State Constitutional and Statutory Restrictions on Local Government Debt
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1 Membership as of September 15, 1961, the date on which this report was adopted.
2 Resigned from the Commission, September 1961.
A COMMISSION REPORT

State Constitutional and Statutory Restrictions on Local Government Debt

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

SEPTEMBER 1961

A-10
The Advisory Commission on Intergovernmental Relations was established by Public Law 380, passed by the first session of the 86th Congress and approved by the President September 24, 1959. Section 2 of the act sets forth the following declaration of purpose and specific responsibilities for the Commission:

"Sec. 2. Because the complexity of modern life intensifies the need in a federal form of government for the fullest cooperation and coordination of activities between the levels of government, and because population growth and scientific developments portend an increasingly complex society in future years, it is essential that an appropriate agency be established to give continuing attention to intergovernmental problems.

"It is intended that the Commission, in the performance of its duties, will —

"(1) bring together representatives of the Federal, State, and local governments for the consideration of common problems;

"(2) provide a forum for discussing the administration and coordination of Federal grant and other programs requiring intergovernmental cooperation;

"(3) give critical attention to the conditions and controls involved in the administration of Federal grant programs;

"(4) make available technical assistance to the executive and legislative branches of the Federal Government in the review of proposed legislation to determine its overall effect on the Federal system;

"(5) encourage discussion and study at an early stage of emerging public problems that are likely to require intergovernmental cooperation;"
“(6) recommend, within the framework of the Constitution, the most desirable allocation of governmental functions, responsibilities, and revenues among the several levels of government; and

“(7) recommend methods of coordinating and simplifying tax laws and administrative practices to achieve a more orderly and less competitive fiscal relationship between the levels of government and to reduce the burden of compliance for taxpayers.”

Pursuant to its statutory responsibilities, the Commission from time to time singles out for study and recommendation 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. One problem so identified by the Commission pertains to the restrictions placed by State constitutional and statutory provisions upon the borrowing power of local governments.

In the following report the Commission sets forth what it considers key facts and policy considerations on this subject, and respectfully submits its conclusions and recommendations thereon.

This report was adopted at a meeting of the Commission held on September 15, 1961.

Frank Bane,
Chairman.
ACKNOWLEDGMENTS

The staff work for this report was conducted by Mr. Allen D. Manvel, Assistant Director (Metropolitan Areas). Mr. Manvel benefited from information and advice generously provided by numerous individuals, including Wade S. Smith, Director of Municipal Research, Dun and Bradstreet, Incorporated; David M. Ellinwood, Vice President, Moody’s Investors Service; Professor Roland I. Robinson, Michigan State University; Frank E. Morris, then Research Director of the Investment Bankers Association; and Frederick L. Bird, formerly Director of Municipal Research, Dun and Bradstreet, Incorporated.

The Commission and its staff express appreciation for this assistance but of course assume final responsibility for the staff work reflected herein.

Wm. G. Colman,
Executive Director.
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Chapter 1

SUMMARY OF FINDINGS AND RECOMMENDATIONS

Borrowing by local governments in the United States is subject to an extensive and complicated body of law, expressed in the provisions of State constitutions, statutes, and individual government charters, and interpreted by official rulings and court decisions. These legal provisions deal with many aspects of local government debt—not only with the amounts that may be borrowed, but also commonly with permissible methods, purposes, time periods, and terms or conditions for local government borrowing.

This report is focused mainly upon those State provisions that are most often mentioned as placing "restrictions" on the borrowing power of local governments. These are of three main types, involving: (1) A limit on indebtedness, expressed as a percentage of the local government's property tax base (its assessed valuation); (2) A limit on tax rates that can be imposed specifically for debt service or for various purposes including debt service; and (3) The requirement of a local referendum to authorize the issuance of bonds, often calling for some kind of "special" majority. The first and third of these types of restrictions apply widely, but the second type is used in only a few States.

State provisions of this nature first developed as an aftermath of the economic crisis of the 1870's, when many local governments that had issued "railroad aid" bonds ran into serious difficulty. Most of the subsequent State enactments have followed a similar pattern, and have involved additions to or amendments of the early restrictions rather than major pruning or recasting of the original provisions.
One feature of these State-imposed restrictions deserves emphasis — the fact that they do not encompass all types of local bond issues, but commonly apply only to local governments' issuance of full faith and credit debt. Various legal doctrines and devices by which local governments can issue nonguaranteed or "revenue" debt, usually exempt from such State restrictions, have developed widely. In recent years, there has been an extremely rapid growth of "unrestricted" local debt. The use of revenue bonds has in some States spread far beyond its initial limited application to the financing of utility-type facilities of local governments.

An attempt is made in this report to appraise existing restrictions in the light of the following suggested statement of the purpose of State action with regard to local government debt: "To empower local governments to make use of borrowing, prudently and in a responsible and locally responsive manner, as one means for financing their requirements."

The most common type of restriction — a ceiling limit related to the local property tax base — is found subject to numerous technical deficiencies. As applied in most States, for example:

It pertains to present or past conditions, rather than those of the future, when long-term debt will be subject to servicing, and thus takes no account of divergent trends for various governments and communities.

It deals with separate layers of local governments rather than the aggregate of local government for a particular area.

It purports to measure economic capacity by reference to only one revenue source, the property tax, which provides less than half of the revenue of most local governments in most States.

This type of limit is, in most States, imprecise and potentially discriminatory because of the nature of the property tax base to which it refers. The real level of limitation is determined by local assessment practices rather than being closely governed by the legal provisions.

Being commonly applicable only to full faith and credit debt, this type of limitation offers no assurance that aggregate local debt will be kept within prudent bounds.

An attempt to appraise broadly the various effects of State restrictions on local government debt leads to the following conclusions:
These restrictions may have helped to prevent debt difficulties for some local governments, but the record is far from clear. Debt restrictions have probably restrained the total volume of local government borrowing to some extent, but the extent to which this is true cannot be definitely measured.

The restrictions have been an important factor in the rapid recent growth of nonguaranteed local debt, as against full faith and credit borrowing. This development has a differential effect among various purposes of local borrowing and various types of local governments. It tends to increase the cost of borrowing, through higher interest rates and more extended bond maturities. It also is likely to impose more rigidity on local governments' future budgeting than would full faith and credit borrowing.

Debt restrictions have tended to impair the public accountability and responsiveness of local governments in various ways, including the promotion of special districts and various kinds of financing authorities, and the complication and obfuscation of financial arrangements.

Debt restrictions have not, apparently, tended to strengthen local property taxation. Tying debt limits to assessed values adds to the pressure upon assessors to assume basic policy responsibilities that legally and properly belong to local governing bodies.

The restrictions have affected governmental relations in various ways. They may artificially increase the need and demand for Federal and State grants to local governments. In some States they have contributed to urban-rural and local-State frictions.

During the coming decade, according to every portent, there will be continuing pressure upon local governments for sizable capital outlays, with a resultant need for extensive borrowing and, in turn, for well considered financial policies by local governments and a receptive market for municipal obligations. All these circumstances add urgency to the need for intensive review and considered revision of existing State restrictions on the indebtedness and borrowing of local governments.

As a summary background for its recommendations, the Commission states the following basic premises at the outset of Chapter 5:

1. States have a legitimate and strong concern with the borrowing power and practices of local governments subject to their jurisdiction.

2. Existing legal provisions on this subject are in most States critically in need of intensive review and major change. Basic revision is widely needed; patching has
been inadequate, and in some instances actually harmful.

3. Any constitutional provisions concerning the debt and borrowing power of local governments should be limited to matters that involve basic principles and relationships of enduring and basic importance.

4. No single legal formula now in effect appears to provide a reasonable and equitable measure of the "safe" debt-carrying capacity of individual local governments.

In the light of these premises, and of the findings which have been summarized above, the Commission believes that the present maze of constitutional and statutory restrictions upon local government borrowing constitutes a serious impediment to effective local self-government in the United States. These restrictions handicap self-reliance of local communities and governments, and impel them toward increased financial dependence on State or Federal Government resources. In many States, present provisions have contributed to complexity and deviousness in local debt operations. The Commission believes that State action to remedy this situation is necessary and urgent, and should be designed to relate any State regulation of local debt more realistically to the ability of local governments to service such debt.

Accordingly, the Commission offers five major recommendations for State action. (Dissents and comments of certain Members of the Commission appear as footnotes in the body of the report following recommendations No. 3 and No. 4.) These recommendations are as follows:

1. Local governments should be granted maximum powers with respect to local government indebtedness. The Commission recommends that State provisions with respect to local government indebtedness take cognizance of all forms of local borrowing and debt. The intended application of such State provisions should be made explicit, and they should be designed to facilitate—rather than hamper—intelligent choice among suitable alternative forms of borrowing by the local governments concerned. This objective is most likely to be served if any conditions that attach legally
to the borrowing power of an individual local government apply uniformly—or subject only to specifically defined exceptions—to any type of long-term debt it can incur.

2. The Commission recommends that authority to issue bonds should be legally vested in the governing bodies of local governments, subject to a permissive referendum only, on petition, and with participation in any such referendum available to all eligible local voters and the results determined—except under unusual circumstances—by a simple majority vote on the question.

3. The Commission recommends the repeal of constitutional and statutory provisions limiting local government debt or debt service by reference to the local base for property taxation.

4. The Commission recommends that the States study and consider measures to regulate long-term borrowing of local governments by reference to the net interest cost of prospective bond issues in relation to the currently prevailing interest rate on high quality municipal securities.

5. The Commission recommends that States make available technical and advisory assistance to local governments with regard to the issuance of long-term debt; and that the State agency responsible for this function be empowered to prescribe the minimum content of official statements prepared by local governments in connection with their issuance of long-term debt, in order to provide prospective investors with data needed to evaluate the security offerings.
Chapter 2

THE USE OF DEBT
FOR LOCAL GOVERNMENT FINANCING

A. Current Magnitudes

Today, as in the past, an important part of all local government expenditure in the United States is financed in the first instance from borrowed funds. It is not true, as is sometimes hastily assumed, that borrowing is undertaken for all capital outlay of local governments. Altogether, about one-third of all local capital outlay — i.e., expenditure for new construction and the purchase of land and equipment — has apparently been financed in recent years from current revenues of local governments. But borrowing has supplied the remaining predominant portion — some $39 billion of the $62 billion devoted to capital outlay by local governments during the 9 years 1952–1960 inclusive.¹

Local governments in the United States now owe about $50 billion in bonded debt.² They have recently been issuing between $5 and $6 billion annually of long-term debt, and have been retiring around $2.0 to $2.7 billion of such debt each year. At the time of the 1957 Census of Governments,

¹ These amounts are derived from the annual summaries of local government finances issued by the Bureau of the Census for years other than 1957, and aggregates for that year reported by the 1957 Census of Governments. It has been estimated here that, of the grand total of $43 billion of long-term debt issued by local governments during the 9-year period, some $0.6 billion was for debt refunding and about $3.3 billion was accumulated in bond funds, still unexpended at the end of 1960.

² Bonded debt in recent years has represented about 95 percent of all local government indebtedness, with the remainder consisting of interest-bearing short-term obligations—bond anticipation notes, bank loans, and tax anticipation notes and warrants. This study is concerned mainly with long-term or bonded debt, although some of the statistics cited (such as the historical data in table 3) comprise total local government indebtedness, including short-term amounts.
long-term debt of local governments totaled $37.3 billion, and was distributed by purpose as indicated in Table 1.

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Amount (millions of dollars)</th>
<th>Percent</th>
</tr>
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<tbody>
<tr>
<td>Education</td>
<td>$11,461</td>
<td>30.7</td>
</tr>
<tr>
<td>Water supply systems</td>
<td>5,082</td>
<td>13.6</td>
</tr>
<tr>
<td>Sewer systems</td>
<td>3,459</td>
<td>9.3</td>
</tr>
<tr>
<td>Streets and highways</td>
<td>3,459</td>
<td>9.3</td>
</tr>
<tr>
<td>Housing and redevelopment</td>
<td>2,977</td>
<td>8.0</td>
</tr>
<tr>
<td>Electric power systems</td>
<td>2,168</td>
<td>5.8</td>
</tr>
<tr>
<td>Transit systems</td>
<td>1,785</td>
<td>4.8</td>
</tr>
<tr>
<td>Airports and terminal facilities</td>
<td>1,464</td>
<td>3.9</td>
</tr>
<tr>
<td>Natural resources</td>
<td>915</td>
<td>2.5</td>
</tr>
<tr>
<td>Hospitals</td>
<td>615</td>
<td>1.6</td>
</tr>
<tr>
<td>Gas supply systems</td>
<td>195</td>
<td>0.5</td>
</tr>
<tr>
<td>Other and unallocable</td>
<td>3,742</td>
<td>10.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>37,323</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>


Roughly similar rankings of public functions appear when one examines the volume of long-term borrowing by local governments, and the distribution of their capital outlays, as in Table 2.\(^3\)

Nearly half of all local government debt is owed by municipalities, i.e., cities, towns and villages. School district governments account for nearly one-fourth of the total, special districts for nearly one-fifth, and county governments for about one-tenth, with town and township units owing the remaining two percent of all long-term local government debt.

The overwhelming majority of sizable local governments in the United States have some indebtedness. The 1957 Census of Governments showed debt outstanding for 94 percent of

\(^3\) Only an approximate distribution of local debt issuance by function is possible. "Statutory Authorities" appear as one type-of-issuer class in data reported regularly in the *Statistical Bulletin of the Investment Bankers Association* (hereafter cited as *IBA Statistical Bulletin*). From a governmental structure point of view, however, some of these are local and some are State government agencies. The percentages shown in Table 2 have, accordingly, been developed on an estimated basis, by subtracting Census Bureau data on State debt issued for various functions during fiscal 1960 (as shown in the *Compendium of State Government Finances in 1960*) from amounts of State and local government bond sales reported by the Investment Bankers Association for the four quarters ended June 30, 1960.
### Table 2.—Bonds Sold by Local Governments, 1959-60, and Capital Outlay of Local Governments During Fiscal 1960—in Percent

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Percent of bonds sold ($), 1959–60</th>
<th>Percent of capital outlay, 1960</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>37.4</td>
<td>34.1</td>
</tr>
<tr>
<td>Streets and highways</td>
<td>3.1</td>
<td>15.7</td>
</tr>
<tr>
<td>Water supply systems</td>
<td>21.5</td>
<td>9.9</td>
</tr>
<tr>
<td>Sewer systems</td>
<td></td>
<td>9.0</td>
</tr>
<tr>
<td>Housing and redevelopment</td>
<td>8.4</td>
<td>6.5</td>
</tr>
<tr>
<td>Airports and terminal facilities</td>
<td>5.2</td>
<td>3.7</td>
</tr>
<tr>
<td>Hospitals</td>
<td>1.7</td>
<td>2.5</td>
</tr>
<tr>
<td>Other and unallocable</td>
<td>22.7</td>
<td>18.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Source: Capital outlay amounts from Bureau of the Census, *Governmental Finances in 1960*, Table 6. As to bond sales data, see footnote 3, p. 7.

all the 2,888 municipalities and New England-type towns of 5,000 or more inhabitants, with about 47 percent of these units issuing some long-term debt during the year. Two-thirds of all county governments in the Nation had some debt at the time of the 1957 Census of Governments, and about one-fifth of them issued some long-term debt during the Census year. Of the approximately 10,000-school districts enrolling 300 pupils or more, 86 percent were found to have some debt in 1957, and nearly one-fourth of them issued some long-term debt that year. But the widespread importance of borrowing and indebtedness for local government financing is even more clearly evidenced, perhaps, by the following fact: Some local government debt was reported by the 1957 Census of Governments for each of the 3,100 county and county-city areas in the Nation, with the exception only of 11 sparsely populated areas, having an aggregate population of only 60,000.

While the most populous city, county, and school district governments account for a major fraction of the dollar amounts of local debt issued and outstanding, a majority of all issues of long-term debt involve smaller governments. Similarly, although relatively large issues make up much of the total dollar volume of State and local bond sales, small-size issues predominate in terms of number; in 1957 and 1958, for example, nearly five-sixths of all bond issues of State and local
governments (11,017 of 13,700 distinct issues) were for less than $1 million each.\textsuperscript{4}

B. The Rationale for Local Government Borrowing

The use of borrowing by local governments to finance capital outlays is commonly justified on two principal grounds.

The first is that major items of capital expenditure tend to arise irregularly, so that they cannot conveniently be financed from recurrent revenue sources which are relatively stable in yield from year to year. This point is particularly relevant to a small government, or one with a limited span of responsibility, for example, a village-centered school district, needing to replace or materially expand its facilities only at rather infrequent intervals. On the other hand, the government of a populous city or county, which commonly must provide a considerable volume and variety of public facilities, is likely to need extensive capital spending every year, merely to replace outworn or uneconomic elements of its physical plant. Whether only for this minimum purpose or also to provide for population growth and rising community standards, the total scale of capital spending by a major government with broad responsibilities may be relatively stable from year to year, even though it is for a changing “mix” of projects, small and large. The irregularity or “bumpiness” of particular projects, then, does not in itself force relatively large multifunctional governments toward extensive reliance on borrowing to finance their capital outlays.

The other common justification for borrowing to finance much of the total plant expenditure of local governments is based upon the differing impact, over an extended period, of this approach as compared with financing entirely from current revenues. Since new public facilities (schools, roads, hospitals, utility plants, etc.) will serve the community population of future years and decades, it may be argued that the taxpayers and facility-users of that future period can reasonably be expected to foot the bill. This they do, the argument runs, when public plant expansion is initially financed by borrowing and the sum involved is then recouped, along with

\textsuperscript{4}IBA Statistical Bulletin, August 1959, p. 2. Corresponding detail is not available separately for local governments as distinct from the States.
related interest costs, over a period that approximates the life of the improvements. In terms of such reasoning, to rely on current revenue to finance all capital outlays as well as current costs will involve not merely "pay-as-you-go," but actually "payment-in-advance." 

