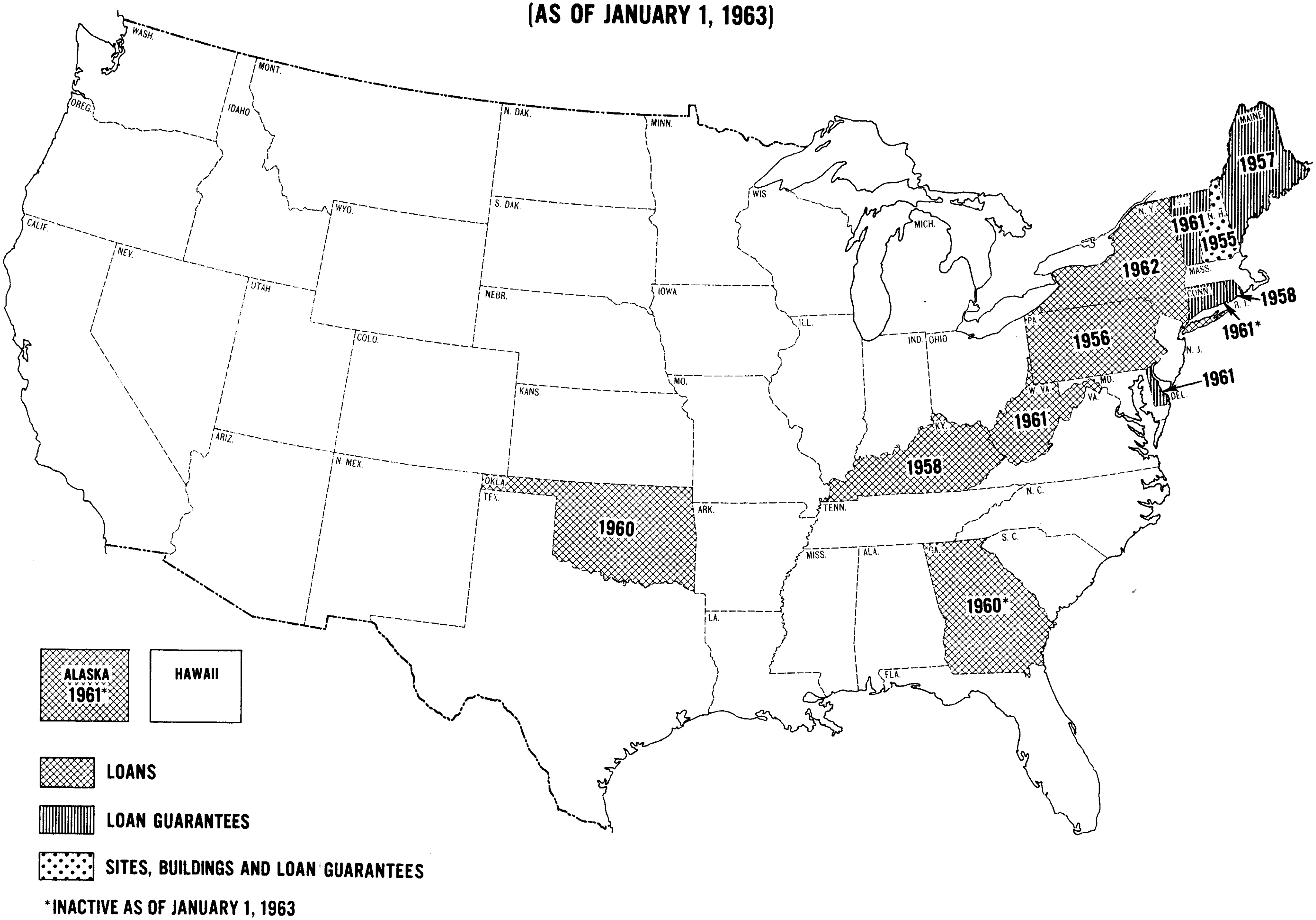
in a community which has little or no industry, it helps to initiate "take-off" into more economic growth. 48/

We have here summarized the case for local public financing of industrial plants to explain the rationale of communities across the country, particularly in the South, which are trying to help themselves, i.e., to provide employment opportunities to their citizens. Their case should be stated because local initiative in the solution of public problems is in the best tradition of a democratic society. The net contribution of these efforts to total national employment necessarily remains conjectural because the quantitative evidence is inconclusive. The role of this relatively minor factor in the legion of variables involved in the national economy is not now identifiable. However, even if these programs have been effective in the short run for individual communities, their value from the viewpoint of national policy, particularly its intergovernmental aspects, is doubtful. The apparent success of communities in selected States in attracting industrial employment has not gone unnoticed in others. Comparable programs are being urged in all parts of the country, presaging local competition for potential employers on an unprecedented scale. As this materializes, the investment of local taxpayers in these efforts will be quickly dissipated. A related consideration is the National Government's concern over the augmented supply of municipal obligations exempt from income taxation, issued for purposes not universally regarded to be an essential function of local governments.

