

INDUSTRIAL DEVELOPMENT BOND FINANCING

Summary of Report A-18



ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

August 1965

First Issued June 1963

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

(As of June 1963)

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PREFACE

Pursuant to its statutory responsibilities, the Advisory Commission on Intergovernmental Relations from time to time singles out for study and recommendations particular problems, the amelioration of which in the Commission's view would enhance cooperation among the different levels of government and thereby improve the effectiveness of the Federal system of government as established by the Constitution.

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.

This is a summary of a report that was approved by the Commission at its regular meeting on June 27, 1963.

Frank Bane
Chairman

1. FINDINGS

The sale of bonds is only one of several ways government credit is used to assist in 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 acquisitions 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.

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.

By 1963, however, 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. Seven additional States had programs of State financing of industrial development. Some of these provided 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

^{1/} Joseph Dorfman, The Economic Mind in American Civilization, 1605-1865, New York, 1946.

from the beginning of the program in 1938 to the close of 1962 is less than a half billion dollars. 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. 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. Involved also is the deeply rooted public aversion to the intrusion of government into activities traditionally reserved for private enterprise.

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

Opponents of tax exemption of the interest from municipal securities, organized labor, certain industrial States where out-migration of industry has occurred, all claim a stake. In the process, a sufficient number of intergovernmental issues has become the focus of public debate to make this type of financing a concern to 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 these intergovernmental aspects 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 beginning of the Republic have freely intervened in and assisted the private economy to enable it better to achieve popular ends. Industrial development financing by State and local governments, as now practiced, appears typically to be associated, however, with surplus labor (unemployment) problems. This is the case both in hundreds of community programs where the objective is to find jobs for displaced agricultural workers as well as in industrial States where the 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 through benefit of State and local financing assistance now number in the hundreds and while there is nothing radically new or revolutionary in a local government's effort to use its fiscal power in behalf of its economic objectives, the advent of the Federal income tax (1913) has necessarily introduced a new factor into the situation. Our concern with tax exemption is 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.^{1/}

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

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 indicates that examples of pirating or runaway businesses associated with industrial development bonds are exceptions, not the rule. However, the use of public tax-exempt financing for the benefit of firms well able to finance their expansion from private sources is increasing and an expansion of these practices could readily jeopardize the usefulness of State and local development programs.

1/ 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.

Moreover, 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 and potentially self-defeating unless confined to economically justifiable proportions and circumstances.

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.^{1/}

1/ 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.'"

It is also concerned with the relationship of these activities to its own programs on behalf of economic growth and development, their effect on the fairness of the Federal tax system, the efficient operation of money markets, employment and unemployment, and the condition of the national economy.

2. RECOMMENDATIONS

Scope for State Action^{1/}

The States' interest 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, control of industrial development bond financing can best be approached on a case by case basis, and qualitative rules and standards can be more successfully developed at the State level than at the national level because they can be tailored to specialized needs and conditions. 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.

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 is whether the operation of the industrial development program should be decentralized among local governments or retained at the State level. Evidence suggests that (a) local programs are best adapted to rural areas while (b) State programs lend themselves more effectively to the needs of urban and industrial areas.

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 local government problems, and which has supervisory jurisdiction over local government financial administration.

^{1/} Suggested legislation for implementing these recommendations appears in the Appendix.

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. 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. This Commission has already stated its misgivings about the proliferation of special districts and agencies.

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, where the corporations aided are most often well established financially, 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.

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. (Urban areas are covered in Recommendation No. 8.)

Because general obligation industrial development bonds are a direct contingent liability of the issuing local government the aggregate volume of such liabilities incurred should bear a reasonable relationship of citizenry of that area to assume them. 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.

Our conclusion in favor of a quantitative limitation on the aggregate volume of this kind of borrowing is not variance with our recommendation elsewhere^{1/} 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 suggests itself as a criterion.

Recommendation No. 5 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.

^{1/} Advisory Commission on Intergovernmental Relations, State Constitutional Restrictions on Local Government Debt, pp. 71-75, September 1961.

The general practice in industrial development 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. 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 interest 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, always reserving for the local electorate, however, the right to initiate a referendum on the question. Community investments in industrial facilities should concern the citizens for a variety of reasons, including the contingent obligation they assume by issuing bonds. 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.

State programs are dominantly of two types--loans secured by a second mortgage to supplement local civic conventional financing and State guarantee of conventional mortgage loans.

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 and might lead to interstate competition in lowering rates to a level that would prejudice private capital accumulations and economical allocation of industry.

Recommendation No. 8. 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.

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.

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.