Especially in present-day American society, with its relatively high rate of population mobility, the issue of which generation is to finance community facilities is far from unimportant. Local taxpayers of the future will not be solely, nor even always mainly, the "next generation" of taxpayers now in a particular community. Each year, according to Census Bureau reports, one-fifth of all Americans change their residence, and about one in 16 moves across county lines, with half of these latter changes involving interstate migration. For many communities, there will be large cumulative effects from such population movements over a period of one to three decades—the usual span of local bond issues.

With rigorous application of the foregoing logic, local governments would borrow only to finance net additions to their fixed plant, and would rely on current revenues not only for current expenditure needs but also for the replacement of previously acquired capital plant (or more precisely, on a

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6 It is an oversimplification to assume, as is sometimes done, that a community which finances capital expenditure from revenue or balances necessarily "saves" the whole sum it might otherwise have spent on interest if it had used a debt-financing approach. An economist would emphasize that additional sacrifice and cost are involved in earlier payment under the revenue approach. This might be illustrated by a government which chooses to borrow even though it has an available beginning balance sufficient to finance a particular outlay. By investing that sum, it could obtain interest that would offset, at least in part, the interest it must pay on its simultaneous borrowing; in other words, the beginning balance is worth more for future use than for immediate application. Similarly, the economist would emphasize that a taxpayer is subject to greater cost by having to make a present payment than by having to pay an identical amount at some time later, since with earlier payment he is deprived of the use or interest value of his money during the interval involved. Whether financing from revenue or from borrowing is more "economical," then, is not a simple question. The answer may depend not only on relative interest rates that are payable or earnable by a government and its taxpayers, but also by any difference in the prudence or efficiency with which spending is carried out under one of these methods of financing as compared with the other. Furthermore, if the use of borrowing permits earlier undertaking of particular projects, any intervening change in price levels will enter into the equation. When costs are strongly upward, for example, deferral might turn out to involve as much or even more total expenditure than the sum of initial debt-financed outlays and related interest charges.
recurrent basis, for coverage of the "current expense" involved in depreciation and obsolescence of existing plant). With relatively limited exceptions—principally involving utility-type operations—local governments in the United States do not maintain accounting records in a manner to reflect these distinctions. Also, public works undertaken by local governments often represent a "mix" of replacement and improvement or extension. For example, a deteriorated school building is likely to be "replaced" by a structure that is not only new rather than old, but also better in some important respects and very often larger.

In actual fact, then, the choice between reliance on revenues or upon debt to finance capital outlays is not generally based upon a precise calculation of this nature. Small governments encounter inter-year variation in major outlays. Legally or politically (in the best sense), they generally cannot set out to accumulate a sizable revenue surplus regularly over an extended period in order to finance a future major project without resort to borrowing. While large multifunctional governments, as already pointed out, do not have as much of a "bumpiness" problem, very few of them have provided for their capital outlays in recent years without some debt issuance. Furthermore, a shift from heavy reliance on debt-financing toward primary reliance on so-called "pay-as-you-go" financing of capital outlay involves something of a bootstrap-lifting effort, by which the taxpayers of the community are not only carrying the service on debt previously incurred but also are providing facilities to be used during the future.

These considerations help to explain why, in recent years of rapid population growth and increasing urbanization, needs for additional public facilities have been largely financed by local government borrowing.

C. Methodology of Local Government Borrowing

There is an extensive body of writing on this subject, from which only key highlights are presented here, tracing the major
steps that commonly take place in the issuance and marketing of local government bonds.6

Advance preparation for long-term borrowing includes, obviously, the development of plans and specifications as to amount, purpose, nature, terms, and timing of the bond issue to be authorized. These matters deserve and receive attention from the local government’s highest-ranking financial and policy officials, and they in turn often seek outside expert advice on these matters.

The first explicit formal step in the process involves authorization of the debt issue. In some instances, this can be accomplished by adoption of a bond resolution by the governing body of the local government, but often there is a legal requirement for popular approval by referendum. In certain instances the original basic authorizing action may provide for bonds which are to be issued at intervals over a period of years, rather than all at once.

Even before formal authorization of a bond issue, the government generally will have engaged the services of a firm of bond attorneys to plan the instruments and proceedings involved, to avoid any possibility of error and serious embarrassment for the issuing government. In any event, such specialized counsel will be employed before the bonds are offered for sale, so that, when issued, they can carry the “unqualified approving legal opinion of some firm of municipal bond attorneys whose opinions are recognized as marketable.”7 A preliminary approval is given before the government’s sale of the issue; a final legal opinion is supplied after the sale, and is sometimes reproduced on the back of the individual bonds.

Most local government bonds are sold as a result of competitive bidding, at a sale scheduled in advance for a specific date, time and place.8 Borrowing governments are encouraged

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7 Ibid., p. 31.

8 Competitive bidding is legally required in most States for the sale of general obligation bonds, and actually applies to practically all such issues as well as to a major portion of the dollar volume of all revenue bonds sold, even though competitive bidding is not so commonly required by law for revenue issues.
to publicize the proposed sale in various media — in local newspapers, in a State financial paper if there is one, and in nationwide and regional financial journals — and to send notices directly to underwriting firms which might be interested in bidding on the bonds. Various professional and financial groups have developed recommendations for minimum subject matter of such advertising, not only covering significant conditions and terms of the prospective issues but also including background information about the government. The borrowing government is encouraged also to prepare and distribute a more detailed prospectus or "official statement" which gives "comprehensive data about the community, its economic background, and its financial situation." 9

Sealed bids received from prospective purchasers are opened at the precisely scheduled time. Except in the unusual circumstance that all offers are rejected, the bonds will ordinarily go to the bidder showing the lowest net interest cost. This can be calculated as the total amount of interest required by the coupon rates in the bid, minus the premium or plus the discount specified. The net interest cost rate, of course, equals the net interest cost divided by the principal amount of the bond issue.

Of the total dollar volume of municipal bonds sold in the United States, a major proportion is marketed through a few score underwriting firms, which purchase issues either individually or, in the case of sizable issues, on a joint-account basis that involves participation by several firms. In the Nation as a whole, more than 700 firms engage regularly in the underwriting and marketing of "municipals."

With printing and execution of the bonds, and their delivery to the purchaser along with necessary closing papers and a final approving legal opinion, the issuing government receives the sum offered for the bonds. At this point, the government will have completed its active role with regard to the particular issue, other than to provide for appropriate record keeping.

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9 Gordon L. Calvert (ed.), op. cit., p 37. Underwriters and bond analysts seem to agree, however, that there is a considerable range in the quality of such official statements as prepared by individual governments. Speakers at meetings of public finance officials commonly stress the need for more complete and informative offering statements than are provided by some prospective borrowing units.
and service of the debt while any portion of it remains outstanding.

The firm or firms that initially purchase the issue, of course, are ordinarily operating mainly as underwriters or marketers rather than as final investors in governmental securities. They therefore "reoffer" the bonds for purchase by investors. For issues of material size, this involves advance advertising in financial and other publications, with delivery of the bonds promised, prior to their actual printing and execution, on a "when, as and if issued" basis. Information about the issue is provided by the dealer(s) handling it by means of an "offering circular," which not only describes the particular bond issue but provides background data concerning the issuing government and its community. Detailed standards for such circulars have been developed and publicized by the Investment Bankers Association, designed "to continue to bring about full disclosure of all material facts which would have any bearing upon the security offered."\(^{10}\) When the bonds are executed and delivered to the underwriters, they are in turn delivered to the purchasers who have ordered them for investment.

As the foregoing summary description indicates, underwriters ordinarily do not operate on a commission basis in marketing new issues of State and local government bonds. They are not acting as agents but as principals, and seek their profit by selling the bonds at a price higher than that which they pay. The amount of this price differential or "spread" is affected by various factors. An authoritative recent review of the operation of this market mechanism led to the following conclusions:

The marketing of new-issue state and local government securities cuts across both the capital and money markets. The marketing institutions include investment banking institutions and a number of commercial banks. These institutions are organized to compete in public bidding to acquire these issues and to resell them to investors. Many high-grade state and local governments raise capital at a marketing cost of less than 1 percent; most of them achieve a cost of less than 1\(\frac{1}{2}\) percent. Only in periods of capital market

\(^{10}\) Gordon L. Calvert (ed.), \textit{op. cit.}, p. 98.
tension do marketing costs go much higher. Lower-grade and longer-term obligations meet somewhat higher costs, anywhere from 2 to 3 percent. Only rarely does one encounter a cost for marketing capital issues in excess of 4 percent, and then generally for marginal projects based on revenue financing.

The marketing institutions constitute a refined and sensitive system. The underwriters do not seem to discriminate against governmental units in any clearly irrational way. In fact, it can be said that the market is remarkably adaptive to the many complexities of state and local government finance; that the marketing institutions, in most cases, tend to have a constructive influence on the financial policies of governmental units; at the same time they help to educate and persuade investors to accept the peculiar and the unusual types of securities that grow out of the exigencies of such finance.\textsuperscript{11}

The underwriting of new issues represents only a portion of the total business of the firms so engaged. Much of their activity concerns over-the-counter trading in outstanding issues with other dealers, individual investors, and financial institutions.

Supplementing and serving this whole field of investment and government finance are various important informational and statistical services. Brief reference has been made above to financial newspapers. The best known of these is the long-established Daily Bond Buyer, which specializes in news and advertising of governmental securities, and has nationwide coverage and circulation. Several nationwide commercial services provide detailed information to their customers or subscribers concerning individual debt issues and issuing governments. To quote a summary description:

For information on new issues Dun and Bradstreet reports are widely used because they include a special report on each important municipality prior to its coming into the market with a sizable new issue and these reports contain practically all the information which investment bankers want on a new issue. The Dun and Bradstreet reports are supplemented by periodic reports on most of the major issuers. The Daily Bond Buyer also has a New Issue Work Sheet service, designed primarily to provide investment bankers with information that they will need in bidding on new issues. Moody’s “Municipal and Government Manual” contains detailed

financial statements and information on a very large number of outstanding bond issues, including maturities, the principal tax sources and the laws in the various states applying to municipal issues. The information in the annual Moody's manual is supplemented by a bi-weekly service which keeps the information in the annual manual up to date. Standard & Poor's "Municipal Bond Selector" also gives important financial information on a large number of outstanding municipal bond issues.12

Two of the services mentioned above (Moody's, and Standard and Poor's Corporation), as well as another (Fitch's Investors Service), issue ratings of State and local government bonds, summarizing results of their detailed appraisal of the investment risk involved in particular issues. Certain types of bonds, as well as bonds issued by relatively small governments, fall outside the coverage of these rating services. However, more than three-fourths of the dollar volume of State and local government bonds sold in 1957 and 1958, comprising nearly 40 percent of the total number of issues, were rated by at least one of the two principal rating services.13

D. Historical Background

Indebtedness has been an important aspect of local government finance in the United States for at least a century. In spite of the absence of a well-developed financial market a century ago, local governments had indebtedness of $200 million in the year 1860, and of $516 million a decade later, in 1870. Since then every decade has witnessed some rise in the amount of local debt outstanding.

Looking more closely at developments of the present century, it is evident that there have been two interruptions of the general upward trend: one which occurred very briefly during World War I, and another which extended from 1931 to 1946. During the entire decade of the '30's, new borrowing and retirement of debt by local governments roughly cancelled out, so that there was practically no change in the total amount outstanding. Owing to restrictions on local capital outlays

12 Gordon L. Calvert (ed.), op. cit., pp. 8-9, the phrase "municipal issues" is used here, as it is generally in the investment field, to refer to bonds of States as well as local governments of all types, and not merely of "municipalities" in the narrower sense.

13 IBA Statistical Bulletin, August 1959, p. 3.
during World War II, the rate of borrowing by local governments was drastically curtailed, and their outstanding indebtedness was reduced from $16.8 billion in 1941 to $13.6 billion in 1946—lower than at any other time subsequent to the late 1920's. Since World War II, as has been widely noted, local government debt has been growing rapidly. The total amount outstanding has increased by about $3 billion a year since 1950. On a per capita basis, local government debt in 1960 amounted to $286, as compared with $124 per capita in 1950 and roughly similar amounts in 1940 and 1930.

Table 3 gives summary historical figures on local government debt, interest, and "calculated debt service requirements." For each fiscal year reported, this latter item represents the sum of interest expenditure during the year plus 5 percent of total debt outstanding at the beginning of the year. Remote historical data are not available on actual amounts of debt retired, or on amounts set aside for that purpose. In any event, this constructed figure is not affected by variations that may have occurred in the actual rate at which outstanding debt was being paid off. Use of a 5 percent factor is essentially arbitrary. However, 1957 Census of Governments data showed that about this fraction of long-term local debt then outstanding would mature annually in the period immediately following that Census.

Between 1948 and 1960, outstanding local government debt moved from 5.8 percent to 10.2 percent of gross national product. (Or, as traced in Table 3, from $58 to $102 per $1,000 of GNP.) This recent ratio, however, is only a little above that calculated for the year 1902, and is well below the ratios that applied from World War I up to World War II. It is perhaps even more noteworthy that the ratio of local government debt to national product is only moderately higher than it was in the latter part of the 19th century. In terms of this period of nearly a century, in other words, the increase in local government debt has not greatly outpaced the rise in the Nation's total annual production. For example, while local government debt was 62 times as great in 1960 as in 1880, GNP grew rather similarly—multiplying 55-fold within this interval.
### TABLE 3.—Local Government Debt, Interest Expenditure, and “Calculated Debt Service Requirements”—Amounts and Relation to Gross National Product—For Selected Years, 1860 to 1960

<table>
<thead>
<tr>
<th>Year</th>
<th>United States totals for local governments (in millions)</th>
<th>Gross national product calendar year (in billions)</th>
<th>“Calculated debt service requirements”</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total debt at end of fiscal year</td>
<td>Interest expenditure during fiscal year</td>
<td>“Calculated debt service requirements” for fiscal year</td>
</tr>
<tr>
<td>1860</td>
<td>$200</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1870</td>
<td>516</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1880</td>
<td>821</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1890</td>
<td>926</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1902</td>
<td>1,877</td>
<td>699</td>
<td>1,837</td>
</tr>
<tr>
<td>1913</td>
<td>4,045</td>
<td>1,245</td>
<td>2,385</td>
</tr>
<tr>
<td>1922</td>
<td>8,978</td>
<td>2,478</td>
<td>2,547</td>
</tr>
<tr>
<td>1927</td>
<td>12,910</td>
<td>3,679</td>
<td>3,649</td>
</tr>
<tr>
<td>1929</td>
<td>14,700</td>
<td>3,679</td>
<td>3,649</td>
</tr>
<tr>
<td>1934</td>
<td>10,373</td>
<td>2,326</td>
<td>2,346</td>
</tr>
<tr>
<td>1941</td>
<td>15,681</td>
<td>718</td>
<td>1,543</td>
</tr>
<tr>
<td>1944</td>
<td>16,786</td>
<td>620</td>
<td>1,455</td>
</tr>
<tr>
<td>1946</td>
<td>15,504</td>
<td>473</td>
<td>1,181</td>
</tr>
<tr>
<td>1948</td>
<td>14,950</td>
<td>457</td>
<td>1,149</td>
</tr>
<tr>
<td>1950</td>
<td>18,830</td>
<td>504</td>
<td>1,347</td>
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<tr>
<td>1952</td>
<td>20,667</td>
<td>540</td>
<td>1,482</td>
</tr>
<tr>
<td>1954</td>
<td>23,239</td>
<td>580</td>
<td>1,573</td>
</tr>
<tr>
<td>1956</td>
<td>25,957</td>
<td>635</td>
<td>1,760</td>
</tr>
<tr>
<td>1958</td>
<td>29,331</td>
<td>723</td>
<td>2,021</td>
</tr>
<tr>
<td>1959</td>
<td>30,099</td>
<td>807</td>
<td>2,274</td>
</tr>
<tr>
<td>1960</td>
<td>35,978</td>
<td>910</td>
<td>2,563</td>
</tr>
<tr>
<td>1961</td>
<td>39,301</td>
<td>1,025</td>
<td>2,824</td>
</tr>
<tr>
<td>1962</td>
<td>42,793</td>
<td>1,141</td>
<td>3,106</td>
</tr>
<tr>
<td>1963</td>
<td>47,180</td>
<td>1,287</td>
<td>3,427</td>
</tr>
<tr>
<td>1964</td>
<td>51,412</td>
<td>1,492</td>
<td>3,851</td>
</tr>
</tbody>
</table>

n.a. Indicates data not available.

1 Except for 1929 and 1960 figures, and the 1951 interest amount, which have been independently estimated, these data are from Bureau of the Census sources, as follows: Prior to 1902, Census of Wealth, Debt and Taxation, 1890; 1902 through 1966, Historical Summary of Governmental Finances in the United States (Vol. IV, No. 3, 1957 Census of Governments); and 1968 to 1960, annual reports on governmental finances.

2 In each case, the sum of interest expenditure and 6 percent of total debt outstanding at the beginning of the fiscal year.

For years prior to 1958, from Bureau of the Census, Historical Statistics of the United States, series F-1 and F-2. For 1958 to 1960, Survey of Current Business, February 1961. Data here for 1913 and prior years have been roughly estimated from averages for several-year intervals appearing in the source cited.

The series shown for interest and for debt service trace broadly similar trends, but are somewhat affected by the historical reduction in rates of interest. Relative to gross national product, local government interest expenditure in 1960 was somewhat less than at the beginning of the 20th century, and only about half as great as in the late 1920’s. Although the “calculated debt service requirements” of local governments have increased considerably since World War II in relation to gross national product, they are still, in terms of this relationship, considerably below the level they maintained during the 1920’s.14

14 In considering these various relationships, it should be recognized that “gross national product” responds promptly to price level changes, while the magnitudes of indebtedness and debt service shown for any particular year represent largely an inheritance from the past.
There have been several periods during the past century when many local governments found it difficult or impossible to keep up payments on their indebtedness.\(^{15}\) By far the most serious of these, in terms of the proportion of all outstanding bonds involved, was the crisis of the 1870's.