48/ For a detailed description of take-off as it applies to national economics see W. W. Rostow, Stages of Economic Growth, Cambridge, 1960. Thompson and Mattila, op. cit., observed a similar phenomenon in a State context.

WHERE AND WHEN STATE FINANCING OF INDUSTRIAL DEVELOPMENT HAS BEEN AUTHORIZED

(AS OF JANUARY 1, 1963)



3. STATE AID IN FINANCING INDUSTRIAL DEVELOPMENT

State support for the financing of industrial development, in one form or another, has been enacted in at least 13 States by the end of 1962. 1/ (See accompanying Chart.) This count excludes the invalidated Illinois legislation and also the Maryland and Minnesota programs limited to supplementation of the Federal area redevelopment program. Programs are known to have been activated in only 10 of these States: Delaware, Kentucky, Oklahoma, Pennsylvania, Maine, New York, New Hampshire, Rhode Island, Vermont, and West Virginia. Similar programs authorized in Alaska, Connecticut and Georgia had not been activated by the end of 1962.

State efforts to assist in financing industrial development take principally three forms: (1) development of sites and construction of buildings for sale or lease to private industry, (2) loans to industry to match local and commercial funds in a proportion prescribed by law, and (3) guaranteeing commercial industrial mortgages or other obligations.

Only the first two of the three types of programs have thus far involved the expenditure of State funds, except for administration. Guaranteeing commercial mortgages involves a contingent liability against the authority to issue bonds and no defaults giving rise to the contingency have been found. The State programs authorizing the sale of bonds or other evidence of indebtedness to raise funds for industrial financing have usually employed as security the authority for borrowing from the State treasury and avoided the distribution of securities through financial channels. Only Oklahoma has sold industrial development bonds, and there the amount was $2 million.

1/ Ohio legislation enacted in 1963 authorizes State revenue bonds payable from interest on loans, rentals and sale of properties.

The enacted State legislation provides scope for about $275 million in industrial development financing, of which re-relatively little has been utilized to date. The volume of each type of authorization, by States is as follows:

Debt authorized		(In millions)
Alaska		$ 18
Delaware		10
Oklahoma		10
New Hampshire		4
New York		100
	Total	$142
Funds appropriated		
Kentucky		2
Pennsylvania		36
West Virginia		2
	Total	$ 40
Guarantee limit		
Connecticut		25
Maine		20
New Hampshire		5
Rhode Island		30
Vermont		10
	Total	$ 90
Grand Total		$272

About $45 million from bond sales, treasury borrowing and appropriated funds has been used to construct buildings and loaned or committed for loans to finance buildings. Nearly $4 million of the $45 million has been employed by New Hampshire where the program has been to develop sites and construct buildings. This type of aid is like that provided by local government industrial development bonds. The remaining $41 million loaned or committed by States to industry was used to purchase second mortgages. Pennsylvania accounts for over 80 percent of this. The New York program is authorized for $100 million and is just getting started.

Loans guaranteed thus far total about $31 million. Rhode Island accounts for half of this amount and Maine for over half of the remainder.

State programs guaranteeing commercial industrial loans as they have so far worked appear to have had two economic results, beyond augmenting the supply of industrial credit: (1) State credit is encumbered but is not necessarily used, and (2) the determination of the interest rate on the credit required in a given operation is removed from the free market.

Loans financed by the State and State loan guarantee programs are designed to expand credit so as to meet that part of the capital requirements of industry which is not met by conventional sources. In this context these programs do not appear seriously to jeopardize the market of private industrial bonds if the supported interest rates are restricted to marginal risks or the rates are substantially above prime rates of interest. With this reservation, State loans and loan guarantee programs appear to be subject to little abuse. As between the two types, however, loan guarantees seem to remove a greater volume of credit commercially available from price determination by the free market and accumulate for the State a contingent liability not in full public view which can mature at a time made most burdensome to the State by reason of a general condition of credit contraction.