Perhaps the clearest case of abuse occurs when the corporation which leases the industrial facility itself buys the tax exempt bonds which financed the acquisition of the facility. It not only enjoys a rental reduction reflecting the interest saving but a tax-exempt interest income as well. 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.

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.^{1/}

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. 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.

^{1/} This recommendation is embodied in H.R. 324, introduced by Congressman Keogh of New York in the 89th Congress, 1st Session.

3. 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.

Direct efforts by local governments to influence industrial location by distributing subsidies of one kind or another have a substantial history. Undoubtedly early civic and governmental offerings of buildings were in the nature of inducements to industry. 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.

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.

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 are usually needed for sales promotion, research, and operating capital.

Economic considerations have operated to make it advantageous for many businesses to lease rather than own necessary real estate. 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.^{1/}

Typically, rental space in small towns is inadequate for industrial needs. Banks are the principal source of credit for industry, and in most of the cities and counties which have issued industrial development bonds, they are small and pursue a conservative investment policy. Some States restrict banks territorially, and banks in large commercial centers often charge higher interest rates than are allowed^{2/} by some States where industrial development bonds are issued.^{2/}

Together, these conditions lead to the conclusion that in rural areas conventional credit facilities do not adequately provide financing for industrial buildings, and credit for lease-back arrangements is missing. In many cases local government is the only entity that has the motivation and power to command capital for this use.

^{1/} Bergin, Thomas P. and Egan, William T., "Economic Growth and Community Facilities," Municipal Finance, May 1961, p. 148.

^{2/} The maximum legal rate of interest is 6 percent in Kentucky and Tennessee.

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.
- (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.
- (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 by the Federal Government, triggered by a third party, the local government. Herein lies a source of dissension. Local officials might dispense a Federal subsidy less carefully than local money or less carefully than Federal officials. Also the use of Federal subsidies to foster inter-area competition or disadvantage private enterprise is obviously objectionable.

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--in the neighborhood of \$9 million--and part of this loss is recaptured in increased taxable income. However, the loss will increase unless the use of such bonds is restricted to assisting small, new and venturesome firms in areas of surplus labor which lack adequate resources for financing and leasing industrial property.

Additional tax advantages may accrue when the lessee of a public financed building purchases the bonds which financed the building.

Exempting leased property from ad valorem taxation is not a necessary complement of local government industrial development bond financing and can be disassociated from such financing simply by selling the building under a conditional sales contract rather than leasing it. Some sentiment is developing for such exemption, however, on the ground that the government costs associated with an industrial establishment are often less than the revenue that the facility provides the ad valorem tax exemption may be more significant than income tax exemption on the interest on the bonds.

Abuses

If use of industrial development bonds is to be continued, 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 of industrial development bonds may also invite abuse in that such districts are typically subject to little if any control by the electorate and many aid the enterprise that does not need help and foster practices unfair to established firms and conventional financial facilities.

General Obligations 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 bonds, 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. 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.

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 industrials are issued confirms the observation that general obligation bonds are better designed to disperse small industry throughout the State.

Industrial development bond interest rates and terms are usually regulated by the States concerned, and general obligation bonds for this purpose usually are related to the property tax base and require voter approval, sometimes by more than a simple majority.

This Commission on a previous occasion has expressed its preference for general obligation bonds over revenue bonds for financing construction of regular governmental facilities.^{1/} Many of the small, new, venturesome enterprises that have been aided by general obligation issues in Mississippi, for example, could not have been financed by revenue bonds. However, revenue bonds may be justified in some circumstances on the ground that they conserve the general credit of the issuing unit of government for other purposes.

^{1/} ACIR, State Constitutional and Statutory Restrictions on Local Government Debt, September 1961, pp. 54-57.

4. THE USE OF THE 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. Mississippi, hard hit as the country was emerging from the Great Depression, in 1936, 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. Soon thereafter other States began to enact similar legislation 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:

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 in Table 1.

The volume of local industrial development bonds reported by States is listed in Table 2.

As noted earlier, the total of such bonds is small in terms of the size of local government financial operations, but the volume of issues, especially the larger ones, is increasing, their use is spreading

Table 1.--Local Government Industrial Development Bond Sales, by Year
1951-1962

	<u>Year</u>	<u>Amount</u>
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 . . .	<u>\$ 441,056,000</u>
Estimate for underreporting . . .		<u>20,000,000</u>
	Grand Total . . .	\$ 461,056,000.

Table 2.--Local Government Industrial Bond Sales, by States, 1951-1962

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. . .	<u>441,056,000</u>
Estimate for underreporting. . .	<u>20,000,000</u>
Grand Total. . .	461,056,000

and in some jurisdictions the volume in relation to conventional criteria of debt load is high.