The serious depression of the 1870's came after many localities had floated bonds for aid to railroads, commonly to assure or encourage the location of routes through particular areas. Some State governments had been seriously embarrassed by over-issuance of "internal improvement" debt for similar purposes in the 1830's. One by-product of that experience was the widespread adoption, during the 1840's and 1850's, of constitutional restrictions on State borrowing powers. Accordingly, the pressure for public efforts to expand transportation facilities was shifted to the local government level. Many of the local railroad-aid bonds were to purchase stock of which the dividend earnings, it was fondly hoped, would provide for debt service plus some surplus for general government financing.

With onset of a sharp depression, many debt-loaded governments found themselves in difficulty, and numerous bond issues went into default. Firm figures are not available, but it has been estimated that in the course of this crisis there was at least some delay in servicing for about one-fifth of all local government debt outstanding.\(^{16}\) Because of the optimism, haste, and carelessness which marked many of the railroad-aid transactions, local officials and taxpayers often felt they had received little or nothing for their money, so they sought means to avoid honoring such debt. A period of costly and bitter litigation ensued.

Two important developments can be traced to this early crisis. There was, in the first place, a sharp contraction in the availability of long-term credit for local governments. Through the 1880's they were forced to finance their essential


\(^{16}\) A. M. Hillhouse, *op. cit.*, p. 17.
capital outlays largely on a pay-as-you-go basis, rather than by borrowing.\textsuperscript{17} Secondly, restrictions on local government debt and borrowing were written into many State constitutions, as more fully described below.

Another period of debt difficulty for local governments occurred in the 1890's, again involving railroad-aid bonds in many instances. However, this crisis was less severe and widespread than that of the 70's.

An easier period followed, but during the 1920's difficulties again began to develop, particularly where considerable amounts of "special assessment" debt had been issued to finance improvements for actual and prospective subdivisions. With the onset of the Great Depression of the 1930's, trouble spread. In many communities, the property tax base diminished as assessed valuations were cut back, though rarely at the pace of the decline in market values. Nationwide, assessed values dropped 18 percent, but in some States there was a considerably greater decline. Delay in property tax collections spread, and delinquency mounted from 10 percent in 1930 to 26 percent in 1933.\textsuperscript{18} Meantime, local governments were carrying the brunt of expansion in public welfare needs, multiplying their expenditure for aid to the needy.\textsuperscript{19} Some local governments were also embarrassed, along with other depositors, in having their current resources lost or at least temporarily tied up in closed banks.

Intensive later review led an expert observer to conclude that, at the worst of this period, some 3,200 local governments fell behind in paying interest or principal on debt. This included some 350 counties, plus 850 cities and towns and similar numbers of school districts and special-purpose districts. It was estimated that some defaulting occurred with regard to bond issues making up about 10 percent of all local government indebtedness, i.e., perhaps half as great a propor-

\textsuperscript{17} A. M. Hillhouse, \textit{op. cit.}, p. 38.
\textsuperscript{18} Ibid., p. 237.
\textsuperscript{19} Local government expenditure for public welfare jumped from $111 million in 1927 to $370 million in 1932 according to the Census Bureau's \textit{Historical Summary of Governmental Finances in the United States}; relatively little of the increased welfare load during the first three years of the depression was financed by States or the Federal Government.
tion as in the crisis of the 1870's. The interest and principal overdue, of course, was a considerably smaller sum than the gross amount of bond issues involved:

An estimate of all municipal debt that has been in default at one time or another during the depression would have to include all defaulted interest and principal together with the accrued interest thereon. The total would probably run well above 2 percent of all municipal debt. Even if municipal defaults amounted to twice such a figure, they could not, relatively speaking, be considered very large. Nevertheless, the municipal finance expert is still faced with the biblical precept of leaving the ninety and nine for the one lost sheep.\(^{20}\)

Iowa in 1857 and Illinois in 1870 had adopted constitutions which set limits on local government debt in terms of a percentage of assessed value. Widespread adoption of this and other types of constitutional restrictions on the borrowing powers of local governments came as an aftermath of the crisis of the 1870's. Within a very few years, some such provisions were placed in the constitutions of a majority of the States. Nearly as promptly also, various devices and legal doctrines were developed to limit or circumvent effects of such provisions.

Aside from limits stated as a percentage of the property tax base, early constitutional "barriers" to local debt abuses included: requirements for popular referenda on bond issues; prohibitions against borrowing for aid to private undertakings; limits on the duration of bond issues; and mandates as to the provision to be made locally for servicing of long-term debt. Similar and related statutory and charter provisions have since been widely enacted. For the most part, however, these have merely involved adjustments and modifications of, rather than drastic departures from, the types of legal restrictions which originated nearly a century ago, largely in reaction to the abuses and difficulties that arose in the 1870's.\(^{21}\)

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\(^{21}\) An exception is the Local Government Commission of North Carolina, which was established in the 1930's to help local governments in that State work out of their existent debt difficulties and, thereafter, to control and facilitate local debt operations; the New Jersey Division of Local Government has a somewhat similar background and responsibilities. Major changes in the original constitutional restrictions have also been made in a few States, most notably New York.
The historical record would not be complete without some reference to various institutional, professional, and informational developments which, since the latter part of the 19th century, have had a strong impact upon the management of local government finance, including local debt operations. Three of these developments may be mentioned.

(1) A cadre of experienced and increasingly professional local finance persons has come into being. This has been made possible as well as necessary by the increased scale and complexity of major local governments, and has been related to such other events as the spread of civil service and of the "city-manager" system. The change is reflected in such bodies as the Municipal Finance Officers Association, which has developed in its lifetime of 55 years from a small group to an organization drawing extensive membership from every State of the Union and all the Canadian provinces.

(2) There has been a parallel development of principles, standards, systems, and techniques for financial administration. Government has drawn upon the advances made in accounting and auditing as a whole, and also has made use of management tools specially oriented to public finance, concerning such matters as budget formulation, control, and reporting. Much further improvement in these respects is widely desirable, but there can be no disputing the great improvement of prevailing present practices over those of a few decades ago.

(3) The institutional system that now exists for informed and orderly marketing of local government securities, as briefly sketched above, developed near the end of the 19th century and has since been greatly strengthened and refined. Present methods of underwriting originated with the financing of Federal loans during the Civil War, and were later extended to "municipal" securities. The specialized profession of the bond attorney originally developed from the difficulties and litigation encountered with railroad-aid securities. *The Daily Bond Buyer* began publication in 1891, and various others of the important informational and rating services in this field have also now operated effectively for several decades. As recently as 1956, another important source of information in
this field became available—the periodic *Statistical Bulletin* of the Investment Bankers Association.

E. Recent Trends

As has already been mentioned, local governments now owe approximately $50 billion of long-term debt, and have recently been issuing bonds at the rate of 5 to 6 billion dollars each year. It may be useful, subject to the limitations of available sources of data,\(^{22}\) to note a few of the major recent developments in the composition of these large sums.

It is possible to discern, as to type of government, some diminution of the previously predominant role of municipalities in local government indebtedness, and a particularly rapid rise of school district debt. Between 1952 and 1959, when long-term debt of local governments altogether rose 84 percent, that of municipalities went up but 63 percent, and long-term debt of school districts increased 148 percent. The portion of all long-term debt accounted for by school districts moved from 19 percent in 1952 to 25 percent in 1959, while the municipalities' portion dropped from 53 to 47 percent of the aggregate. There was little change in the smaller percentages accounted for by county, township, and special district governments.\(^{23}\)

Less of an historical record is available regarding trends in the purposes of local government indebtedness, but there is enough to demonstrate the increasing place of debt for public school purposes. Between 1957 and 1959, when outstanding local long-term debt as a whole rose 20 percent, that for schools

\(^{22}\) Detailed analysis of trends in local government debt is handicapped by various factors, including (1) the lack of a comprehensive Census of Governments between 1942 and 1957; (2) the limited amount of detail obtained on this subject in the Census Bureau's annual sample surveys of local government finances; and (3) the lack of a clear-cut distinction between local and State government amounts in most other sources concerning "municipal" bond issues. (See also footnote 2, p. 6.)

\(^{23}\) Bureau of the Census, *Summary of Governmental Finances in 1952*, and *Governmental Finances in 1959*. 
increased 29 percent, utility debt 12 percent, and long-term debt for all other purposes 17 percent.\textsuperscript{24}

By far the most striking change in the composition of local government debt during recent years (and which has also involved State government debt) concerns the \textit{type of liability incurred}. There is an increased proportion of nonguaranteed bonds, as distinguished from bonds backed by full faith and credit of the issuing governments.

Nonguaranteed debt, as defined for Census Bureau reporting on governmental finances, is debt "payable \textit{solely} from pledged specific sources—e.g., from earnings of revenue producing activities . . . , from special assessments, or from specific nonproperty taxes." In the bond issue data reported regularly in the \textit{Statistical Bulletin} of the Investment Bankers Association, "revenue bonds" are similarly defined, except that public housing authority bonds (not guaranteed by the issuing unit, but backed by the Federal Government), and any nonguaranteed bonds purchased by the Federal Government are excluded from this broad category, and are separately reported.

Published Census Bureau data, summarized in Table 4 below, show a marked increase since 1952 in the proportion of long-term debt of local governments which is nonguaranteed. A limited portion of the trend indicated by the table is apparent rather than real, and results from changes which have been made in Census classification of the debt of certain types of special districts and authorities. These changes cannot be carried back to earlier years; however, it can be roughly estimated that if the present classification had been applied in 1952, nonguaranteed debt then would have been reported about a half billion dollars greater, and full faith and credit debt a corresponding amount less, than in Table 4. On this adjusted basis, local nonguaranteed debt rose by about $10.9

\textsuperscript{24} Bureau of the Census, \textit{Compendium of Government Finances}, (Vol. III, No. 5, 1957 Census of Governments), and unpublished data from sample survey of local government finances for 1959. In this context "utility debt" is limited to bonds issued specifically for water supply, electric power, transit, or gas-supply systems. It should be noted that some debt for schools is owed by local governments other than independent school districts and that (while it does not enter into the calculations reported above) there is also some State government debt for public school purposes.
billion or 214 percent during the 8-year period, and full faith and credit debt by about $15.7 billion or 92 percent. The proportion of the total represented by nonguaranteed debt moved from about 23 percent to 33 percent.

Table 4.—Outstanding Long-Term Debt of Local Governments at End of Fiscal Year, 1952 to 1960

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Full faith and credit</th>
<th>Nonguaranteed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>$22,080</td>
<td>$17,509</td>
<td>$4,571</td>
</tr>
<tr>
<td>1953</td>
<td>24,499</td>
<td>19,115</td>
<td>5,384</td>
</tr>
<tr>
<td>1954</td>
<td>27,581</td>
<td>21,222</td>
<td>6,359</td>
</tr>
<tr>
<td>1955</td>
<td>31,322</td>
<td>23,396</td>
<td>7,926</td>
</tr>
<tr>
<td>1956</td>
<td>34,424</td>
<td>25,895</td>
<td>8,529</td>
</tr>
<tr>
<td>1957</td>
<td>37,323</td>
<td>26,087</td>
<td>11,236</td>
</tr>
<tr>
<td>1958</td>
<td>40,672</td>
<td>28,495</td>
<td>12,177</td>
</tr>
<tr>
<td>1959</td>
<td>44,706</td>
<td>31,052</td>
<td>13,654</td>
</tr>
<tr>
<td>1960</td>
<td>48,673</td>
<td>32,738</td>
<td>15,935</td>
</tr>
</tbody>
</table>

Source: Bureau of the Census, Compendium of Government Finances (Vol. III, No. 5, 1957 Census of Governments), and annual reports (variously titled) on governmental finances. Classification is not strictly comparable throughout the period shown; see text.

This development results not only from increased use of the “revenue bond” approach for new borrowing, but also from the fact that nonguaranteed debt commonly extends over a longer period than full faith and credit debt, so that there is less rapid reduction of outstanding nonguaranteed debt. However, recent debt-issuing performance alone promises a continuance of the upward trend.

Nonguaranteed debt originally developed to finance utility-type operations of local governments, such as water supply. It was later broadened (with Federal backing) to provide for local public housing projects. As recently as 1957, the bulk of all local nonguaranteed debt outstanding had been incurred

25 The IBA Statistical Bulletin has reported $22.7 billion of bonds issued by State and local governments in the three calendar years 1958 through 1960, of which $7.9 billion, or 35 percent were nonguaranteed (i.e., “revenue bonds” plus housing authority bonds and Federally purchased bonds). While a sharp distinction of the amount for State governments (including dependent State agencies) cannot be made, it seems likely that the nonguaranteed proportion for local governments is at least as high as that indicated for the State-local aggregate.
for these two kinds of purposes. But the past few years have witnessed a rapid extension of the so-called “revenue bond” device to finance types of projects traditionally financed by full faith and credit borrowing, e.g., public schools and office buildings, with debt service paid from “rentals” derived from taxes or other general government revenue; and various projects with debt service payable from the yield of earmarked nonproperty taxes or other specific revenue sources.

The *Statistical Bulletin* of the Investment Bankers Association has indicated a marked increase, during the past few years, in the proportion of all “revenue” bonds representing such departures from the earlier pattern; less than half of the State-local aggregate of revenue bonds issued in 1960 were reported as being utility bonds.
Chapter 3

EXISTING STATE RESTRICTIONS

Of the numerous kinds of State provisions which regulate borrowing and indebtedness of local governments, three are of particular relevance to this study because of their restrictive effects:

(1) Limits on the amount of outstanding local government debt in relation to the property tax base;
(2) Limits on property tax rates that can be levied for debt service requirements, or for various purposes including debt service; and
(3) Requirements for specific referendum approval of proposed bond issues.

Some such provisions apply in all the States, although in a considerable number of instances they appear only in statutes (and charter provisions of particular governments), rather than being constitutionally expressed. The common case involves both constitutional and statutory provision for one or more of these kinds of restrictions.

A. Limits on Debt in Relation to the Property Tax Base.

Debt limits of this nature were incorporated in constitutions of numerous States during the 1870's and 1880's, as has been

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26 Excluded from direct consideration are the following widespread types of State regulative provisions: prohibitions of borrowing to finance loans or gifts to private individuals or enterprises; limits on the maturity period of long-term debt; requirements governing methods of bond issuance (e.g., public sale of full faith and credit bonds); and limitations on the interest rate payable. Although interest rate limits for full faith and credit bonds are not uncommon, these do not widely restrict local borrowing, mainly because the interest rate specified (generally 6 or 5 percent) is well above the prevailing market rates of recent years.

27 Much of the information which follows concerning State constitutional provisions for control of local debt, and their judicial interpretation, has been based upon a study undertaken for the Government Affairs Foundation by Frederick L. Bird and Mary E. Mann, and kindly shared for reference use in preliminary manuscript form.
pointed out, and some additional States have since taken similar action. At present, all except 16 of the 50 State constitutions specify some percentage limitations on outstanding debt of local governments in relation to the property tax base.28 However, in a half-dozen of the other 34 States, these constitutional limits apply only to a single type of local government or to debt for a particular purpose.29 Thus, there are 22 State constitutions which are entirely or nearly free of this type of specific limitation on local government debt. These include 12 of the 16 present constitutions that were adopted before 1870; percentage-type limits appear in only 4 of the 16 oldest constitutions.

The significance of constitutional as against statutory expression of percentage debt limits results, of course, from the fact that constitutional provisions are generally far more difficult to modify. It is even more important to note that the degree of “restrictiveness” of State provisions cannot be inferred merely by reference to the existence of constitutionally stated percentage limitations. Other kinds of provisions may supplement or substitute for these; moreover, as noted below, there is great variety in the actual percentages prescribed.

There is no recent, reliable, and comprehensive source of nationwide information regarding percentage limitations on local debt expressed by statutory as well as constitutional provisions of the various States. Until about 1939, a presentation on this subject for each State appeared annually in the authoritative reference source, Moody’s Municipal and Government Manual, but the proliferation of enactments then led to abandonment of the effort, and it has never been revived. Recent limited-focus presentations on this subject suggest why any attempt to “summarize” all existing provisions comprehensively

28 Following is a list of these 16 States, showing also for each the adoption date of its present constitution: Alaska (1959), California (1879), Connecticut (1818), Delaware (1897), Idaho (1890), Kansas (1859), Massachusetts (1780), Mississippi (1890), Nevada (1864), New Hampshire (1784), New Jersey (1947), North Carolina (1868), Ohio (1851), Rhode Island (1843), Tennessee (1870), and Vermont (1793).

29 Following are these States, and the dates when their present constitutions were adopted: Florida (1886), Michigan (1908), Minnesota (1858), Nebraska (1875), Oregon (1859), and Virginia (1902).
in an intelligible form would be doomed to failure.\textsuperscript{30} Limits prescribed in various States are often tailored to particular types and sizes of local governments, and may also involve exceptions or alternatives affected by the form or purpose of the debt or by the process of its local authorization. Variety especially tends to develop where debt-incurring power is extended to local governments predominantly through numerous special laws, tailored to particular purposes of debt as well as types and classes of governments, rather than through general laws of widespread common application. A recent Kansas study identifies 433 separate statutory grants of debt-incurring power to local governments in that State.\textsuperscript{31}

Another illustration of the problem of summarizing debt limits can be seen in a 1940 report of the Illinois Survey of Local Finance, \textit{Bonded Indebtedness of Local Governments, 1927–1940}.\textsuperscript{32} In that study, a digest of statutes authorizing local government issuance of general obligation bonds required 15 pages of small-print tabulation, and dealt with 167 separate sets of authorizing provisions. Many of these laws specified a percentage limitation, but frequently this was related to debt incurred for a particular purpose or in a particular manner — and with some choice often available to the borrowing government to issue bonds under one or another set of authorizing provisions. Under such circumstances, no single percentage might correctly be said to represent "the" limit on general obligation debt that could be incurred by a particular class of local governments, or even by a particular local government.\textsuperscript{33}

\textsuperscript{30} Note, for example, the difficulties encountered in an effort to summarize percentage debt limits pertaining only to local bond issues for school purposes, in Table 37 (page 59) and individual-State portions of the U.S. Office of Education study, \textit{Public School Finance Programs of the United States, 1957-58}.