State financed loan and State loan guarantee programs appear to have their greatest utility in urban and industrial areas having surplus labor. They also seem by their nature to require sponsorship by a unit of government possessing sufficient resources to enable the risk to be spread. Furthermore, by taking the risks that private financial institutions reject, they do not compete with conventional credit sources as industrial development bonds would under similar circumstances.

Developments in Selected States

The principal features of the several State programs are summarized below. It will be noted that with one or two minor exceptions, State programs do not involve the issuance of industrial development bonds, the focus of this investigation.

Alaska

In 1961 Alaska created a State Development Corporation to make loans for 90 percent of the cost of plants, with banks furnishing the remainder. Funds to carry out the program are to be obtained through the sale of debenture certificates up to a total of $18 million. When debentures are offered to raise money for a project, the manufacturing concern involved must take 5 percent of the issues. It was anticipated that $9 million of these bonds would be sold before the middle of 1963. 2/

Connecticut

The Connecticut plan authorizes guaranteeing a maximum of $25 million in loans, and is similar to the Maine and Rhode Island plans, except that the Connecticut Industrial Building Commission may insure a mortgage when the title is vested in private ownership. The legislation was enacted in 1961 and no activity is reported. Its constitutionality is being tested. 3/

Delaware

The Delaware State Industrial Building Commission, established in 1961, may pledge the credit of the State, up to $10 million total and $2 million per project (raised to $3 million by 1963 legislation), to guarantee the bonds and other obligations of local non-profit development corporations located in areas where a substantial portion of the labor force is unemployed or employed in seasonal work. The legislation has been validated by the Delaware Supreme Court and $1.25 million in bonds has been approved for the expansion of a local luggage firm. No other projects have been approved. 4/

Georgia

Late in 1960 Georgia ratified a constitutional amendment authorizing an Industrial Development Commission to be empowered to make second mortgage loans to local industrial development agencies that raise sufficient other funds to insure the completion of a project. This authority has not been used. 5/

2/ Letter from the President of the State Development Corporation dated May 8, 1963.

3/ Letter from the Connecticut Development Commission dated Aug. 21, 1962.

4/ Telephone conversation with representative of Delaware State Development Department, January 18, 1962.

5/ Letter from the Industrial Development Division, Georgia Institute of Technology, dated November 26, 1962.

Kentucky

Kentucky in 1958 established a second mortgage loan program patterned after the Pennsylvania model but without restriction to depressed areas and in 1960 appropriated $2 million to it. It has made one site development and two building loans totaling $517,000.

Maine

Maine in 1957 was the first State to create an industrial mortgage insurance agency -- the Maine Industrial Building Authority. A constitutional amendment permitting pledge of the faith and credit of the State and the issuance of bonds to guarantee mortgages, given by local non-profit development corporations on new industrial buildings, was approved by referendum. Legal and administrative problems were resolved in 1958 and the first loan insured early in 1959. Through 1962 loans for twenty-eight new plants had been insured for an aggregate of $8,000,000. Mortgage loan insurance is limited to $2,000,000 for any one plant and to $20,000,000 outstanding at any one time. 6/

New Hampshire

New Hampshire in 1955 established its Industrial Park Authority with broad powers to issue revenue bonds to develop sites and construct industrial buildings and provided that the Governor, with the advice and consent of the Council might guarantee such bonds with a pledge of the full faith and credit of the State. Actually, no bonds have been issued but the Authority borrows on three year notes from the State Treasury. Thirteen projects have been financed by the Authority totaling $3,927,000 -- ten of the projects were for buildings, four to specification and six speculative. Investment in property unsold and unleased totals $540,000. 7/ The Industrial Park Authority is also empowered to pledge the credit of the State not to exceed $5 million to guarantee first mortgage bank loans limited to not more than 50 percent of the total loan on the project. The topmost portion of this loan is the part guaranteed. 8/

6/ Letter from Maine Industrial Building Authority, dated May 1, 1963.

7/ Industrial Park Authority, Biennial Report to the General Court, as of March 31, 1961.

8/ Letter from the New Hampshire Department of Resources and Economic Development, dated April 30, 1963.