In summary, by the end of 1962, at least 23 States had some type of specific authorizations for local government industrial development bond programs.^{1/} Eleven States authorized both general obligation and revenue bonds, eleven authorized revenue bonds only, and one, general obligation bonds only.

Proposals to authorize local industrial development bond financing are active issues in a number of States. Four (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 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.

Effect 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?

^{1/} This excludes North Carolina where Rocky Mount issued \$501,000 industrial development bonds without specific legislative authority.

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.

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.^{1/} Yet, Mississippi's relative position in the per capita personal income ranking of the States has not increased.

Many other factors also must be weighed--the beneficial effect, if any, on rural communities; the adverse effect on areas suffering out-migration of industry, whether such development bonds appeal to or encourage foot-loose or run-away industry, and the net effect on the production of goods and services.

All of these hypotheses suggest that local government industrial bonds merely accelerated what was happening anyway. The net contribution of these efforts to total national employment remains conjunctural.

1/ 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.

5. STATE AID IN FINANCING INDUSTRIAL DEVELOPMENT

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

Only one State, Oklahoma, has sold industrial development bonds, and there the amount was \$2 million.

The enacted State legislation provides scope for about \$275 million in industrial development financing, of which relatively little has been used to date. About \$45 million from treasury borrowing and appropriated funds has been used to construct buildings, and \$31 million in loans guaranteed, mostly by Rhode Island and Maine.

Developments in Selected States

Alaska has created a State Development Corporation to make loans up to 90 percent of cost for plants. Connecticut, Maine and Rhode Island have similar plans to guarantee loans up to specified maximums. Delaware has established a State Industrial Building Commission which may pledge the faith and credit of the State up to \$10 million total and \$2 million per project. New Hampshire in 1955 established an Industrial Park Authority with broad powers to issue revenue bonds to develop sites and construct industrial buildings. In New York State, the Job Development Authority became effective in 1962 and made available \$100 million in lending power for use in critical economic areas or those less critical where mortgage loans for industrial building may not be available from other sources at reasonable rates.

Pennsylvania in 1956 established an Industrial Development Authority with power to make second mortgage loans to non-profit voluntary community development corporations in chronic labor surplus areas. Rhode Island in 1958 established an Industrial Building Authority with authorization to insure industrial mortgages of local non-profit development corporations or foundations for 90 percent of project costs.

Vermont, through an Industrial Building Authority pledges full faith and credit of the State up to \$10 million to guarantee local development agency loans for industrial plants. West Virginia provides second mortgage loans in depressed areas, and Ohio has set up a \$100 million State revolving fund as a source of loans for industrial development.

APPENDIX

Suggested State Legislation for Local
Industrial Development Bond
Financing

7Title should conform to state requirements. The following is a suggestion: "An act relating to industrial development bonds."7

(Be it enacted, etc.)

1 Section 1. Purpose. The legislature hereby finds and
2 declares that the issuance of industrial development bonds
3 as herein described must be placed under proper safeguards
4 in order that the fiscal integrity of the state and its
5 political subdivisions be preserved, that the conventional
6 credit facilities of private enterprise not be displaced,

7 and that local government financing not be abused. It
8 is the intent of this act, therefore:

9 (a) To insure that the issuance of local government
10 industrial development bonds is conducted in such a
11 manner as to make a maximum contribution to the orderly
12 industrial development of the state;

13 (b) To avoid overextension of local government in-
14 dustrial development credit;

15 (c) To prevent abuse of tax-exempt local government
16 industrial development bonds; and

17 (d) To provide technical assistance to local units
18 of general government choosing to utilize industrial de-
19 velopment bond financing.

1 Section 2. Definitions.

2 (a) "Industrial development bond" means any general
3 obligation or revenue bond issued by any local unit of
4 general government of the state for the purpose of financing
5 the purchase of land, the purchase or construction, in-
6 cluding reconstruction, improvement, expansion, extension
7 and enlargement, of buildings and appurtenances and the
8 purchase and installation of machinery, equipment or
9 fixtures, the purpose of such purchases being primarily for
10 sale or continuing lease to a private individual, partner-
11 ship or corporation for use in connection with the operation
12 of an industrial enterprise, except √docks, wharves and
13 marine warehouses, airport terminal and hangar facilities,

14 other transportation facilities, municipal stadiums,
15 theaters, or ...7.

16 (b) "Local unit of general government" means a county
17 or a city or a town, township, borough, etc.7

18 (c) "Governing body" means the body or board charged
19 with exercising the legislative authority of a local unit
20 of general government.