\textsuperscript{31} Kenneth E. Beasley, \textit{State Supervision of Municipal Debt in Kansas: A Case Study} (Lawrence, Kansas: Governmental Research Center, University of Kansas, 1961), p. 40. This study, providing a detailed historical and factual background for one particular State, arrives at conclusions and recommendations which in important respects parallel those offered herein.

\textsuperscript{32} Illinois Tax Comission (Chicago: 1940).

\textsuperscript{33} Such a statutory situation does not, of course, make it impossible to determine whether a \textit{particular} bond issue, proposed to be authorized for a certain purpose and in a particular manner, would be permissible under the governing provisions; such a determination is essential to the legality and marketing of local government bonds.
age that could apply, combining all possible exceptions and special circumstances allowed; but such a figure would probably have little significance in relation to the actual circumstances of most local governments, and might therefore be more misleading than informative.

In spite of these complicating circumstances, it has seemed desirable, in connection with the present study, to accumulate data which would at least illustrate the widespread use and diversity of State-prescribed percentage limitations on local government debt. At the request of the Advisory Commission, accordingly, the Council of State Governments circulated a questionnaire regarding debt limitations to each of the States. Some use of percentage debt limits—constitutionally, by statute, or by charter—is indicated for substantially all the States. The survey findings are summarized in Appendix A.

B. Limits on Taxes for Debt Service

Another method of restricting the debt-incurring power of local governments is to limit the rate of property taxes they may impose for servicing of debt, or to set limits on their property-taxing power as a whole, which must cover any debt service charges as well as other requirements.

In only a few States are local governments subject to such a debt service restriction, even though some legal limits on property tax rates of local governments apply in a majority of States. The explanation is that debt service requirements are specifically exempted from tax rate limits in most instances. The logic behind such an exemption is that when a government has actually incurred debt as a general obligation, there should be no legal obstacle to the use of its taxable resources to pay the resulting interest and retirement charges.

The financial community and investors in municipal bonds, for understandable reasons, view with particular distrust this type of restriction on the borrowing power of local governments. Questions of borrowing power that might arise from the more usual kind of total-amount limit on debt can be resolved at the time of bond issuance, but the tax-rate type of limitation involves the chance that uncertainty or difficulty may arise at any time until the particular bond issue has been entirely paid off. Commonly, therefore, publicity concerning
a new issue of full faith and credit debt will either indicate specifically that local property taxes for debt service are not subject to any rate limitation or, in the exceptional instance where this is not true, will make reference to the fact. Only a very minor proportion of all local government borrowing in the Nation is of this nature.\textsuperscript{34}

Appendix A includes a preliminary summary of information reported to the Council of State Governments with regard to this type of restriction in several States.

C. Referendum Requirements

Another common State device for regulation of local government debt involves a requirement that the issuance of bonds be approved by referendum. Any such provision, obviously, tends to limit the power of the \textit{governing bodies} of local governments, which on many other matters are ordinarily empowered to take action without direct popular authorization. The extent to which a particular referendum requirement also tends to restrict \textit{local government borrowing} will, of course, depend upon its terms, e.g., whether bonds can be authorized by a simple majority of all eligible local voters who express themselves on the question, or whether something more than a simple majority is necessary, or approval by some selective portion of the local electors.

While all or nearly all the States make some use of the referendum device with regard to local debt issuance, the legal provisions differ greatly in actual nature and potential restrictiveness. Furthermore, variety on this score appears not only between States but commonly within individual States. Differing provisions may apply to various types or sizes of local governments, or for proposed bonds for various purposes. In some instances a borrowing government can elect to act under alternative procedures that call for differing levels of popular majority. In other instances a “step” approach is used, with more stringent requirements for a bond

\textsuperscript{34} Of the $7.1 billion of State and local government bonds sold in calendar 1960 (of which at least $5 billion were local government issues), only $274 million was reported as “general obligation-limited tax” bonds by the IBA \textit{Statistical Bulletin} (February 1961).
issue that would raise the government's debt above some stated percentage of its property tax base.

As in the case of general limits on outstanding debt in relation to the tax base, some referendum requirements are constitutionally provided and others appear only in statutes and charters. There appear to be 19 State constitutions which lack any provision for popular referenda on local debt issuance, and 2 others where the constitutional requirement is extremely limited in application. In another 6 States, the constitutional requirement for popular referendum applies only to bond issues which would raise the debt above a total-amount limitation.

Taking account of statutory as well as constitutional provisions, it is possible to recognize several main patterns of referendum requirements for local government borrowing. Two sources of information have been drawn upon in this connection—the U.S. Office of Education study, Public School Finance Programs of the United States, 1957–58, and the survey recently conducted for the Advisory Commission by the Council of State Governments.

Findings of the Office of Education with regard to individual-State requirements governing local authorization of bonds for public schools seem to indicate that:

1. In at least 3 States (Maryland, South Carolina, Tennessee), the authorization of school bonds for particular areas frequently involves action specifically by the State legislature (in the form of a local act) rather than, or in addition to, action by the community involved.

2. In a very few States, the governing bodies of school districts or certain other local governments may authorize school bonds without popular referendum, at least up to some limited percentage of the property tax base;


36 Nebraska and Oregon.

37 These 6 States are Arizona, Michigan, New York (school districts only), North Dakota, Pennsylvania, and Washington. In several other States (California, Idaho, Kentucky, North Carolina, and Oklahoma) the constitutional provision is rather similarly expressed, demanding a referendum only on debt above some limit, but with such a minimal allowance that the requirement would commonly apply.
3. In an additional 15 States, simple majority approval by the participating electorate will suffice to authorize a school bond issue; and

4. In the remaining States—apparently a few more than a majority of the entire 50—something beyond a simple local majority vote is needed to authorize school bonds. The additional requirements vary widely. Some of them call for a certain degree of voter participation (e.g., at least 50 percent of eligible electors voting on the question); more of them require a special majority, e.g., a 60%, 65%, or two-thirds favorable vote; and there are about a dozen States where a school bond proposal must be approved by property-owning voters as distinct from the electorate as a whole, or (in two instances, Nevada and Wyoming) by majorities of property owners and of other voters on the question, counted separately. In most instances where property ownership is a factor, something more than a simple majority vote is required.

Findings on this subject from the survey conducted by the Council of State Governments are summarized in Appendix A. Nationwide data on bond election results are reported regularly in the Statistical Bulletin of the Investment Bankers Association. That source shows that, of the "municipal" bond issues subjected to popular referenda during each of the four years 1957 through 1960, about three-fourths were approved and one-fourth defeated.\footnote{The IBA Statistical Bulletin figures cover referenda on State as well as local bonds, though the latter predominate in dollar volume as well as number of issues; it seems likely that elections for some relatively small local issues are missing from the series.} No doubt some proposals entered into this overall record at least twice, through being submitted again after an initial rejection. Furthermore, it is impossible to judge the extent to which local governing bodies may have abandoned tentative plans for borrowing which they felt could not receive popular sanction, or the extent to which they made use of some alternative method or form of borrowing which avoided resort to referendum. Thus, while these data on results of bond elections are useful, they do not tell the entire story about the restrictiveness of referendum requirements.

D. Coverage of Existing Restrictions

Not all long-term borrowing of local governments is subject to the foregoing kinds of State-imposed restrictions. Some exceptions have been specifically enacted, and others have developed from judicial interpretation of the term "debt" as
it appears in State provisions. It is extremely important to note that where States do impose any of the several types of restrictions described above, these usually apply only to local governments' issuance of full faith and credit debt, and not to the issuance of nonguaranteed debt.\(^9\)

Several legal doctrines and governmental devices have provided means to delimit the coverage of debt restrictions, or to minimize their effects.

By far the oldest of these is the *special fund doctrine*, which developed promptly after the enactment of legal restraints tied to the property tax base, and initially with regard to the financing of municipal water supply facilities. Under this doctrine, a municipality that wished to acquire a waterworks system without encroaching on its legal debt limit (or, perhaps, to avoid having to obtain referendum approval) would authorize and issue revenue bonds subject to servicing solely from water charges. Such debt was widely held not to represent debt of the borrowing government, within the purview of the legal provisions.

In a few States, only a *restricted special fund doctrine* has traditionally been recognized. Under this variant, the revenue bond approach would provide exemption from legal restrictions only where it involved the pledging of prospective *new* charges or earnings revenue, but not when the revenue proposed to be pledged was from sources that had previously fed the general funds of the borrowing government.

Another avoidance device has been the *special district* — a local government created by or pursuant to State authorizing legislation. Where these are authorized to issue full faith and credit debt and to impose property taxes, they typically have general-obligation borrowing power which is in addition to, and not affected by, the borrowing power of other property-taxing units. Where special districts are authorized only to issue revenue bonds, they may be considered a particular application of the special fund doctrine. The Federal program to

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\(^9\) In some instances, however, referendum requirements apply to the issuance of nonguaranteed debt as well as other bonds; and in a number of States certain full faith and credit debt has been specifically exempted from otherwise-applicable restrictions. Illustrations are cited in Appendix A.
encourage local public housing activities, set up in the late 1930's, helped stimulate the spread of the independent special district or authority as an instrument for "revenue bond" borrowing.

Another method for avoiding debt restrictions makes use of the *executory or installment contract*. Under this approach, a government contracts with a private builder who agrees to construct a particular facility—such as a local waterworks—and to lease it to the government for an extended period, with title to be conveyed to the municipality at the end of the lease period. Where this device has been legally upheld, the rental payments are held not to represent debt service.

Some of the foregoing methods are combined in *building or financing authorities*—a relatively recent invention, but one of increasingly widespread use. With this approach, a local or State government agency borrows to construct a facility, issuing bonds that are to be serviced from rentals paid by the benefited governmental unit. Where this device is judicially sustained, the bonds fall outside debt restrictions because of the special fund doctrine, and the rental payments—as in the older case of executory contracts—are considered to represent something other than debt service.

Recent years have witnessed a growing variety of applications of these and related devices to avoid the impact of traditional limits on total debt outstanding and of requirements for popular referenda on the issuance of full faith and credit bonds. For example, the special fund doctrine has been extended in some States to exempt from such restraint "revenue" bonds which are backed, not by user charges or earnings, but rather by earmarked revenue from State grants or from particular local nonproperty taxes.

A rapidly growing volume of court cases offers a bewildering array of judicial rulings on the concepts and issues involved in these various approaches to the avoidance of debt restrictions.

Altogether, it may be judged that at least one-third of all outstanding bonded debt of local government is outside the scope of the prevailing kinds of State-imposed restrictions, and that this is the case for over one-fourth of all local debt for general government purposes, i.e., excluding amounts for pub-
licly operated water supply, electric, gas supply, and transit systems. The proportions involved may actually run consider-
ably higher than these minimum fractions, which are merely based on the presumption that all nonguaranteed debt is ex-
empt from, and all full faith and credit debt is subject to, the kinds of restrictions discussed above. No doubt the minor amounts of nonguaranteed debt which are actually subject to such restrictions are more than offset by various exemptions of full faith and credit debt.
Chapter 4

AN APPRAISAL OF EXISTING RESTRICTIONS

A. Purposes Sought by State Action

For a local government as for an individual or business, the ability to borrow is a useful power, but one which needs to be exercised prudently. Incurrence of long-term debt by a local government, with resulting responsibility to provide for interest payments and debt repayment over an extended period, introduces an element of rigidity in its financial operations which is well reflected by the term "fixed charges." Excessive indebtedness is likely at best to involve, for the government concerned, a relatively high interest cost for any further borrowing it needs to undertake. Moreover, with debt service taking a material portion of its current resources, there is an impairment of the government's future budgetary flexibility — its ability to finance new needs or adjust itself to revenue lags. In a very real sense, then, since long-term borrowing involves some mortgaging of the future — by a government as by an individual — it is not lightly to be undertaken.

Not only the individual borrowing unit and its community but also other local governments have an interest in its debt practices. Historically, this is perhaps most clearly illustrated by the aftermath of the municipal debt crisis of the 1870's. Even in that most difficult period, only an estimated one-fifth of all municipal debt was in default at one time or another; yet in the following decade, apparently, local governments everywhere found credit scarce and costly. In large part they were forced to defer important capital outlays, or to finance them from current revenues. Undoubtedly the modern financial market, with its improved sources of information, is far better able to discriminate among individual borrowers and bond issues than
were lenders of 80 years ago. Nonetheless, particular local governments still have a definite stake in the general standing of municipal bonds, and their own credit position may be partly affected by the financial and administrative reputation of other units in their respective States.

Even in a very direct financial sense, State governments also are affected by the borrowing practices of their local governments. If undesirable debt situations impair the credit and financial strength of local units of government, pressures will grow for the State government to take on additional responsibilities, either directly or in the form of further aid to local governments. But the State's concern, of course, rests on more fundamental considerations. The citizens served locally are also its citizens, and the debt-incurring authority of local governments within its boundaries is derived ultimately from the State's constitutional powers. There is a legitimate statewide interest that the possibility of unwise local debt practices be minimized.

The ultimate in "safety" on this score might presumably be accomplished if a State were to withhold entirely from local governments the power to incur debt. Notably, even after the widespread difficulties of the 1870's, no State attempted such drastic action, nor has any State since removed or withheld borrowing power from its local governments generally."""" Thus, the State's concern with local government indebtedness is not merely negative, calling for restrictive or regulative action to minimize the hazards of borrowing. This is but a corollary to another proposition which has been universally recognized — namely, that legal authority to incur debt is a reasonable and necessary financial power for local governments.

This point deserves emphasis. It extends the criteria for appraising State "restrictions" on local government debt beyond the two most obvious tests that might otherwise apply: (1) Whether they tend to minimize local borrowing; and (2) The extent to which they may prevent individual governments' getting into financial difficulties. These are important ques-

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40 Debt-incurring power appears to have been granted to local governments throughout the Nation, with the exception of certain types of special-district governments in some States.
tions, which deserve consideration. But since the States are not solely concerned with these objectives but, more fundamentally, with the ability of local governments to handle and finance prudently their authorized responsibilities, effects of State-imposed debt restrictions upon local government need to be considered in this broader perspective.

There may be some value, then, in expressing the purpose of State constitutional and legislative action concerning local government debt in some such terms as the following: To empower local governments to make use of borrowing, prudently and in a responsible and locally responsive manner, as one means for financing their requirements.

B. Technical Deficiencies of Total Debt Limits

Of the three main types of State restrictions on local borrowing, the most widespread and probably the most widely criticized is that which sets a ceiling on the indebtedness of individual local governments in terms of some percentage of their property tax base. As a measure of reasonable or "safe" borrowing capacity, a debt limitation of this nature is subject to a number of serious deficiencies.

1. Focus on the past. The servicing of long-term debt extends well into the future, so that any ideal measure of debt carrying capacity — if one might be imagined — would look in that direction. In appraising the quality of particular bond issues, municipal bond analysts try to take account of the future prospects of the borrowing government and its community, as well as of present conditions and past developments. However, they have not been able to develop any precise instrument for this attempted forward look, and would concede that judgment finally has an important bearing in particular instances. The deficiency of the usual kind of legal debt limit as a measure of "capacity" is not unique to this particular approach; it is inherent in the basic problem of anticipation involved. Nonetheless, it must be recognized as a serious deficiency; a debt load that would be hazardous for a stagnating community could well be entirely reasonable for another community having strong prospects for healthy economic growth.

2. Individual-government application. Any percentage ceil-
ing on local government debt must apply, of course, to the particular unit of local government that proposes to borrow. The “tax base” to which the percentage relates, however, is ordinarily shared by one or more other local governments, since in most parts of the country there are at least two and very often three or more “layers” of local governments, each empowered to impose property taxes and to incur debt. Municipal bond analysts try to take account of this problem by gathering information not only about the debt of the borrowing government itself but also about “overlying” debt, i.e., full faith and credit bonds of other property-taxing governments that serve some or all of the same area. State constitutional and statutory debt limits, however, commonly make no allowance for the problem of “overlying” debt.

For a particular geographic area, then, the aggregate ceiling on local debt which is subject to State percentage limits is the sum of any such percentages that apply to the several types of local units serving the area. But an identical percentage limit will ordinarily apply to any two governments of the same kind, regardless of whether their respective overlying governments are indebted little or much. For example, a particular city government obtains no additional legal leeway from the fact that the school district serving the same area has little or no indebtedness (though ratings of the city’s bonds can take this situation into account).

These circumstances put a premium on local government fragmentation, by providing an incentive for the establishment of new special districts with their own separate debt ceilings (or, depending upon legal provisions and their interpretation, none at all), and by handicapping any effort to achieve a simpler local government structure through consolidation of diverse

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41 County governments in all but 3 of the 50 States; municipal governments serving incorporated urban areas in all States; township and New England town governments operating throughout most of 20 States; independent school districts throughout 29 States and in parts of 16 others; and special districts of various types (some with and some without property-taxing power) serving particular areas in all States.

42 A few States have attempted to deal with this problem: South Carolina by specifying an over-all limit (but with numerous special exceptions subsequently enacted); New York by restricting the creation of additional types of special districts with separate borrowing authority, and New Jersey by setting a statutory over-all limit below the county level (subject to exceptions with State approval).
existing units, e.g., city, county, school district, special districts. Under most present debt limit provisions, any such consolidation would normally curtail the public borrowing authority of the community involved.