New York

The New York Job Development Authority legislation became effective in 1962 and made available $100 million in lending power -- $50 million of special purpose notes and bonds guaranteed by the State for use in critical economic areas and $50 million of similarly guaranteed notes and bonds for use in critical economic areas and areas of defined but less critical unemployment provided mortgage loans "are not reasonably available from other sources at a comparable rate of interest." 9/ No bonds have been issued. Five hundred thousand dollars in bond anticipation notes was initially borrowed in each category and a total of $2 million bond anticipation notes have been issued. 10/ Interest rates charged project occupants in critical unemployment areas may not be less than one percent below the average cost of money to the Authority and in other areas not below the average cost. Loans made to local development corporations may not exceed 30 percent of the cost of the project, take the form of second mortgages, and all second mortgages may not exceed 50 percent of the cost of the project.

Oklahoma

In 1960 Oklahoma amended its constitution, creating a State Industrial Finance Authority and providing for a second mortgage loan program similar to that in Kentucky and Pennsylvania. The Authority is empowered to issue full faith and credit bonds up to $10 million. Two million has been issued and $678,489 loaned. 11/

Pennsylvania

Pennsylvania in 1956 established an Industrial Development Authority as an instrumentality to make second mortgage loans for industrial building purposes to non-profit voluntary community development corporations in chronic labor surplus areas. Originally

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9/ New York Job Development Authority Act, Subtitle IV, Sec. 1823, Par. 3.

10/ Letter from the New York Job Development Authority dated April 29, 1963.

11/ Oklahoma Economic News, Oklahoma Department of Commerce and Industry, Aug., 1962.

the Development Authority could lend up to 30 percent of the cost of plant construction, provided the community development corporation furnished at least 20 percent of the equity and arranged for the other 50 percent from conventional sources and a responsible manufacturer was committed to occupy the building on a lease or lease-purchase agreement. At the outset the Legislature appropriated $5 million for this purpose. The appropriation has been increased to a total of $36,020,000 and the State participation raised to 45 percent. The community's minimum share has been reduced to 5 percent. Pennsylvania advertises that it offers 100 percent financing for industrial development. By the end of 1962 about $35 million in loans had been disbursed or committed for over 260 projects to create over 41 thousand new jobs. 12/

Rhode Island

Rhode Island, like Pennsylvania, advertises a 100 percent financing plan for industry. In 1958 Rhode Island established its Industrial Building Authority and authorized it to insure industrial mortgages of local non-profit development corporations or foundations for up to 90 percent of the total project cost, backed by the full faith and credit of the State. In providing the 100 percent financing the local industrial organization may either furnish the remaining ten percent of the project cost itself, or may obtain the remainder needed by a second mortgage arrangement from the cooperating Business Development Company of Rhode Island. 13/ Title to the project for the life of the loan is vested in the non-profit foundation and the facility is leased to the occupant with an option to buy at a nominal purchase price. Interest on the guaranteed first mortgage has presently been set by Rhode Island banks as 1% over the prime rate. The Business Development Company interest on the 10% second mortgages averages 8%. 14/ The Building Authority determines what premium

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12/ Letter from the Pennsylvania Department of Commerce dated April 30, 1963.

13/ The Rhode Island Industrial Building Authority, The Rhode Island 100% Financing Plan, Providence, R. I., p. 3.

14/ Interview with Rhode Island Development Council personnel, Sept. 18, 1962.

should be charged for its mortgage insurance up to a maximum rate of 3% per year of the unpaid principal balance of the mortgage. The Authority has presently established the interest premium rate at 1% of the unpaid principal balance on projects up to $1,000,000 and 1/2 of 1% for projects exceeding $1,000,000. 15/ The original authorization limited the volume of mortgages that might be guaranteed to $20 million. This has been increased to $30 million.

No defaults have been experienced in Rhode Island. If a default is experienced in the future, the Authority plans to meet the mortgage payments on the property until a new tenant is found out of reserve funds being created from mortgage insurance premium payments. Should this fail to take care of default mortgage payments, the State will issue bonds to meet the payments as authorized in the original legislation. 16/ From inception of the program through 1962, 19 projects were approved for guaranteed mortgages representing a total of 1,626,200 square feet of new manufacturing space and an investment of $15,293,000. 17/

Vermont

In 1961 Vermont created an Industrial Building Authority and empowered it, as in Maine and Rhode Island, to pledge the credit of the State up to $10 million to guarantee local development agency mortgage loans on industrial plants. One loan in the amount of $108,000 has been guaranteed. 18/

West Virginia

In 1961 West Virginia created a State Industrial Development Authority and appropriated $2 million for second mortgage loans to local development groups in depressed areas. Seven loans aggregating $720,000 have been consummated and most of the $2 million was expected to be loaned by July 1, 1963. 19/

15/ The Rhode Island Industrial Building Authority, op. cit., p. 5.