21 (d) "Agency" means insert name of the appropriate agency
22 of state government, normally the agency, if any, that is
23 charged generally with concern or oversight regarding local
24 government debt, provides technical assistance to local
25 governments in the sale of their bonds, or that provides
26 general services or assistance to local governments7.

1 Section 3. Authorization. Industrial development bonds
2 may be issued only by local units of general government
3 located in such areas designated by the agency as having
4 chronic surplus labor and as being outside the area of
5 regular and effective operation of existing conventional
6 credit facilities which are able to provide credit in ade-
7 quate amounts.¹ Such local units of general government are

¹ Some states may wish to designate as eligible under this provision all local units of general government having surplus labor that are outside any standard metropolitan statistical area, as defined by the U. S. Bureau of the Census, on the ground that conventional credit facilities may be presumed adequate in the large urban areas. States may also wish the agency to take into consideration projects that are being constructed or proposed under such federal programs as the Area Redevelopment Administration and Small Business Administration.

8 hereby authorized to issue industrial development bonds
9 subject to the conditions of this act.

1 Section 4. Statutory limitations imposed upon the
2 borrowing powers of local units of general government
3 shall be construed as not being applicable with respect
4 to the issuance of industrial development bonds. In
5 addition to the limitations on the powers of local units
6 of general government provided in this act, the agency
7 shall limit the aggregate volume of industrial develop-
8 ment bonds outstanding at any time on behalf of all local
9 units of general government in the state to an amount not
10 to exceed percent of the personal income of the
11 population in the state as last determined by the United
12 States Department of Commerce⁷ or percent of
13 total state and local tax collections in the state during
14 the preceding fiscal year⁷ dollars⁷. The
15 agency shall determine from time to time the aggregate
16 volume of industrial development bonds which may be issued
17 pursuant to this limitation and in the light of employment
18 needs and industrial development prospects shall allot
19 among all eligible local units of general government the
20 amount of industrial development bonds each may issue.

1 Section 5. The agency may employ personnel necessary
2 to carry out the provisions of this act. The agency is
3 empowered to issue rules and regulations and to require
4 information necessary for the administration of this act.

5 Section 6. All departments, divisions, boards, bureaus,
6 commissions or other agencies of the state government shall
7 provide such assistance and information as the agency may
8 require to enable it to carry out its duties under this
9 act. In its deliberations incident to the administration
10 of this act the agency shall consider the advice of the
11 /state planning and development agencies and/ local planning
12 agency regarding resource utilization and developmental
13 plans for the various areas of the state.

1 Section 7. No local unit of general government may
2 issue industrial development bonds without first having
3 been issued a certificate of convenience and necessity
4 therefor. Such certificate shall be issued by the agency
5 upon a petition of the governing body of the local unit of
6 general government proposing to issue industrial development
7 bonds upon the agency finding:

8 (a) That the local unit of general government has
9 a contract, approved by its governing body, with an indivi-
10 dual, partnership or corporation to lease the property to
11 be acquired with the proceeds of the industrial development
12 bonds for occupancy and use in connection with the conduct
13 of an industrial enterprise for a period of years, and for
14 the lessee to pay an annual rental adequate to meet interest
15 and principal payments falling due during the term of the
16 lease;

17 (b) That the lessee of the property is a responsible
18 party;

19 (c) That the contract for lease of the property provides
20 for:

21 1. The reasonable maintenance, less normal wear
22 and tear, of the property by the lessee;

23 2. Insurance to be carried on the said property and
24 the use and disposition of insurance moneys;

25 3. The rights of the local unit of general government
26 and the lessee respecting the disposition of the property
27 financed by the proposed industrial development bonds upon
28 retirement of the bonds or termination of the contract by
29 expiration or failure to comply with any of the provisions
30 thereof;

31 (d) In addition to the above, the contract may provide
32 for the rights of the bondholders; the care and disposition
33 of rental receipts; and such other safeguards as are deemed
34 to be necessary by the agency;

35 (e) That opportunities for employment are inadequate
36 in the area from which the proposed industrial plant would
37 reasonably draw its labor force and that there exists in
38 that area a condition of substantial and persistent unemploy-
39 ment or underemployment;

40 (f) That the proposed project will provide employment
41 having a reasonable relationship to the volume of the bonds
42 issued as compared to investment per employee of comparable
43 industrial facilities;

44 (g) That financing by banks, other financial institutions

45 or other parties, of the property required by the lessee
46 is not readily available to the lessee on ordinary commer-
47 cial terms in adequate amounts either on the local market
48 or on the national market;

49 (h) That no portion of the proposed industrial develop-
50 ment bond issue will be purchased by the lessee or any
51 affiliate or subsidiary of the lessee at the time of the
52 initial marketing;

53 (i) That the facility offered the lessee is intended
54 to accommodate expansion of an enterprise located elsewhere
55 or a new enterprise and not primarily the relocation of an
56 existing facility.