The present degree of layering and governmental fragmentation in major urban centers is illustrated by the Nation's 43 largest cities — those with a 1960 population of 300,000 or more.\(^4\) These cities were served in 1957 by a total of 219 separate local governments — an average of 5 in each. In only a dozen of these instances were there fewer than 4 local governments serving the city area (or some portion of it); for 10 of the 43 cities, the number of separate local governments was 7 or more. All or practically all these local governments have borrowing power, but for some of the special districts this power is limited to nonguaranteed debt, so that there is less potential layering of full faith and credit debt than would appear directly from the count of overlying layers. Nevertheless, with but very few exceptions, each of the 43 largest cities has at least two separate property-taxing governments.\(^4\)

3. Type-of-government uniformity. Some States specify different debt limits for large and small governments of a particular type, or provide special limits for one or a few of the largest municipalities. It is more common, however, and especially with constitutionally set limits, for a single percentage to apply to all units of a broad class, such as counties or municipalities; and in a number of States the same percentage limit applies constitutionally to all types of property-taxing local governments.

Such uniformity is likely to discriminate against the most populous local governments of various types, or against those operating in major urbanized areas, since a metropolitan community requires more varied and intensive public services than smaller cities and towns, and a relatively greater investment in local government facilities.

For local government as a whole, this is illustrated by the

\(^4\) This analysis is based on Table 4 of *Local Government Finances in Standard Metropolitan Areas* (Vol. III, No. 6 of the 1957 Census of Governments).

\(^4\) The apparent exceptions, each having only one property-taxing local government, are New York City, Baltimore, Boston, Norfolk, and Washington, D.C.
Census Bureau's recent special study, *Local Government Finances and Employment in Relation to Population: 1957* which not only shows that local government debt per capita runs higher in the most populous counties than in others, but also that these larger counties generally have more local government debt in relation to assessed valuation than do less populous counties. For municipal governments alone, the relationship between population size and city debt and capital outlay is summarized in Table 5, below.

**Table 5.—Per Capita Capital Outlay and Long-Term Debt of City Governments, by Population Size of City: 1960**

<table>
<thead>
<tr>
<th>Size-group (1960 population)</th>
<th>Capital outlay per capita</th>
<th>Outstanding long-term debt per capita</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>General government</td>
</tr>
<tr>
<td>All cities</td>
<td>$31.83</td>
<td>$23.60</td>
</tr>
<tr>
<td>1 million or more</td>
<td>55.97</td>
<td>43.81</td>
</tr>
<tr>
<td>500,000 to 999,999</td>
<td>41.56</td>
<td>31.57</td>
</tr>
<tr>
<td>300,000 to 499,999</td>
<td>36.90</td>
<td>28.82</td>
</tr>
<tr>
<td>200,000 to 299,999</td>
<td>38.03</td>
<td>30.17</td>
</tr>
<tr>
<td>100,000 to 199,999</td>
<td>34.32</td>
<td>25.67</td>
</tr>
<tr>
<td>50,000 to 99,999</td>
<td>29.19</td>
<td>21.96</td>
</tr>
<tr>
<td>25,000 to 49,999</td>
<td>25.07</td>
<td>18.63</td>
</tr>
<tr>
<td>Less than 25,000</td>
<td>18.96</td>
<td>12.42</td>
</tr>
</tbody>
</table>

1 For city-operated water-supply, electric, gas-supply, and transit systems.

4. **Limited revenue-base reference.** The potential burdens and hazards of long-term debt are often considered in relation to the borrower's resources. A prospective home buyer, for example, is generally advised against taking on a mortgage that exceeds some multiple of his income. A local government similarly needs to avoid getting into a situation where the fixed charges associated with long-term debt demand such a large portion of its revenue that its future budgetary leeway will be materially curtailed. But the common type of State-imposed limit on local debt is not related to a local government's revenue as a whole but, instead, to the base for one revenue source only — the local property tax.

When this kind of debt limit first developed nearly a century ago, the property tax supplied the bulk of all local government revenue, but this is no longer true. In 1902, the property tax supplied three-fourths of all general revenue of local govern-
ments in the United States; since 1952, the property tax proportion has been less than one-half. Furthermore, this shift has been widespread. According to the 1957 Census of Governments, there are only 20 States where the local property tax provides as much as one-half of all local general revenue, and only 8 States where property taxation yields two-thirds or more of the total. A similar situation appears for each of the prevalent classes of local governments; in a majority of States, property taxation supplies less than half of the general revenue of county governments, municipalities, school districts, and special districts. A detailed distribution appears in Table 6, below.

**Table 6.—Distribution of States According to the Percentage of General Revenue of Local Governments Provided by Local Property Taxes: 1957**

<table>
<thead>
<tr>
<th>Property tax percentage of all general revenue</th>
<th>All local governments</th>
<th>County governments</th>
<th>Municipalities</th>
<th>Towns and townships</th>
<th>School districts</th>
<th>Special districts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total*</td>
<td>51</td>
<td>48</td>
<td>51</td>
<td>21</td>
<td>44</td>
<td>51</td>
</tr>
<tr>
<td>Under 25%</td>
<td>2</td>
<td>1</td>
<td>4</td>
<td>1</td>
<td>3</td>
<td>33</td>
</tr>
<tr>
<td>25% to 49.9%</td>
<td>29</td>
<td>25</td>
<td>31</td>
<td>4</td>
<td>3</td>
<td>18</td>
</tr>
<tr>
<td>50% to 66.6%</td>
<td>12</td>
<td>12</td>
<td>10</td>
<td>3</td>
<td>3</td>
<td>12</td>
</tr>
<tr>
<td>66.7% to 74.9%</td>
<td>7</td>
<td>7</td>
<td>3</td>
<td>5</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>75% or more</td>
<td>1</td>
<td>3</td>
<td>3</td>
<td>9</td>
<td>2</td>
<td>2</td>
</tr>
</tbody>
</table>

*The maximum total number of 51 includes the District of Columbia and Alaska and Hawaii, as well as the other 48 States. The total count is less than 51 for those types of units (townships, school districts, and counties) which do not exist in certain States.

Source: *Compendium of Government Finances* (Vol. III, No. 6, 1957 Census of Governments), Table 46.

It is true, of course, that those local government bond issues subject to State-imposed limitations are generally, by their terms, subject to being financed specifically or ultimately from property tax revenue. Nonetheless, to the extent that a particular government also has other kinds of revenue which are not entirely subject to some sort of earmarking or “fixed charge” commitment, its debt carrying capacity is inadequately measured by reference solely to its property tax resources. In view of the increasing importance to local governments of revenue from sources other than the property tax, the traditional type of debt limit has lost much of whatever underlying logic it may have originally possessed.

5. The percentage applied. It is difficult to find instances where the levels of State-imposed percentage limits on local debt appear to reflect a reasoned consideration of the prudent or “safe” borrowing requirements of local governments. Most of
the present constitutional limits originated at least a half century ago. Both those provisions and subsequent adjustments have, it seems clear, largely resulted from urgent particular pressures rather than having been based upon a study of community needs and capacities, and their implications for local government financing.

The haphazard and arbitrary nature of existing levels of debt limitation can be illustrated in various ways. One demonstration comes from those States which impose the same percentage ceiling on local units of various kinds, disregarding the wide discrepancy which exists in the scope of responsibilities and financial needs of one type of local government as against another.

Municipal governments commonly average several times as much indebtedness per capita as do county governments, school districts, or township governments in the same States. Under these circumstances, any single limiting percentage low enough to prevent "excessive" city debt but high enough to leave most municipalities with reasonable freedom of action will have little or no regulatory impact on other types of governments. Conversely, if a single percentage were designed to exercise some protective control over county governments, for example, it would be widely repressive for municipalities. Table 7, below, shows the relative amounts of per capita debt for various kinds of local governments, as of 1957, in 8 of the States that have standard constitutional "across-the-board" limits.

### Table 7.—Per Capita Debt of Various Types of Local Governments in 8 Selected States: 1957

<table>
<thead>
<tr>
<th>State</th>
<th>Municipalities — Average amount</th>
<th>County governments</th>
<th>School districts</th>
<th>Townships</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Average amount</td>
<td>Percent of municipal average</td>
<td>Average amount</td>
<td>Percent of municipal average</td>
</tr>
<tr>
<td>Illinois</td>
<td>$122</td>
<td>$16</td>
<td>13%</td>
<td>$93</td>
</tr>
<tr>
<td>Indiana</td>
<td>194</td>
<td>9</td>
<td>9</td>
<td>33</td>
</tr>
<tr>
<td>Iowa 1</td>
<td>71</td>
<td>5</td>
<td>7</td>
<td>57</td>
</tr>
<tr>
<td>Oklahoma 1</td>
<td>168</td>
<td>15</td>
<td>9</td>
<td>40</td>
</tr>
<tr>
<td>Pennsylvania 1</td>
<td>142</td>
<td>34</td>
<td>24</td>
<td>69</td>
</tr>
<tr>
<td>South Carolina 1</td>
<td>107</td>
<td>13</td>
<td>12</td>
<td>16</td>
</tr>
<tr>
<td>West Virginia 1</td>
<td>86</td>
<td>4</td>
<td>5</td>
<td>19</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>184</td>
<td>20</td>
<td>13</td>
<td>50</td>
</tr>
</tbody>
</table>

1 No township governments in this State.

Similar evidence comes from the tremendous interstate range of percentage limits that apply to particular kinds of local governments. Uniformity is not to be expected, even with a completely rational approach, since various States may well arrive at differing policies as to what they consider a "safe" relation of local debt to the tax base. There are also interstate differences in the responsibilities vested in particular types of governments. But existing variations in prescribed debt limits appear to go far beyond any conceivable explanation on such grounds. If a 2 percent limit on city debt in Indiana has any rationale, what is the logic underlying the 5 and 10 percent levels allowed municipal governments in numerous other States, or the 19 percent maximum permissible in Arizona? If 10 percent of the tax base is a reasonable limit for school district debt in the various States where this percentage applies, what can be said for the 5 percent school district limits of numerous other States, or the 2 percent limits of Indiana and Kentucky? Such questions are not answered by differences in the level of assessment from one State to another. Even when these are taken into account, a tremendous range of "effective rate" percentages is still to be found, as well as many interstate differences that challenge logical explanation. For example, the constitutional limits set on school district debt by six neighboring Midwestern States ranged in 1956 from about 1.1 percent up to 2.9 percent of the approximate market value of taxable property.45

6. Fractional assessment. Percentage debt limits are imprecise and potentially discriminatory because of the nature of the property tax base to which they commonly refer.

With but few exceptions, State-imposed limits on local debt are determined by the assessed value of property subject to taxation by the borrowing government. Assessed values commonly represent but a limited fraction of the current market value of taxable property. For locally assessed realty, the 1957 Census of Governments indicated a nationwide average assessment ratio of about 30 percent, with average statewide ratios

45 This refers to Illinois, Indiana, Iowa, Kentucky, Missouri, and Wisconsin, with constitutional limits stated at 2% (Indiana and Kentucky), 10% (Missouri) and 5% (the other 3 States), and statewide average assessment ratios indicated by real property transfers in 1956 that ranged from 21% in Indiana up to 48% in Wisconsin.
ranging from 7 to 66 percent. As already mentioned, such interstate differences in the level of assessment complicate any effort to compare the debt limits that apply in various States. But the really serious problem for debt limitation has to do with the quality of assessment within any particular State which applies debt limits based on assessed values. This problem involves both the diversity of assessments within the State, and the prevailing average level of assessment.

Unless there is a substantially uniform level of assessment throughout the State, debt limits tied to assessed valuations differ in their impact from one area to another. Very few States, if any, can claim to have achieved a high degree of uniformity of assessment level as among various local areas. Some States have adjusted their formulas for distribution of school aid or other local grants to take account of marked interarea diversity in assessment ratios.

But in very few States thus far, apparently, has there been statutory or constitutional action to relate debt limits to the "full value" of taxable property or some uniform fraction of it. Thus, in the great majority of States with percentage debt ceilings, these involve a wide range in relationship to the "real" property-taxing capacity of individual local governments.

Even with a reasonably uniform statewide level of assessment, the question arises, is this the level which was intended in the imposition of percentage debt limits? The property tax provisions of most States clearly contemplate assessment of property for tax purposes as its full market value, yet in 1956 only two States showed an average assessment ratio for taxable realty as much as half this high; and in those States that specifically provide for assessment at some particular fraction of "current market value," the actual assessment level typically averages considerably lower. One might conclude that the constitutional "founding fathers" had some expectation that the debt limits they set would be measured against a valuation approaching full

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46 New York, since 1951, by constitutional provision; New Jersey beginning with 1962, under a recent statutory enactment; Indiana and Pennsylvania also under 1961 laws not yet tested in the courts; and recently also Oregon for some limitation provisions.

market worth, so that any real restrictiveness of constitutional
debt limits has resulted largely from administrative failure to
comply with the basic property tax provisions, rather than from
the debt limits as originally intended.\footnote{48}

Whatever one’s view of the historical background, the im-
portant present fact is that the real level of debt limitations is
determined in most States largely by local assessment practices,
rather than being closely governed by legal provisions. It is
generally within the power of assessors, by changing the valua-
tion level they employ, to lower debt ceilings or to increase
them—and in many States the leeway upward that is legally
available could double or even triple present ceilings. Of
course, local assessors’ freedom of action is limited not only by
constitutional and statutory provisions but also by other factors,
including their reaction to community attitudes. But this of
itself does not improve the case for assessment-based debt limits
as a tool for equitable State regulation of local government
borrowing, since the impact of the debt-limit provisions is
largely determined by localized pressures.\footnote{49}

7. Incompleteness of coverage. The usual kind of State-
imposed debt limit may also fail to offer protection against
imprudent debt practices by local governments because, as has
been pointed out, it commonly applies only to full faith and
credit bonds, and places no restraint on other debt. To the
extent that alternative types of local borrowing are available,
the purported “limitation” may operate rather as a “diversion,”
tending to affect the form rather than the amount of debt. Ev-
dence that this has actually occurred in many States is presented
in the following section, “Effects of Present Restrictions.”

Given the historical background and the usual legal form of

\footnote{48} It would be harder to defend this view about later constitutional amendments and
statutes setting debt limits, for the phenomenon of fractional assessment has been
chronic and widely known. (Note the estimated assessment ratios shown for various
years from 1900 to 1922 in the Census Bureau report, Estimated National Wealth, pub-
ished in 1924.) However, instances can be cited of some recent State enactments that
provide for a much closer approach to full value than has actually been accomplished
in the setting of tax valuations or their “equalization” by a State agency, so that debt
limits based on such valuations are lower than the legislature ostensibly intended.

\footnote{49} Such local leeway is not to be equated with “home rule” for debt-incurring gov-
ernments. In most parts of the country local assessors are county or township officials
having no direct tie or responsibility to governing bodies of municipalities and school
districts—the types of governments most likely to feel the effect of debt limits.
percentage debt limits, it is not difficult to see why they generally apply only to full faith and credit debt. Many judicial rulings appear to view debt restrictions as having been intended solely to prevent excessive property taxation, so that they would apply only to debt which, by its terms, is to be financed from property taxes.

Whatever their original purpose, debt limits need now to be considered in a broader perspective which, as already suggested, takes account of the importance of borrowing power for local governments as well as the difficulties and hazards that can result from imprudent use of this power. Such hazards are not limited to any one form of debt, but arise basically from the fact that indebtedness involves a commitment of some of the borrower's future resources. For a borrowing local government, then, the first rule of prudence is to avoid tying up or "mortgaging" an excessive portion of its prospective revenues from all sources. The picture may be complicated by the terms of particular obligations or the earmarking or channelling of particular revenues, but these offer no safe refuge from the difficulties that may result from a violation of this basic rule. 60

The traditional type of percentage debt limitation, then, to the extent that it is incomplete and selective in its coverage, is a faulty device for attempting to keep aggregate local government debt within prudent bounds.

C. Effects of Present Restrictions

The foregoing discussion dealt with only one of the three major kinds of State-imposed restrictions on local debt — percentage limitations on outstanding debt in relation to the prop-

60 The author of the Kansas study cited above makes a similar point, and also questions how basic is the difference, as a resource for debt financing, between revenue from local taxes and revenue from certain kinds of service charges: "...Revenue bonds are a debt burden even though they carry a non-general obligation recital. In a bond market which is competitive and fluid, but with some tendency to centralization, no municipality can afford to default on a revenue debt any more than it can on others, because credit ratings are based on not only capacity but willingness (as evidenced in previous years) to meet one's total obligations....As more services are financed by revenue bonds, the charges for them become in fact taxes since one cannot always divest himself of the service and thereby free himself of the charge; for example, in the interest of disease prevention, a person who receives municipal water and sewer services would probably not be allowed to stop availing himself of either one. Fixed costs for debt service charges are just as fixed whether they are in the form of service charges or mill levies on property." Kenneth E. Beasley, op. cit., pp. 68-9.
erty tax base. Most of the technical deficiencies indicated for that type of restriction are found also for State-imposed limits on the rate of property tax available for servicing of local debt. As already pointed out, however, the tax-limit approach to debt control applies in relatively few States, and it directly affects but a very minor proportion of all local government borrowing.

One of the deficiencies cited for percentage debt limitations—that they usually relate only to full faith and credit bonds—is also characteristic of both the tax-limit approach to debt control and the third main type of State restriction on local borrowing: the requirement of a popular referendum to authorize bonds. Constitutional provisions and general State laws which specify such a requirement have generally been interpreted narrowly (like percentage debt limits) as pertaining only to tax-supported debt. However, there is great variation in the extent to which referendum requirements are included also in statutes that authorize local revenue bond financing. The governing bodies of local governments empowered to issue such bonds often may do so without specific approval of the electorate. In other instances a referendum is legally required—though not necessarily with the same standards of participation or plurality that apply to the issuance of full faith and credit debt.\footnote{The Census Bureau report 	extit{Local Government Structure} (Vol. I, No. 3 of the 1957 Census of Governments) enumerated the various kinds of special district governments legally authorized in each State, including in most instances a summary description of financing powers. A tally of these descriptions indicates that power to issue bonds is mentioned in about 3 cases out of 4, with a reference to required voter approval in only about one-third of these instances.}

The degree to which local governments in a particular State actually are affected by centrally imposed debt “restrictions” will depend on the composite total nature of the various legal provisions which apply, rather than necessarily by any one provision alone.