16/ Letter from Rhode Island Development Council dated Aug. 24, 1962.

17/ Rhode Island Industrial Building Authority, Annual Report, 1962.

18/ Letter from Stephen B. Richardson, Burlington, Vt., dated November 30, 1962.

19/ Letter from the West Virginia Department of Commerce dated November 14, 1962.

Other developments

Hawaii

In 1963 Hawaii authorized the State Department of Planning and Economic Development to make loans for the promotion of industrial development.

Ohio

A program involving the authorization of $100 million State revenue bonds to establish a rotary fund as a source of loans for industrial development to the extent of 40 percent of an expansion or new location project was proposed by the Governor. 20/ Legislation creating a State Development Financing Commission with authority to issue revenue bonds was enacted in 1963.

Illinois

In 1961 Illinois enacted legislation somewhat similar to that in New Hampshire and appropriated $500,000 to guarantee up to ten times this amount in revenue bonds. The appropriation was invalidated as pledging the credit of the State and being a continuing appropriation and the legislation held inseparable and invalid. 21/

Maryland by 1962 legislation may lend five percent of the total cost of Area Redevelopment Administration industrial projects at a maximum interest rate of four percent. Minnesota is reported to allow State funds to take a subordinate position to Area Redevelopment Administration industrial loans. 22/

20/ James B. Rhodes, *New Jobs and Industrial Development in Ohio*, 1962.

21/ Bowes *v.* Howlett, Illinois Supreme Court, Docket No. 37014, January 1962.

22/ Area Redevelopment Administration, *States Having Means to Assist Industrial Financing*, Staff Memorandum, July 30, 1962.

4. CITATIONS TO STATE CONSTITUTIONAL AND STATUTORY PROVISIONS AUTHORIZING INDUSTRIAL DEVELOPMENT FINANCING

Local Industrial Development Bonds

Alabama

(1) Alabama Code, Title 37, sections 815-830 (1958). Recompiled edition. (1949)
(2) Alabama Code, Title 37, Chapter 12, sections 511 (20-32), authorizes cities and towns to issue (30 year) industrial revenue bonds. (1961)
(3) Certain Constitutional Amendments (nos. 84, 94, and 95, ratified in 1950, and No. 104, ratified in 1953) authorize certain cities to issue a variety of debt instruments for aiding industrial development.
(4) Alabama Code, Title 12, Chapter 24, section 298, authorizes counties to issue (30 year) industrial revenue bonds. (1961)
(5) Certain Constitutional Amendments (no. 128, ratified in 1957, Nos. 183, 186, 188, 190, 191, and 197, ratified in 1961) authorize certain (individual) counties to issue a variety of debt instruments for aiding industrial development.

Alaska

Constitution, Article X, section 11 authorizes home rule boroughs and cities to exercise all powers not prohibited.

Arkansas

(1) Arkansas Constitutional Amendment No. 49, sections 1-4, authorizes first and second class cities, towns and counties to issue general obligation industrial bonds. (1958)
(2) Statutes, Chapter 16, sections 13-1602 and 1603, supplemented the above amendment by authorizing revenue bonds.

Colorado

Revised Statutes, Chapter 36, Article 20, sections 1-10, referring to public projects, authorizes cities and counties to issue anticipation warrants and to lease to private parties. (1955)

Georgia

(1) Starting in 1960, numerous amendments to Section 2-6005 of the Constitution, as proposed by the Legislature, authorize the issuance by counties of revenue bonds for industrial development.

(2) Sub. H. B. 24 (1963) provides general authorization to counties, cities and towns to issue industrial development revenue bonds.

Illinois

Revised Statutes, Chapter 24, sections 11-74-1 to 13, authorizes any city, village, or incorporated town to issue industrial revenue bonds.

Iowa

H. B. 149 (1963) authorizes cities and towns to issue industrial development revenue bonds.

Kansas

General Statutes, Chapter 12, Article 17, sections 41-47, authorizes cities to issue revenue bonds for industrial development.

Kentucky

Revised Statutes, Chapter 103, sections 200-240, authorizes cities and counties to issue industrial revenue bonds.