57 (j) That adequate provision is being made to meet any
58 increased demand upon community public facilities that
59 might result from the proposed project; and

60 (k) That the issuance of the proposed bonds and the opera-
61 tion of the enterprise of the lessee will not disrupt the
62 fiscal stability of the issuing local unit of general
63 government in the event it should become necessary for it
64 to assume responsibility for payment of the interest and
65 principal of the proposed industrial development bonds.

1 Section 8. (a) Within [] days after a local unit
2 of general government files a petition, completed in accord-
3 ance with the rules and regulations authorized by Section 5,
4 the [appropriate state agency] shall upon due notice, hold
5 a hearing upon the petition. The [appropriate state agency]

6 shall reasonably expedite any such hearing and shall advise
7 the petitioning local unit of general government of its
8 decision within [] days of the adjournment of a
9 hearing. If the [appropriate state agency] approves the
10 petition a certificate of convenience and necessity shall
11 be issued forthwith. Failure of the agency to advise the
12 petitioning local unit of general government of its decision
13 within [] days of the conclusion of the hearing shall
14 constitute approval of such petition, and the local unit
15 of general government shall be entitled to receive such
16 certificate. Decisions of the [appropriate state agency]
17 shall be [reviewable as provided in the state administrative
18 procedure act]/[final as to findings of fact].

19 (b) A certificate of convenience and necessity issued
20 as provided in this act shall expire in twelve months from
21 the date of its issuance provided that, upon written appli-
22 cation by the local unit of general government to the
23 [appropriate state agency], supported by a resolution of
24 such local unit's governing board and such information as
25 the [appropriate state agency] may require, the [appropriate
26 state agency] may in its discretion extend the expiration
27 date of such certificate for a period not to exceed []
28 months.² If, at any time during the life of such certificate,

2 States including Section 9 (b) in their acts may wish to consider a longer period of initial life for a certificate in order to accommodate the time intervals necessary for the referendum procedure.

29 the authority of the local unit of general government to
30 proceed thereunder is contested in any judicial proceeding,
31 the court in which such proceeding is pending or, upon
32 proper application, to the appropriate state agency, the
33 appropriate state agency may issue an order extending the
34 life of such certificate for a period not to exceed the
35 time from the initiation of such proceeding to final judg-
36 ment or other termination thereof.

1 Section 9. (a) A local unit of general government
2 which holds a certificate of convenience and necessity
3 issued and in force pursuant to this act may incur bonded
4 indebtedness, subject to the limitations and procedures
5 of this act and of other applicable laws.

6 (b) Prior to authorization of the incurring of bonded
7 indebtedness pursuant to this act by resolution of the
8 local governing board, public notice as provided in cite
9 appropriate sections of state law shall be given. In
10 addition to any other items which the notice is required
11 to or may contain, such notice shall include: the nature
12 of the project; the amount of bonds to be issued; whether
13 such bonds are to be revenue bonds or general obligation
14 bonds; the right, as provided herein, of petition for a
15 referendum; and the place at which a true copy of the
16 contract is available for examination. If, within 60
17 days thereafter, no petition for a referendum has been
18 received the governing body may proceed with the issuance

19 of the bonds.

20 (c) Except to the extent that they are in conflict with
21 this act, the [cite statutes empowering local governments
22 to issue bonds and prescribing applicable procedures]
23 shall apply to the authorization, and issuance and sale of
24 industrial development bonds by the local units of general
25 government.

1 Section 10. If within the time limits prescribed in
2 Section 9 (b), [] percent of the eligible voters
3 resident of the unit of government proposing to issue in-
4 dustrial development bonds, by signing a petition to the
5 governing body, shall request that the proposal to issue
6 the said bonds be subjected to referendum of the electorate,
7 an election shall be ordered in accordance with [cite those
8 sections of the law applicable to bond elections], except
9 that, notwithstanding any other provisions of law, a
10 majority of the qualified voters voting on the question
11 shall resolve it. If a majority of those voting on the
12 question vote "no" the certificate of convenience and
13 necessity shall be void.

1 Section 11. The [appropriate state agency] shall make
2 an annual report to the Governor and the legislature, in-
3 cluding recommendations to further the purposes of this
4 act.

1 Section 12. Sections [insert any legal citations authorizing
2 other issuance of industrial development bonds] are hereby
3 repealed.

1 Section 13. Insert separability clause.

1 Section 14. Insert effective date.

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