Accordingly, the impact of State control cannot be judged merely by reference to a single type of regulatory measure, such as percentage debt limits. The California constitution specifies no such limits, but is restrictive otherwise in requiring a popular referendum with a two-thirds majority to authorize tax-supported local bonds. In such other States as Arkansas and
Texas, tax-rate limits rather than overall debt-amount limits offer the main legal restraint on local borrowing.

Numerous other factors also tend to determine how widely and strongly particular State-imposed "restrictions" will affect local governments: not only the level of property tax assessments, as already mentioned, but also such factors as the extent of urbanization and the rate of population growth (with their strong impact on public facility needs); the extent of voter interest and participation in local elections; the structure of local government and the range of functions assigned to various types of local units; and the extent and nature of State financial assistance to local governments.

Clearly, then, it is not possible to rank individual States, or even to group them, in terms of the net "restrictiveness" of their legal provisions concerning local government debt. In large part, generalizations about the effects of such provisions must be based on observation and logic, with some support from particular examples but without the backing of clear statistical demonstration.

Subject to this limitation, the following paragraphs consider various effects of State restrictions on local borrowing.

1. *Have these restrictions prevented defaults and other debt difficulties for local governments?* Surely not entirely, in view of the record of the 1930's. On the other hand, as has been pointed out, the local debt problems of that period were far less widespread than those of the 1870's, and State limitations may have contributed to this relative improvement. But the record is far from conclusive. Some of the States where many local governments got into difficulty had restrictive provisions; and of the eight States showing few or no defaulting units, seven had no constitutional restrictions of this type.\(^{52}\) In some areas defaults mainly involved bonds secured by special assessments; such debt then, as is generally still the case, fell outside the scope of State-imposed percentage limitations.

In at least some instances the common type of percentage debt limitation, tied to assessed valuations of the current or immediately preceding year, may actually have contributed to local debt problems. There was a marked growth in assessed

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values during the 1920's reflecting increased land values in many areas but probably also, in some instances, an adjustment of local valuation "policy" in order to raise debt ceilings. With the depression, some governments that had overextended themselves found their legal debt margin used up and their budget problems complicated by a heavy burden of fixed charges.

It has sometimes been said that percentage debt limits tend actually to induce excessive borrowing by giving an unwarranted sense of leeway to a local government which has a considerable unused margin within its legal debt "ceiling," and that purchasers of municipal bonds may similarly be given a false sense of security. Perhaps some such tendencies operated 30 years ago, but there seems little or no evidence of them now. As more fully noted below, many local governments subject to debt limits have made use of only a minor fraction of their legal borrowing power. Moreover, the rating of a particular municipal bond issue is determined by judgment of the community's prospective actual debt-carrying capacity; the rating is not likely to be strengthened by the fact that the issuing government would be permitted legally to incur further debt. Thus, we may discard the notion that percentage debt limits tend actually to promote excessive local borrowing.

During the past two decades, there have been relatively very few instances of defaults or delayed servicing of local government debt, and these few have involved nonguaranteed or "revenue" obligations falling outside the scope of State restrictions. Such a limited record, covering a period of general economic growth, provides no basis for judging how immune local governments may be from debt difficulties in the future. The answer probably depends a great deal on the degree of stability in the economy as a whole. It might be argued that no conceivable pattern of debt practices by local governments would have prevented their sharing painfully in the economic collapse of the 1930's. On the other hand, imprudent borrowing undoubtedly does increase the chance of a local govern-

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53 There is no comprehensive source of published cumulative information on municipal bond "defaults"; this statement is based on conversation with experienced municipal bond analysts.
ment being hurt or embarrassed by an economic trough it might otherwise weather handily.

Altogether, the historical evidence suggests that traditional types of State restrictions afford no firm assurance of preventing debt difficulties for local governments.

2. Have State-imposed debt restrictions tended to restrain the total volume of local government borrowing? Probably yes, but to an indeterminate extent. That methods to circumvent debt restrictions have been so widely sought indicates that they have some restraining effect. But to the degree that means of circumvention have been found or developed, the restraint has in many instances been only temporary or has mainly affected the form rather than the amount of local debt incurred.

As already mentioned, numerous variables hamper any effort to relate interstate differences in the volume of local government debt to differences in the apparent stringency of State provisions. However, a limited effort of this kind has been made, as described in Appendix B. The findings seem to show some tendency toward greater local government debt in States which lack constitutional restraints on local borrowing than in States having such constitutional provisions. As of 1957, local debt for general government purposes amounted to $82.28 per $1,000 of personal income in the median "free" State, as against $71.06 per $1,000 in the median State of those with constitutional debt restraints. On the other hand, the inter-group differences are not striking or universally applicable, and some individual States that are constitutionally "free" show relatively less local government debt than do many of the States that impose constitutional restraints.

This tends to confirm what other observation would suggest — namely, that in recent years at least, State-imposed percentage limitations have been a direct constraint on debt issuance for only a minority of local governments. A larger proportion of

54 However, this generalization cannot readily be proved. Numerous States gather and publish some statistics on local government finances, but apparently only New Jersey, New York, and Wisconsin include, as part of such State reporting, data showing for individual property-taxing units the relation between outstanding debt and the tax base or legal debt "ceiling." A regular Alabama report provides such data for counties, but not for other local governments, and unofficial sources give such information for at least some types of governments in several other States.
prospective borrowing units have probably been constrained by State-imposed referendum requirements; as already noted, of municipal bond issues submitted to popular vote in recent years, about one-fourth have failed of adoption.

3. Have State-imposed debt restrictions affected the form of local government debt? Yes, and in a highly demonstrable way. They have been an extremely important factor, if not the main one, in the strong trend toward local governments’ increased use of revenue bonds in lieu of full faith and credit debt.

This trend cannot be accounted for by any drastic broadening, historically, in the span of local government responsibilities. The four functions classed as “local utilities” for Census Bureau reporting on governmental finances (water supply, electric, gas supply, and transit systems) accounted for nearly as large a fraction of all local expenditure in 1913 (9.5%) as in 1952 (11.1%) and 1959 (10.8%). During this long interval also, those “general government” (i.e., non-utility) functions which involve significant financing from user charges have continued to represent but a minor part of all local outlays and operations. The bulk of local government expenditure today, as was true 50 years ago, is for social and protective functions — education, roads, public welfare, police and fire protection, health, and the like, which call for general community support, rather than being subject to financing largely by nontax charges against beneficiaries.55

Housing authority bonds, which are backed by the Federal Government as well as by the issuing local agency — represent a rather special subclass of what is being discussed here as “nonguaranteed” indebtedness. Such debt, as well as direct local government spending for public housing, originated around

For the present study, there was some consideration of an effort to gather information or opinions about how many local governments in various States are currently at or close to their legal debt “ceiling.” This idea was abandoned partly on grounds of the doubtful feasibility of such a survey but even more because any findings on this subject alone would have extremely limited significance: they would not indicate how many units would have approached their legal debt ceilings if it were not for the various devices available in most States for circumventing percentage limitations. 55 In 1957, user charge revenue equalled at least a third of local government expenditure for only a few functions—housing, hospitals, airports, and water transportation and terminals; and also as much as 10 percent for only the additional functions of sanitation, natural resources, and recreation. These various functions altogether involve only about one-sixth of local government general expenditure.
1940. However, only a minor portion of the recent growth in local nonguaranteed debt is thus accounted for; other nonguaranteed debt also has been increasing much more rapidly than full faith and credit debt of local governments.

The importance of debt provisions to this development is indicated by Appendix B, which shows that in 1957 the "nonguaranteed" proportion of all long-term general debt of local governments ran considerably higher in States with constitutional debt restrictions than in those which lack such restrictions. Exclusive of debt for schools and housing, half the States in the "restriction" group had more than 28.6 percent of nonguaranteed obligations, while the midpoint among the constitutionally "free" States was only 13.4 percent.

Many illustrations could be cited of particular bond issues planned on a nonguaranteed "revenue" basis in order to avoid the impact of State provisions that would have applied if full faith and credit obligations had instead been issued.

Emphasis should be given to several implications of this tendency for State restrictions to encourage the use of nonguaranteed debt.

a. It involves a strong bias among the various possible purposes of local borrowing and, potentially, among the various types of local governments. This is most vividly illustrated by school districts, which are concerned solely with a function and facilities that cannot normally be financed to any significant extent from user charges. A municipality, on the other hand, is concerned with capital outlays and potential borrowing for some functions — water supply, sewers, perhaps parking facilities, an airport, and the like — which may be financed to at least a considerable extent from user charges. Thus, in the usual situation of State restrictions which exempt nonguaranteed "self-financing" or "revenue-backed" debt, the municipality has automatic legal leeway for particular portions of its borrowing needs, but the school district has no such automatic exemption.

Especially because of the relatively large portion of all local government borrowing which is required for public school purposes, this implicit bias of debt restrictions has widely tended to promote various special devices and arrangements for local
school financing, through State and local building "authori-
ties," special State grant programs, and the like. 56

b. Borrowing costs tend to be increased by the use of revenue bonds in lieu of full faith and credit debt. No firm estimate can be made of the average differential, and the margin would no doubt range materially among various issues and circumstances. However, some background is available from the monthly Public Health Service data on local bond issues for water supply and sewer systems. These series have recently reflected a differential of about 0.5-0.6 percent in the rate of interest payable on revenue bonds as compared with general obligation bonds. 57 Thus stated in percentage rate form, the margin may sound inconsequential. It is not. For example, with 30-year level-payment serial bonds, an increase in rate from 3.0 to 3.5 would raise the interest cost by 19 percent. Table 8, below, shows illustrative cost differentials for level-payment serial bonds of alternative maturities.

| TABLE 8.—Percentage Increase in Total Interest Cost with Specified Increases in Interest Rate for Serial Bonds of Various Maturities |

<table>
<thead>
<tr>
<th>Increase in interest rate</th>
<th>Duration to final maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>15 years</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>By 0.50 percent —</td>
<td></td>
</tr>
<tr>
<td>From 3.0 to 3.50</td>
<td>17.9</td>
</tr>
<tr>
<td>From 3.25 to 3.75</td>
<td>16.6</td>
</tr>
<tr>
<td>From 3.50 to 4.00</td>
<td>15.4</td>
</tr>
<tr>
<td>By 0.75 percent —</td>
<td></td>
</tr>
<tr>
<td>From 3.0 to 3.75</td>
<td>27.0</td>
</tr>
<tr>
<td>From 3.25 to 4.00</td>
<td>25.0</td>
</tr>
<tr>
<td>From 3.50 to 4.25</td>
<td>23.3</td>
</tr>
</tbody>
</table>

Revenue bonds commonly involve a longer period of repayment than most general obligation bonds. (The need to provide a safe margin for coverage of costs and debt charges, in connection with revenue issues, offers an understandable pressure toward extended-period maturities.) Of the dollar volume of

56 For some illustrations, see the U.S. Office of Education, Public School Finance Programs of the United States, 1957-58.

revenue bond issues sold during the year ended June 30, 1957, more than 40 percent had maturities in excess of 30 years—a far higher proportion that would appear for full faith and credit borrowing. Lengthening of maturity also involves an increase in the cost of borrowing, if one considers interest expenditure simply in dollar amount terms, and with no allowance for the lightening of burden that may perhaps be attributed to deferred payments (as discussed in footnote 4, chapter 2). For example, about 60 percent more interest will have to be paid on an issue of 30-year level-payment serial bonds which are marketed at a 3.5 percent rate than would be required for a 20-year issue carrying the same average interest rate. But the extension of maturity also tends to increase the average interest rate. For example, the Community Facilities Administration recognizes an average differential of $\frac{1}{5}$ percent for each full five-year reduction in length of maturity, involving loans that extend for less than 30 years.

Some striking differences appear in the simple dollar cost of borrowing on alternative bases that can be reasonably imagined. For example, on a one-million dollar issue of 3$\frac{1}{2}$ percent general obligation bonds to be retired serially over a 20-year period, total interest expenditure would amount to about $407,000. With a 40-year serial issue at 4 percent, total interest expenditure would be about a million dollars, or nearly 2$\frac{1}{2}$ times as much.

c. The future budgetary leeway of borrowing governments tends to be more restricted by the use of revenue bonds than by full faith and credit, and in two ways. One of these has been mentioned—the tendency toward more extended maturities with revenue bonds; in other words, with this type of borrowing, a longer future period is subject to some “mortgaging” for fixed debt charges.

The other factor concerns the earmarking arrangements which form part of the covenant for revenue bonds. Quite understandably, to provide reasonable assurance to prospective investors, the resources to be reserved under such covenants are generally estimated conservatively and with a considerable

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margin for error or fluctuation. The result may well be the accumulation of excess reserves which, although appropriate in relation to the standing of the particular securities, can considerably narrow the budgetary discretion of the government as compared with the choices it might exercise if general obligation bonds had been issued instead. The net effect resembles that of constitutional and statutory provisions requiring that revenue from various sources be earmarked for particular narrow funds and purposes. Such provisions, as has been widely noted, may hamper efforts at budgeting based upon recurrent, responsible consideration of a government's responsibilities as a whole, in relation to its present and prospective financial resources. As recognized by the National Committee on Government Accounting:

Every municipality should establish the funds called for either by law or by sound financial administration. It should be recognized, however, that funds introduce an element of inflexibility in the financial system. Accordingly, consistent with legal provisions and requirements of sound financial administration, as few funds as possible should be established.

4. What have been the effects of State-imposed debt restrictions upon the responsiveness and public accountability of local governments?

At least some of the widespread requirements for popular referenda on the issuance of local bonds may be recognized as efforts to assure that local governments borrow only according to the wish of the electorate. However, where the conditions for "popular" approval are so onerous that favorable action can often be blocked by a limited minority of interested local voters, one can hardly say that responsiveness and accountability are being promoted.

This problem is limited, of course, where revenue bonds are issued on a callable basis, or subject to accelerated retirement; but this in turn is likely to increase the interest rate required. It may also be recognized that the need for specific covenants in connection with revenue bonds has undoubtedly promoted more thoughtful and responsible dealing with the financial requirements of some particular projects and activities. Neither of these points, however, contradicts the basic proposition that the detailed and potentially excessive "earmarking" which is implicit in revenue bond covenants restricts the future budgetary discretion of the borrowing government.

National Committee on Governmental Accounting, Municipal Accounting and Auditing, (Chicago: Author, 1961).
One can, however, describe several ways in which efforts to circumvent State-imposed debt restrictions (including mandatory referendum requirements as well as percentage debt limits and debt-restricting limits on property tax rates) have widely operated against responsiveness and accountability of local government.

a. One illustration is the proliferation of special district governments, which in many instances have developed to circumvent legal restrictions on local debt. They serve this purpose most obviously where, as in Indiana, an additional layer of property-taxing government is credited with its own separate percentage debt ceiling. Some special districts cannot issue general obligation debt nor impose property taxes; under such circumstances, their power to issue nonguaranteed "self-financing" debt is merely a particular expression of the common doctrine that such debt falls outside the purview of general constitutional or statutory restrictions.

The dispersion of local government responsibilities among multiple layers of specialized units is often a handicap not only to consistent planning and administration, but also to citizen understanding and control of local government as a whole.

b. Devices for avoidance of legal debt limitations have also made it more difficult for the general public to understand—and, thereby, intelligently to exercise ultimate control over—the finances of regular existing governments. Many official financial reports omit data for nonguaranteed debt of the government itself or of some of its agencies. This is not surprising, in view of the common legal doctrine that such obligations are not "debt" within the purview of controlling State provisions. The problem of public understanding has become especially complicated where special financing "gadgets" have been provided: "building authorities" of various types, subject to financing from long-term rental contracts legally taken as differing from indebtedness, even though they involve an identical type of burden; and other intergovernmental and interagency arrangements for the flotation and servicing of debt—some so
complex they are difficult for the financial expert to explain, much less for ordinary citizens to understand.\(^6\)

The whole concept of governmental accountability to the public rests on the presumption that the "facts of the matter" can be made reasonably plain to interested citizens. The excessive complexities of local government structure and finance which have resulted from avoidance of debt restrictions undermine this basic premise of responsible local government.

c. A similar conclusion can be drawn if one considers public accountability of local government as operating partly to or through State governments. It has already been pointed out that State "control" through percentage debt limits is widely subject to the vagaries or weaknesses of local assessment practices. But accountability to or through the State is also diluted by the growing volume of "non-debt" debt. Doctrines and devices by which certain obligations of local governments have been removed from percentage limits on "debt" have also led to differential leeway for incurrence of those obligations. Such obligations are often omitted or incompletely reflected in State-assembled reports on local government finances. The development of devices to circumvent debt restrictions has been a major stimulus toward the welter of legal provisions and diverse judicial interpretations which appears in numerous States.

According to qualified observers, the proliferation of court cases on the meaning of "debt" has been especially notable in States which impose relatively severe constitutional restraints on the amount of local debt or on methods for its authorization.

5. How have State-imposed debt restrictions affected the property tax system? Evidence on this score is difficult to obtain or evaluate, but the question is urgent because of the importance to local governments of sound and equitable property taxation.

One conceivable argument for percentage limits might run as follows: The general tendency toward fractional assessment is undesirable on various grounds, but most of all because it contributes to non-uniformity in the relation of assessed to full

\(^6\) It may be noted also that, in the conduct of the 1957 Census of Governments, the U.S. Bureau of the Census encountered unusual difficulty in assembling local finance data in those States where the use of "financing authorities" was widespread.
value of taxable property;\textsuperscript{62} the use of assessed valuations as a base for debt ceilings should exercise an upward pressure on assessment ratios, and thereby contribute to more uniform property taxation. To test this reasoning, a comparison has been made of data for the 14 States which lack constitutional debt restrictions with data concerning the other 34 States for which extensive property tax information was provided in the 1957 Census of Governments. The findings lend no support to the kind of argument summarized above. While marked differences between the two groups of States do not appear, the constitutionally "free" States seem typically to have a somewhat higher level of assessment (i.e., come closer to current market value in their assessment of taxable real property), and to have at least as good a record of uniformity of valuation within and among major assessment jurisdictions as do States where debt restrictions are constitutionally imposed. Background for this conclusion is offered in Appendix B.