Louisiana

Article 14, section 14, b.2, of the Constitution, permits parishes, cities, and wards to issue general obligation industrial bonds.

Maine

Constitution, Article IX, Section 8A authorizes cities and towns to issue revenue industrial development bonds (Constitutional Amendment adopted November 1962).

Maryland

(1) Code of Maryland, Article 45-A, sections 1-3, authorizes counties, including the city of Baltimore, to issue revenue bonds for industrial development. (1960)

(2) A special act of the legislature grants comparable authority to at least one other city, Frostburg. (Acts 1953, Chapter 662, section 103).

(3) S. B. 256 (1963) provides general authorization to counties and cities to issue industrial development revenue bonds.

Michigan

P. A. 62 (1963) authorizes counties, cities, incorporated villages, townships, and port districts to issue industrial development revenue bonds.

Minnesota

Minnesota Statutes, Chapter 472, sections 8 and 9 authorizes municipalities to create local redevelopment agencies which are empowered to issue industrial development bonds.

Mississippi

The Mississippi Code, Title 33, Chapter 2, sections 8936-01 to 24, authorize cities and counties to issue general obligation bonds for industrial development and sections 8936-51 to 59 authorize municipalities to issue revenue bonds.

Missouri

Revised Statutes, Section 71.790-820, authorizes cities and towns to issue (G. O. and revenue) industrial bonds. (1961)

Article VI, section 23(a) of the Constitution, as amended, provides similar authorization.

Nebraska

Revised Statutes, Article 16, sections 18-1614 to 1620 authorizes cities, villages, and counties to issue industrial revenue bonds. (1961)

New Mexico

Statutes, Chapter 14, Article 41, sections 31-43, authorizes municipalities to issue industrial revenue bonds. (1955)

North Dakota

(1) Century Code, Chapter 40, sections 57-01 to 18 authorizes municipalities to issue industrial revenue bonds. (1955)

(2) Century Code, Chapter 40, sections 57-02 to 20, as amended, extends the authorization to include the issuance of general obligation bonds. (1961)

Oklahoma

(1) Statutes, Chapter 5, sections 651-664, authorizes local government units to issue revenue bonds for industrial development. (1961)

(2) Article 10, section 35 of the Constitution extends this authority to include the issuance of general obligation bonds. (1961)

Tennessee

(1) Tennessee Code, Title 6, Chapter 17, sections 1-16, authorizes cities to issue industrial revenue bonds. (1951)

(2) Code, Title 5, Chapter 7, section 15, provides similar authority to counties. (1953)

(3) Code, Title 6, Chapter 28, sections 1-20, authorizes cities and counties to incorporate Industrial Development Corporations which may be empowered to sell industrial revenue bonds. (1955)

Vermont

Statutes, Title 24, Chapter 61, sections 2701-2714, authorizes any city, town or village to issue revenue bonds (forty year, 6%) for industrial development. (1955)

Virginia

Acts of Assembly (Regular Session), 1962. Chapter 632 authorizes the creation of a Norton Industrial Development Authority empowered to issue revenue bonds, and Chapter 623 authorizes the creation of local development authorities in former Federal areas with similar authority.

Washington

(1) Revised Code, Chapter 53, sections 4.010 to .020, permits a port district created by counties to establish an industrial development district empowered to develop or redevelop land use and advance cash or credit for this purpose.

(2) Revised Code, Chapter 53, sections 4.010 to .020 authorizes any county, by referendum, to create a port district.

West Virginia

H. B. 367 (1963) authorizes counties and specified cities to issue industrial development revenue bonds.

Wisconsin

Statutes, Title 8, Chapter 66, section 52, authorizes municipalities to issue bonds for the development of industrial sites.

Wyoming

Session Laws 1963, Chapter 155, authorizes counties and cities to issue industrial development revenue bonds.

State Aid to Finance Industrial Development

Alaska. Laws of Alaska, 1961, Chapter 135, Acts 1 and 2.

Connecticut. General Statutes, Title 32, Chapter 579, sections 10-22. (1961)

Delaware. Delaware Code, Title 6, Part IV, Chapter 70, Sections 7001-7009.

Georgia. Constitution, 2-5507, Paragraph IV(A).

Illinois. Revised Statutes, Chapter 48, sections 831-847. (1961)

Kentucky. Revised Statutes, Chapter 154, sections 1 to 170. (1958)

Maine. Revised Statutes, Chapter 38-B, sections 1-14. (1957)

Maryland. Acts 1962, Chapter 126.