But a more basic issue is involved. It concerns the nature of property tax assessment, and the appropriate role of the assessor. His task is to identify all pieces of taxable property and attach to each a value which represents its current market worth, or some fraction of that worth which is as nearly as possible the same for every property. The essential purpose of assessment is to supply a basis for distributing property tax levies according to the proportion of the total taxable base that is represented by every taxable item. In the absence of legal limitations on nominal tax rates or debt, expressed as a percentage of the assessors' valuations, it would not really matter, from the standpoint of an equitable distribution of the property tax burden within a community, whether assessments were uniformly at 100\%, 10\%, or even 500\% of market value.\textsuperscript{63} But percentage limitations make the matter of assessment level important. They


\textsuperscript{63} \textit{Interarea differences} in level of assessment may also be important, of course, to the extent that the localized valuations form part of the base for a statewide property tax, or enter into formulas measuring local financial capacity or effort in connection with State grants. Widespread abandonment of State property tax levies, and various devices for interarea equalization have, with varying degrees of success, tended to reduce the (generally downward) pressure of these influences on local assessment levels.
expose the assessor — whose difficult task needs to be handled on a ministerial basis and with maximum possible reliance on objectives guides to sound valuation — to pressures for this exercise of judgment on issues of financial policy which properly rest with local governing bodies.

This point was emphasized in a Connecticut Supreme Court decision of 1957. Holding that fractional assessment was invalid and contrary to the express provisions of the State statutes, the court said:  

Nor can we overlook a further matter in demonstrating the impropriety of pursuing a role of fractional valuation. When assessors adopt such a role, they indirectly assume a role which rightfully is not theirs. . . . The borrowing power of the municipality is affected, since its indebtedness may not exceed specified percentages of the grand list. Assessors who use fractional valuations . . . therefore, interfere . . . with a power that belongs to others.

The fundamental question, then, is not whether tying legal debt limits to assessed values will tend to push the assessment level upward or downward. The prevailing influence no doubt differs from time to time and from area to area. In any event, the result of such a tie is unfortunate from the standpoint of a sound property tax system and the proper distribution of governmental powers. Assessment should be a ministerial task. Policies of expenditure, taxation and financing should be determined — subject to State law and the ultimate control of the electorate — by elective local governing bodies.

6. How have State-imposed debt restrictions affected intergovernmental relationships? Some aspects of this issue have already been discussed, and generalization is risky because of differences from one State to another. However, a few points may be briefly made.

Debt restrictions have been a complicating element for various Federal programs of public works loans since the 1930's. Debt limitations also were a major factor in the Federal Government's promotion of the prevailing pattern for public housing authorities. In most States these operate legally as units separate and independent from other local governments.

Percentage debt limits have probably tended in recent years

64 Ingraham Co. v. City of Bristol, 144 Conn. 374.
mainly to affect communities in process of rapid urbanization within present and emerging metropolitan areas. The selective impact of such restrictions has undoubtedly contributed in some States to unhappy relationships between urban and rural areas, and between metropolitan communities and the rest of the State.

Percentage debt limitations have stimulated pressures for new or enlarged programs of State and Federal financial assistance. This observation is not offered as a flat criticism, for intergovernmental sharing in the cost of particular functions or facilities is demonstrably a useful device in various circumstances. However, to the extent that there are serious technical deficiencies in debt limitations as they now apply, they have capriciously and artificially restricted the independent financing capacity of local communities. In the absence of such restraints, there would be a broader range of choice between reliance entirely on local financing and possible resort to State or Federal assistance. Moreover, while debt restrictions have probably had a direct restrictive effect upon only a minority of local governments in most States, grant programs proposed or adopted to deal with the resulting difficulty "at the local government level" are commonly of general application.

D. Looking Ahead

In most States, provisions governing local government debt took shape 60 to 80 years ago. The adjustments and new enactments which have since come into operation, along with an extensive body of judicial opinions, make up in most States a conglomerate array of patches on patches. In few instances has there been a thoughtful recasting of legal provisions that provide and regulate local borrowing power.

The technical deficiencies which attach to prevailing kinds of State-imposed restrictions have characterized them for many years—and have, in fact, been pointed out by competent scholars writing on this subject from time to time for decades past.65 But some of the most striking and disturbing effects of

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65 Many of the critical observations offered here resemble points that were made in 1914 by Horace Secrist in An Economic Analysis of the Constitutional Restrictions Upon Public Indebtedness in the United States. Skeptical questions about the value of percentage tax and debt limits were also raised in the Tilden Commission report to the New York legislature in 1877—nearly a century ago.
State debt restrictions have developed largely within the past few years. This is reflected in the tremendous expansion of non-guaranteed debt of local governments, and especially the spreading use of revenue bonds to provide for public facilities which traditionally and in sheer logic are not "self-financing." Responsibility for this development rests in the first instance with the borrowing local governments and agencies directly involved. But the States are more fundamentally responsible — most of them by failure to recast their legal debt provisions so as to eliminate barriers to sound local borrowing practices, and many of them even more directly by creating or authorizing new instrumentalities designed specifically to circumvent inherited restrictions on "ordinary" debt and borrowing.

One result is the growing and confusing never-never land of "non-debt" debt, which largely falls outside the scope of general State constitutional and statutory provisions.

The most serious long run hazard, perhaps, concerns the reputation and standing of municipal obligations as a whole. In the 19th century, sad experience with railroad improvement bonds dried up the market for municipal bonds generally. In the 1930's, imprudent practices with debt for rural improvement districts and for subdivision special assessments helped to discredit local government debt broadly — perhaps to an exaggerated degree. It is hard to imagine that "municipal" credit as a whole will remain unaffected if there should be any wave of difficulty with the rapidly growing volume and variety of "non-debt" obligations of local governments. One observer writes: 66

Since World War II State and local governments are being called upon to provide a large volume of additional capital improvements. . . . All too often the development of an efficient plan to finance the badly needed capital improvements is made difficult by restrictions and limitations in the law which are the result of unfortunate experiences in an era very different from the present.

The strong resistance to change in the basic laws results in a great deal of time and effort being spent in developing complicated circumventions. When skillfully presented such circumstances are

likely to be approved, while straight-forward revisions of the basic laws are seldom ratified . . .

As we come to the end of this description of the highlights of the formative century in the history of State and local bonds, we can well wonder if our generation is drawing upon the past experience to develop new plans for the use of public credit.

. . . The possibility exists that an analysis of all the evidence would result in the unflattering conclusion that our generation is making essentially the same mistakes, on a much grander scale.

We are entering a decade in which, according to every portent, there will be continuing pressure upon local governments for sizable capital outlays, with resultant needs for extensive borrowing and in turn, for well considered financial policies by local governments and a receptive market for municipal obligations. All these circumstances add urgency to the need for intensive review and considered revision of constitutional and statutory provisions governing the indebtedness and borrowing of local governments — a task which is long overdue in most States.
Chapter 5

CONCLUSIONS AND RECOMMENDATIONS

A. Guidelines for Action

The recommendations which follow are based on the following major premises. Two of these have been explained and supported in previous chapters, and need only to be summarized here:

1. *States have a legitimate and strong concern with the borrowing power and practices of local governments subject to their jurisdiction.*

2. *Existing legal provisions on this subject are in most States critically in need of intensive review and major change. Basic revision is widely needed; patching has been inadequate, and in some instances actually harmful.*

Our third major premise is as follows:

3. *Any constitutional provisions concerning the debt and borrowing power of local governments should be limited to matters that involve basic principles and relationships of enduring and basic importance.*

Nearly one-third of all the State constitutions differ from the remainder in that they omit, entirely or substantially, specific provisions with regard to indebtedness and borrowing power of local governments. This minority group includes some of the earliest State constitutions still in effect, as well as one of the most recent — that of New Jersey. No evidence has been found that this lack of constitutional specification has been accompanied by difficulties or abuses that might have been avoided by more detailed provisions in the constitutions of the States concerned. On the other hand, it has been shown that questionable and potentially hazardous recent developments in the form of
local government debt, as well as voluminous legislation and litigation on the subject, have been most common in States that have detailed constitutional restrictions.

The degree to which constitutional provisions on local debt will actually hamper good practices, or prevent statutory adjustments dictated by changing conditions, will of course depend upon their nature. We are convinced, however, that thoughtful review will disclose in most States a need to eliminate from the constitution some unduly specific provisions and also, in many instances, procedural detail of a transitory nature that could more appropriately be handled by statute.

Our fourth major premise is as follows:

4. *No single legal formula now in effect appears to provide a reasonable and equitable measure of the “safe” debt-carrying capacity of individual local governments.*

We have noted the many serious deficiencies of the common kind of State-imposed limit on indebtedness of local governments — i.e., a percentage of the local property tax base. The persistence of this device, with all the weaknesses that have time and again been pointed out, may be taken as one evidence of the very serious difficulty of measuring debt capacity by any single formula intended for universal or widespread application in a State. But even more impressive evidence is provided by the fact that bond underwriters and specialized rating agencies, working intensively in this field for decades past, have been no more able than State legislative and administrative agencies to come up with a standard or formula kind of answer to the problem. This is because so many factors affect debt carrying capacity, and because the future rather than the present or past is the subject of the conundrum. To quote an officer of Moody’s Investors’ Service:  

67 ... Ratings cannot reflect the fine shadings of risk which actually occur.  

taken into account. Naturally, such material is used extensively in our studies, but we give great weight also to numerous economic and other nonfinancial factors . . .

The ratings represent the considered judgment of a group of experienced security analysts about the probable future performance of bonds over the long-term. To us, "long-term" means: as far ahead as the practical imagination will permit. . . . We make use of historical data as a matter of course. But it is in the future, not the past, that presently outstanding bonds will become due and payable. Thus in our appraisal of long-term risks, among other things we consider economic, social and political trends. Particular consideration is given to the possible capital needs, and to current revenue requirements as well which can be met only by new burdens placed upon the same economic and credit base. This means that we consider the needs and requirements of all governmental units imposing both direct and indirect taxes on the business life of the community whose bonds are under study.

It is obviously more exacting to group bond issues and rate them in terms of their relative quality than—as is contemplated by legal debt limits—to determine only those prospective issues which seem so risky or imprudent they should, perhaps, be prevented entirely. But the latter kind of determination is like the bond-rating process in that it mainly involves the future rather than the past, and properly should be concerned with many factors and not only with one or a few.

It may nevertheless be worthwhile to note some inherent limitations of various summary kinds of local debt limits that might be suggested as possible alternatives to a tax-base percentage ceiling.

(1) A dollar amount per capita would take no account of population changes that occur after some firm reference period. Furthermore, reliable population figures never become available for numerous school districts and special district jurisdictions that do not coincide with such other political subdivisions as counties, townships, or municipalities. Price level changes could make any such debt-limiting standard rapidly obsolescent. It is difficult to see how such a limitation could take account of the complex overlapping of local governments which exists in
many areas. Moreover, prospective changes in population are likely to differ widely from one area to another.68

(2) A standard related to the community’s *economic capacity as measured by personal income of its residents* sounds attractive. However, reliable data of this nature are not regularly available for minor local areas, although some States have carried out useful studies on a county-by-county basis. Even as annually developed by the U.S. Department of Commerce for entire States, personal income data are estimates subject to qualification. Furthermore, fiscal capacity may be very much affected locally by the placement of industrial and commercial activity, and not merely by the residential distribution of the population, which determines the geographical allocation of personal income. Property tax valuations represent the only kind of economic data available annually for the geographic areas of most local governments, and even such information is lacking for the areas of special districts that do not have property taxing power and are not coterminous with local governments having such power.

3. It might seem more feasible to limit local government debt to some stated *ratio of the borrowing government’s total current revenue*. However, the problem of achieving meaningful definition and reliable reporting of revenue should not be overlooked or minimized. If revenue were defined on a gross basis under this approach, for example, a government’s aggregate debt limit could be greatly increased by its taking on a new activity with large user-charge revenues (e.g., parking lots, or the local public transit system). On the other hand, if some revenues were to be omitted or counted only on a net-profit basis, a far more complex system, including enforcement of accounting distinctions, would become urgent. Above all, any limit based on present or recent levels of revenue could not fully recognize the potentially wide range of *future* prospects of the

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68 Even though the U.S. population has been increasing rapidly, half the counties in the Nation lost population between 1950 and 1960. The 83 municipalities that had a population of 25-30 thousand in 1950 provide another illustration of diversity in trends. Ten of these cities lost population between 1950 and 1960, and 25 others had an increase of less than 10 percent; but 13 were up at least 50 percent, including 4 whose population more than doubled.
various governments or communities that would, by this test, be identically controlled.

Each of the foregoing conceivable alternatives to a debt limit stated as a percentage of the local property tax base has its own problems. What about a major recasting of the traditional type of percentage limitation? A pattern can be found in the constitutional provisions which have applied in New York State since 1951. These are substantially paralleled by a recent New Jersey enactment scheduled to become effective in 1962 as well as by the "Model County and Municipal Bond Law" issued by the National Municipal League in 1953. These provisions differ from the common type of assessment-based percentage limitation of local debt in two extremely important respects: (1) The limiting percentage is not applied to assessed value as determined and used for local property taxation, but to that value as inflated by a State-determined measure of its relationship to full market value of recent years; (2) Exemption from the limitation is provided for debt incurred for facilities that are legitimately "self-financing," even though such debt is backed by the borrowing government's full faith and credit.

The desirability of these departures from the usual pattern of percentage debt limitations will be clear from previous discussion. Above all: (1) These features remove or at least reduce the tie between the debt limit and any local assessment "policy" concerning the level of property valuation; and (2) They remove the discrimination which operates under most debt-limit laws in favor of nonguaranteed debt and against full faith and credit debt, insofar as borrowing for revenue-producing facilities is concerned.

On the other hand, such provisions would not deal with all the deficiencies of a debt limit tied to the property tax base. The resulting criterion of debt capacity would still ignore the availability to local governments of various types of nonproperty tax revenue. And the limitation would apply only to local governments vested with property taxing power; special districts without such power make up a significant part of the local government structure in some States—though not in New Jersey and New York.

Furthermore, the problems and limitations that many States
would face in attempting to apply such improvements to their existing limits on local government debt need to be recognized. It is easy to require that local assessed valuations be multiplied by a State-determined multiplier, but the development of assessment ratio data is a demanding operation, and the findings inevitably are imprecise. Very few States have developed regular ratio-measurement activities which approach in scale and intensity those of New York and New Jersey. More widespread and better measurement of this kind is clearly desirable, especially as it can contribute to greater equity in local property taxation and in the allocation of State grants which take account of basic property tax data. At best, however, the resulting measures of local economic capacity will necessarily be approximate—especially for application to relatively minor jurisdictions, such as rural school districts and small municipalities.

But perhaps the most serious problem with this “adjusted” type of local debt limitation is this: What are its likely effects upon the quality of the State agency’s data regarding local assessment levels? More specifically, how can this use of the State’s ratio findings be prevented from increasing to an irresistible degree the pressure on the responsible State agency to adopt some non-objective “policy” concerning the full value standard? This is not necessarily a hopeless problem, but its recognition will at least qualify unreserved faith that required use of State-determined ratios would automatically minimize debt-limit difficulties.

B. Basic Recommendations for State Action

The Commission believes that the present maze of constitutional and statutory restrictions upon local government borrowing constitutes a serious impediment to effective local self-government in the United States. These restrictions handicap

69 Independent analysis in 1953 led to the conclusion that the Illinois “full-value assessment program” provided an overall average level of nearly 90 percent at its outset in 1946, but had slipped to around 60 percent by 1950. The Census of Governments indicated further erosion, to less than 50 percent by 1956. One observer has pointed out: “As there are statutory tax rate limits in Illinois, the failure to allow the market to control assessment levels places the department in the position of controlling local budgets and State grants-in-aid to local governments.” Robert H. Pealy, Comparative Study of Property Tax Administration in Illinois and Michigan (Ann Arbor: University of Michigan, 1956), p. 101.
self-reliance of local communities and governments, and impel them toward increased financial dependence on State or Federal Government resources. In many States, present provisions have contributed to complexity and deviousness in local debt operations. The Commission believes that State action to remedy this situation is necessary and urgent, and should be designed to relate any State regulation of local debt more realistically to the ability of local governments to service such debt.

No single feature of present State restrictions on local government debt stands out as “the” cardinal flaw. The problems which have resulted from cumbersome and unduly repressive provisions are closely interconnected. By the same token, no single kind of State action will be adequate to deal with these problems; they must be attacked in a variety of ways. Accordingly, the proposals for State action which follow are closely related to one another. Accomplishment of any one alone, or on some but not others, will fall short of what is needed in most States. The Commission offers them as a set of recommendations to be implemented through appropriate statutory enactment and, where necessary, constitutional amendment.

1. Local governments, should be granted maximum powers with respect to local government indebtedness. The Commission recommends that State provisions with respect to local government indebtedness take cognizance of all forms of local borrowing and debt. The intended application of such State provisions should be made explicit, and they should be designed to facilitate — rather than hamper — intelligent choice among suitable alternative forms of borrowing by the local governments concerned. This objective is most likely to be served if any conditions that attach legally to the borrowing power of an individual local government apply uniformly — or subject only to specifically defined exceptions — to any type of long-term debt it can incur.