Minnesota. Statutes, Chapter 472, section 11, subdivision 6.

New Hampshire. Revised Statutes, Chapter 162-A, sections 1-11. (1955)

Ohio. Sub. H. B. 270 (1963)

Oklahoma. Constitutional Amendment, Article X, section 34, adopted in 1960, subsequent to Laws 1959, p. 483, proposing same.

New York. New York Job Development Authority Act, Chapter 443, Subtitles I-IV, 1961.

Pennsylvania. Statutes, Title 73, Chapter 8, sections 301 to 314. (1956)

Rhode Island. General Laws, Title 42, Chapter 34, sections 1-18. (1958)

Vermont. Statutes, Chapter 11, sections 201-215. (1961)

West Virginia. Official Code, Chapter 31, Article 15, sections 3242 (84-98). (1961)

Hawaii. H. B. 976 (1963).

5. INVENTORY OF LEADING COURT CASES

In 1925 the political subdivisions of Tennessee were precluded from issuing general obligation bonds to induce industry by aiding it to locate within their jurisdiction because it violated the concept of a "public purpose." 1/ The Tennessee ruling was followed in Mississippi in 1934; 2/Arkansas in 1949; 3/ in Florida for revenue bonds in 1952; 4/ in New Mexico in 1955 for revenue bonds, and subsequently withdrawn; 5/ in Nebraska for revenue bonds in 1957; 6/ and for revenue bonds in Idaho in 1960. 7/ In the meantime, however, when the public purpose of aiding industry was legislatively declared to be to increase employment and improve the general welfare, the Mississippi Court in 1938 approved general obligation industrial bonds and the Federal courts held that determination of public policy was a State question. 8/ Kentucky followed suit for revenue bonds in 1950; 9/ and for general obligation bonds in 1956; 10/ Alabama for revenue bonds in 1951; 11/ Tennessee for revenue bonds in 1951; 12/ and for general obligation bonds in 1955; 13/ New Mexico for revenue bonds in 1956; 14/ Maryland for revenue bonds in 1957; 15/ Arkansas for revenue bonds in 1960; 16/ and Kansas for revenue bonds in 1961. 17/

Several States, Arkansas, Georgia, Louisiana, Maine, Missouri, Nebraska and Oklahoma have amended their constitutions to allow political subdivisions to issue industrial bonds.

1/ Ferrell v. Doak, 274 S. W. 29, 1925.
2/ Carothers v. Town of Booneville, 153 S. 670.
3/ Williams v. Harris, 224 S. W. 2nd 779.
4/ State v. Town of North Miami, 59 S. 2nd 9.
5/ Village of Deming v. The Hosdreg Co., Inc., 303 P. 2nd 920.
6/ State v. City of York, 82 N. W. 2nd, 269.
7/ Village of Moyie v. Aurora Mfg. Co., 353.
8/ Allbritton v. City of Winona, 178 S-799, and 303 U. S. 627.
9/ Faulconer v. City of Danville, 232 S. W. 2nd 80.
10/ Dycke v. City of London, 288 S. W. 2nd 648.
11/ In re Opinion of Justices, 53 S. 2nd, 840.
12/ Holly v. City of Elizabethton, 241 S. W. 2nd 1001.
13/ McConnell v. City of Lebanon, 314 S. W. 2nd 12.
14/ Village of Deming v. The Hosdreg Co., Inc., on rehearing.
15/ City of Frostburg v. Jenkins, 136 A. 2nd 852.
16/ Wayland v. Snapp, 33 S. W. 2nd 633.
17/ State v. City of Pittsburg, 364 P. 2nd 71.

Only one case invalidating a State operated program for financially aiding industrial development loans was found. The decision was based on technical grounds and did not pass substantively on the problem of State financed aid to private industry. 18/ Several State financial programs avoid a substantive problem by making loans to non-profit development corporations which in turn make loans to private industry.

18/ Illinois Supreme Court Docket No. 37014, Supra, Chapter 5, footnote 19.

6. SOURCE OF DATA ON THE VOLUME OF LOCAL GOVERNMENT INDUSTRIAL BONDS ISSUED

Data for 1962 are from the Investment Bankers Association of America (IBA), (a mimeographed compilation supplied on request) except for Alabama, Arkansas, Georgia, Kansas and Nebraska. 1/ Data for 1961 and prior years are from the sources indicated for each State.

Alabama. IBA, Municipal Industrial Financing, A Report of a Special Committee to Study Industrial and Financing by States and Political Subdivisions, approved by the Board of Governors, May 12, 1961, Washington, D. C., for 1960 and prior years, for 1961, a mimeographed compilation supplied on request by IBA and letter of May 1, 1963, from the Alabama Planning and Industrial Development Board.

Arkansas. Kornelis Walraven, "Financing New Industry," The Arkansas Economist, Vol. 3, No. 2, University of Arkansas, Winter 1961, and Arkansas Industrial Development Commission.

Georgia. Georgia Department of Commerce.

Kansas. Kansas Industrial Development Commission

Kentucky. Kentucky Department of Commerce, Industrial Financing in Kentucky, 1962, and interviews with local development officials.

Louisiana. Board of Commerce and Industry.

1/ The IBA cautions that its data do not include issues sold locally and neither reported by members nor nationally advertised. In Louisiana the Board of Commerce and Industry data confirm the IBA data through 1960. In other States data from the sources cited show greater volume than reported by IBA. The absence of any State control in Alabama suggests that the IBA data for this State may substantially understate the volume. The same observation applies with respect to the 1961 data for Arkansas. The Arkansas data of Dr. Walraven are reported as the amount made available to plants. Kentucky and Washington data are believed to understate the volume. The Tennessee data are reported as bonds sold. Unconfirmed allegations exist that local governments in Florida and West Virginia have issued industrial development bonds without specific legislative authority.

Maryland. Maryland Department of Economic Development.

Mississippi. Mississippi Agricultural and Industrial Development Board.

Nebraska. Nebraska Division of Resources.

New Mexico. *Business Week*, August 9, 1958, and *Wall Street Journal*, October 11, 1960, p. 25.

North Carolina. *Report to the Governor of North Carolina from the Committee to Study Financing for Industrial Development*, November, 1962.

North Dakota. North Dakota Economic Development Commission.

Tennessee. Tennessee Taxpayers Association, *Tennessee Taxpayer*, Nashville, July 1, 1962.

Washington. Interviews with local officials.

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Investment of Idle Cash Balances by State and Local Governments. Report A-3. January 1961. 61 p., printed.

Intergovernmental Responsibilities for Mass Transportation Facilities and Services. Report A-4. April 1961. 54 p., offset. (Out of print)

Governmental Structure, Organization, and Planning in Metropolitan Areas. Report A-5. July 1961. 83 p., U.S. House of Representatives, Committee on Government Operations, Committee Print, 87th Cong., 1st sess.

State and Local Taxation of Privately Owned Property Located on Federal Areas: Proposed Amendment to the Buck Act. Report A-6. June 1961. 34 p., offset.

Intergovernmental Cooperation in Tax Administration. Report A-7. June 1961. 20 p., offset.

Periodic Congressional Reassessment of Federal Grants-in-Aid to State and Local Governments. Report A-8. June 1961. 67 p., offset.

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State Constitutional and Statutory Restrictions Upon the Structural, Functional, and Personnel Powers of Local Governments. Report A-12. October 1962. 79 p., printed.

Intergovernmental Responsibilities for Water Supply and Sewage Disposal in Metropolitan Areas. Report A-13. October 1962. 135 p., offset.

State Constitutional and Statutory Restrictions on Local Taxing Powers. Report A-14. October 1962. 122 p., offset.

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Transferability of Public Employee Retirement Credits Among Units of Government. Report A-16. March 1963. 92 p., offset.

*The Role of the States in Strengthening the Property Tax. Report A-17. June 1963. (2 volumes). In Press.

Industrial Development Bond Financing. Report A-18. June 1963. 96 p., offset.

*Tax Overlapping in the United States, 1961. Report M-11. September 1961. 136 p., printed. ($1.00)

Factors Affecting Voter Reactions to Governmental Reorganization in Metropolitan Areas. Report M-15. May 1962. 80 p., offset.

Measures of State and Local Fiscal Capacity and Tax Effort. Report M-16. October 1962. 150 p., printed.

*Directory of Federal Statistics for Metropolitan Areas. Report M-18. June 1962. 118 p., printed ($1.00)

1/ Single copies of reports may be obtained from the Advisory Commission on Intergovernmental Relations, Washington, D.C. 20575, except those marked with an asterisk (*) which may be purchased from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.