In a majority of States, and especially those with detailed constitutional provisions on local debt, existing law as it has been judicially interpreted tends to remove or bias the choice of local governments among alternative kinds of long-term borrowing. The lack of comprehensive and clear definitions of debt has widely operated not only to promote expensive bor-
rowing practices but also to handicap sound financial management by existing local governments, and to spawn additional special districts and "financing authorities" with preferential debt-incurring power.

2. The Commission recommends that authority to issue bonds should be legally vested in the governing bodies of local governments, subject to a permissive referendum only, on petition, and with participation in any such referendum available to all eligible local voters and the results determined—except under unusual circumstances—by a simple majority vote on the question.

This recommendation contemplates repeal of State provisions which now require a popular referendum for local governments' issuance of full faith and credit debt, in favor of an arrangement whereby responsible governing bodies could authorize such borrowing, in the absence of a referendum specifically sought by a portion of the local electorate. (The Commission's proposal, of course, is not intended to prevent a governing body itself from obtaining an advisory referendum on the question of a particular debt issuance.)

Our proposal is consistent with the Model County and Municipal Bond Law of the National Municipal League, which also has provisions particularly designed to insure orderly and careful consideration of bond issue proposals by the responsible governing body, including action at two meetings, with appropriate publicity and public hearings. The introduction to the Model Law includes the following comment:70

Provision for public hearings and permissive referenda, in the opinion of many observers, not only safeguards adequately the public interest but tends to stimulate more critical alertness on the part of the electorate than does the provision for mandatory referenda—which frequently receive only perfunctory attention. When there is general community agreement on the need for a proposed capital project, the procedure favored in this law permits expeditious action and saves election expense . . .

Existing State provisions that make a popular referendum a mandatory condition for the issuance of full faith and credit

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debt, and especially those which require a large or selective type of majority vote, have stimulated undesirable developments of local government structure and financing in many areas. Such provisions trace their origin to the post-Civil War period, when official morality was widely suspect at all levels of government. In the largely rural and agricultural society of that time, debt issuance was for the overwhelming majority of local governments a relatively rare undertaking, which could without great inconvenience or expense be made specifically subject to action by the local electorate. Today, however, a major part of the population lives in and around urban areas, and is served by relatively large units of local government which must make frequent use of long-term borrowing to finance essential public facilities. Especially for such areas, the direct "town meeting" approach of an earlier society has little relevance. Efforts to retain or apply it, as in the case of mandatory debt referenda, can seriously hamper effective and responsible local government.

The Commission sees a marked difference in the role of an elective local governing body with regard to a petition-based referendum on its action to authorize bonds, as compared with a mandated referendum on all such actions it may propose. In the former instance, the burden of proof rests with the objectors; in the latter, the governing body presumably must in every case prove the wisdom of its action — and often, with the legal requirements that apply, hampered at least as much by disinterest of the voters as by overt opposition. Thus, mandatory referendum requirements should be eliminated not only because of their widely undesirable effects on local debt practices but, more fundamentally, because they contradict sound principles of representative local government. These principles call for the placement of extensive responsibility with an elective legislative body, subject to popular control primarily through recurrent election rather than by automatic exposure of its actions to "item-veto" at the polls.

This comment applies with special force where referendum requirements are so onerous that action of local governing bodies can be nullified by a very small minority of the entire electorate. As is evident from Appendix A, this possibility
arises especially in those States where a bond issue cannot be authorized without approval of some loaded majority (such as 60% or two-thirds) of those voting; by a majority of all eligible voters (rather than merely of those voting on the question); or by a majority, or even a loaded majority, of property owners voting, and with the rest of the electorate disfranchised for this purpose. Like so many other features of debt-limiting provisions, the practice of restricting to property owners the right to vote on proposed bond issues was originated when our economy was largely rural, and when the property tax made up a much larger part than it now does of local government revenue. In the States concerned, such provisions today represent gross discrimination against a sizable fraction of the total citizenry.\(^7\)

However, the chance that a small minority of the electorate may nullify action of a local governing body is not limited to cases where a special type of majority is required for approval. In an extensive recent study that covered 1,512 local school bond elections held between 1948 and 1959, voter turnout is shown to run typically under 40 percent. For small school districts, average turnout was 39 percent, for medium-size districts 33 percent, and for large districts 30 percent.\(^7\) Thus in the average situation, and where even a simple majority of those voting could carry a school bond proposal, a negative vote by 15 to 20 percent of the entire local electorate may well constitute a veto.

There is a close relationship between this recommendation and our first one, looking toward more uniform treatment of various types of local government debt in State legal provisions. Except in a very few States, existing requirements for

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\(^7\) The 1960 Census of Housing has reported the proportions of occupied housing units occupied by "owners" and by "renters." Following are the reported proportions of "renters" for some cities in States that limit voting on bond issue matters to property-owners or taxpayers: Detroit, 41.8%; Denver, 46.5%; New Orleans, 62.4%; Great Falls, Montana, 45.4%. However, since the renter-occupied dwellings average smaller than the owner-occupied units and since some renters are property owners or taxpayers, these percentages should not be taken as a direct measure of the extent of disfranchisement.

debt referenda apply only or most restrictively to the issuance of full faith and credit debt, and not to the issuance of non-guaranteed or "revenue" bonds. If uniformity were sought merely by broadening present legal definitions of local debt or borrowing, the effect would commonly be an even more restrictive overall control, unless full faith and credit debt is freed of the mandatory referendum requirements to which it is widely subject.

3. The Commission recommends the repeal of constitutional and statutory provisions limiting local government debt or debt service by reference to the local base for property taxation.\(^3\)

It has been nearly a century since such provisions became widespread. This should be a long enough period for the States to have learned that any possible benefits from such provisions have been vastly outweighed by their undesirable effects—upon the borrowing and financial practices of local government, upon intergovernmental relationships, upon the property tax system, and upon the structure of local government. In the form they now take in most States, such restrictions have outworn whatever value or necessity they might have had at the time of their development. They have persisted as barriers rather than stimulants to improved local government budgeting, accounting, and reporting. Their continuance to the present period marks a failure by the States to take account of the major changes which have occurred in the scale of local governments and their financing, the compe-

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\(^3\) Mr. Michaelian dissents from this recommendation, commenting as follows: "Although in agreement with the proposition that existing local debt restrictions of numerous States are in need of review and realistic adjustment, I believe that the property tax base is one of the factors by which debt-carrying capacity should be measured. I cannot support the repeal of limitations based on the local property tax base unless replaced by some other specific measure of revenue potential."

Mr. Burton dissents from this recommendation and the following recommendation (page 77) by which debt limits might be expressed in terms of net interest cost. He states: "There is much room for improvement and modernization of governmental debt limits, but either recommendation, and particularly the two taken together, give a flavor of wanting to abolish all limitations that are directly related to ability of paying debt service. Property taxpaying ability as expressed in true value of the property base can be given better measurement than is now the case, but it is not realistic to expect the property tax base to be discarded as one base for debt limitation. Further study would seem to be required before a 'net interest cost' limitation should be built into a debt limit formula."
tence of public finance officials, the local government revenue structure, and the market mechanism for sale of local government securities.

Some of the most undesirable features of debt limits as they now apply in most States could be reduced by their amendment (if backed by effective administration of a State program for measuring local assessment levels) along the lines of provisions that now apply in New York, are pending in New Jersey, and have been outlined by the National Municipal League in its Model County and Municipal Bond Law—apparently as an optional feature. As a goal for State action, however, the Commission considers such amendatory action inferior to the complete elimination of constitutional and statutory provisions that set percentage-type limits on local government debt.

The present New York provisions, and the percentages given in the National Municipal League model, would appear to provide potential restraint on aggregate debt in only very rare instances. This is undoubtedly better than a formula which would set ceilings with a widespread impact, since the

74 This portion of the model law is said to be offered "for States which do not have constitutional debt limitations, or which desire to supplement such constitutional limitations." National Municipal League, op. cit., p. xv.

75 In 1958, for example, according to a Special Report on Municipal Affairs by the State Comptroller (1959 Legislative Document No. 97), none of the 57 county governments in New York was using as much as half its constitutional debt ceiling, and only 2 were using as much as one-fifth; of the 62 cities in New York State, only 6 were at least halfway to their debt ceiling, and only 35, including those 6, were using at least one-fifth of the constitutional limit. Among the more numerous villages and towns as well, only a limited proportion were in debt beyond a minor fraction of the legal limit.

The percentages in the Municipal League's model law, if applicable everywhere in 1957, would have permitted local government debt totaling more than $100 billion in the Nation as a whole, exclusive of amounts for utilities and other self-financing purposes. This is about five times the amount of such local debt that was then actually outstanding. This aggregative kind of comparison is of limited significance, of course, since unused debt leeway in one area is not transferrable to another. It is more significant (though interarea differences are also buried in these figures), that not one of the most populous county or city-county areas in the Nation had outstanding, in 1957, long-term local government debt exceeding the total percentage ceiling suggested in the model act—i.e., 15 percent of the estimated full value of taxable realty. For nearly all counties with a 1960 population of at least 300,000, the 1957 Census reported assessment ratios for residential property; applying these to the total real property assessment to arrive at an approximation of full value, it was found that total long-term local debt exceeded 10 percent of that value in only 4 of the 55 major areas subject to analysis. If debt for utility purposes is excluded, not one of the 55 areas showed total general government debt exceeding 10 percent of the full value of taxable realty.
measure of economic capacity being employed is crude at best and, being based upon the past, makes no allowance for the direction and rate of change in economic prospects of various communities.

But the question arises: Is it desirable to impose a universal pattern of potential restraint — with all the controversy, pressures for adjustment, and popular misapprehension of effects which have appeared historically with percentage debt limits — in order to provide a control of dubious validity over extremely rare problem situations? At least, the burden of demonstrating the importance and potential usefulness of percentage debt limits, even on some improved basis, rests with those who would argue for their retention or modification. We believe, rather, that efforts which might be devoted to improving this crude device could better be applied to the elimination of arbitrary percentage limits on local debt, and to the exploration of completely different means for States to encourage sound financial management by the local governments subject to their jurisdiction. Our two remaining major recommendations are pointed in that direction.

4. The Commission recommends that the States study and consider measures to regulate long-term borrowing of local governments by reference to the net interest cost of prospective bond issues in relation to the currently prevailing interest rate on high quality municipal securities.\(^76\)

\(^76\) Mrs. Cutler, with Mayor Clinton joining, dissents from this recommendation, and says: "State regulation of this nature might make it impossible for some local governments to borrow for outlays they urgently need." See also the dissent indicated by Mr. Burton, as reported in connection with the Commission recommendation on page 75. (Recommendation No. 3)

Secretary Dillon expresses a reservation on this recommendation, as presently worded, with the following comment: "It is quite possible that interest costs could provide useful measures or guidelines in the regulation of long-term borrowing by local governments. A careful technical study would, however, be needed to provide a proper framework for such guidelines and we feel that the recommendation as presently worded is too positive in setting up interest cost as a guideline. We would prefer that the recommendation be phrased in terms of an advocacy of technical studies to see if interest costs can provide a set of guidelines that would prove useful in the regulation of local government borrowings.

"The Commission report itself has made a useful first step in the development of such guidelines but at the present stage of study the case for any one particular guideline or set of guidelines can only be classified as not proven. It is believed that attention to borrowing costs could properly be considered in the discharge of technical and
Some States already, constitutionally or by statute, set a ceiling on the interest rate that may be specified on local government bonds. This is not the kind of regulation our recommendation has in view. As applied merely to coupon rates, such a simple provision can be nullified by the marketing of bonds at a price below par. More important, there is considerable variation over time in the interest rate at which governmental securities of similar quality are marketed. During 1960, for example, the monthly median (re-offering) yield on new issues of 20-year Aaa bonds of State and local governments showed a range from 2.95% to 3.50%. Thus, an absolute interest rate limit set in terms of a specified percentage would have to be so high, to avoid a complete blockage of borrowing at some intervals, that it would be of little or no consequence most of the time.

The financial market itself, however, takes account of such fluctuations in the "going" rate of interest on municipal securities. Bond issues offered at any particular time are sold at net interest costs which tend broadly to reflect their relative quality in the context of the market then current for "munipals" in general. Within any limited time period, the bulk of new issues falls within a rather limited range of interest rates, and only a minor proportion shows a relatively very high rate. We believe these characteristics of the municipal bond market offer a basis for such regulation of the amount of long-term borrowing or indebtedness of local governments as the States may find necessary or appropriate. Such regulation could be applied in any of several forms, but it can most readily be

advisory assistance proposed in Recommendation No. 5 but whether this can be extended in a more direct way to Recommendation No. 4 is still an open question.

"There is a danger that application of interest cost guidelines in a rigid or inflexible manner would substitute a new restriction for the more traditional restrictions that this report proposes should be abolished. Overly rigid application of interest cost considerations might leave governmental units dependent on admittedly imperfect bond ratings and the happenstance events in the municipal bond market."


78 In the first 3 months of 1961, for example, when the median rate of net interest cost on State and local bond issues was slightly below 3.5%, about 95 percent of all issues were sold at a net interest cost of less than 4.25%. Additional data of this nature are presented in Appendix C.
illustrated in terms of what might, perhaps, be an unduly restrictive provision:

A State law provides that no local government shall issue bonds at a net interest cost which is more than 1.4 times the current yield rate of the highest grade municipal securities (as indicated by a statistical series or group of series designated for such reference use by the State treasurer, or some other specified official). At the time of a particular bond sale, the yield rate for "high grade municipals" is 3.0%. If the best bid at the sale would involve a net interest cost rate of 4.2% or less (1.4 times 3.0%), the award could be made and the sale carried out. But if no bid involved this low a rate, all offers would have to be rejected.

Recent market data suggest that with a 1.4 factor, as in this illustration, only an extremely small proportion of all prospective issues would be directly affected by such a control device in the typical State. A lower specified factor, such as 1.33 or 1.3, would of course extend the control to more prospective issues; and a higher factor, such as 1.5, would limit the control to an even smaller group. A graphic illustration appears in Appendix C.

In lieu of complete prohibition, as in the hypothetical case above, the State might specify that prospective local bond issues with a relatively high interest cost rate should be specifically considered again by the local governing body, perhaps with special publicity and another public hearing; or be submitted to popular referendum; or be submitted for review and approval, or perhaps only for comment, by a State agency. It would also be possible, of course, to provide some exemption, in terms of a minimum dollar amount of interest or of debt outstanding, before a particular government or proposed borrowing action would be subject to the controlling act. Provision for any such exemptions, however, would need to be carefully weighed against the possibility of their stimulating avoidance practices such as have accompanied traditional types of State restrictions on local debt.

One question likely to arise about any such regulative device is: Would it tend to operate especially against small governments and bond issues, which are generally thought to involve somewhat higher rates of interest than the larger
issues of widely known governmental units? One answer, in rebuttal, rests on evidence from extensive recent studies which tend to discount earlier impressions about the prevalence of such a size-related differential. For example, a study by the U.S. Office of Education of the $2.2 billion worth of bonds issued for public school purposes during the 1959–60 school year led to the following conclusion:79

By whatever method we analyze 1959-60 bond–60 bond sales, we find no proof that large sales obtain lower rates than small sales. If, during the year, there was a relationship between size and cost, it was obscured by other factors.

There are at least three additional answers: (1) To the extent that small issues carry relatively high rates because of the risks or uncertainties they involve, the resulting pressure toward more conservative forms of debt (e.g., shorter maturities) is inherently desirable here as well as for larger issues; (2) The Federal program of public works loans and the special loan or grant programs in certain States which are designed to supplement or substitute for the public capital market in particular critical circumstances, are generally more helpful to small units of government than to larger ones; and (3) Where small borrowers are being penalized by inadequate reporting on local finances and community background, better reporting might be stimulated through State action, as proposed later in this report.

Another question of potential “discrimination” should be noted with regard to such a simple formula for State regulation as has been illustratively described above. The use of only a single multiplying factor to determine relatively high cost issues would, clearly, tend to operate especially against certain types of bonds—nonguaranteed issues as compared with full faith and credit debt, and extended-maturity issues as compared with those having a shorter life. A State might recognize this prospect but nonetheless adopt a simple formula with a single test “ceiling” factor, on the deliberate policy ground that the resulting pressure toward the use of lower-

cost forms of debt in marginal instances is considered desirable.\textsuperscript{80} Or, alternatively, the State formula might specify a pattern of multiplying factors, to make specific allowance for the usual effects of the term and form of various kinds of bond issues upon their relative interest costs.

It will be evident that any State provisions to regulate local borrowing along these lines should be expressed in statutory rather than constitutional form. Sad experience with traditional limitations on local debt should demonstrate that a constitution is no instrument to carry quantitative specifications, which are likely to deserve periodic review and adjustment in the light of experience and changing conditions.

The Commission is recommending that States "study and consider" rather than specifically that they "enact" provisions to regulate local government borrowing by reference to current interest rates. The recommendation takes this form because:

(1) While we believe this approach has potential value, it has not yet been applied anywhere. Nor has any specific recommendation of this nature, to the best of our knowledge, been previously the subject of intensive consideration by financial officials of State and local governments, and by persons closely acquainted with the municipal bond market.\textsuperscript{81} Such consideration and related discussion will provide a better basis than is now available for States to con-

\textsuperscript{80} Even a summary and simple kind of interest cost control, it may be noted, would not necessarily be absolute in its impact. Adjustments in the nature or duration of a particular marginal issue, or even a later offering on identical terms, might often offer an opportunity for a prospective borrowing government to come within the interest limit specified. In contrast, the usual type of debt limit, where it actually takes effect, may completely foreclose further issuance of the controlled type of debt for a long time, pending debt retirement or an increase in the reference tax base. During the recession of the 1930's, declining assessed values put some major governments so far beyond their "ceilings" that they could not legally issue any full faith and credit debt for several years.

\textsuperscript{81} In the course of the study on which this report is based, only two references to this type of possible State control over local borrowing were encountered—a brief paragraph in Volume 5 of the Illinois Tax Commission Survey of Local Finance in Illinois, \textit{Bonded Indebtedness of Local Governments, 1927-1940}, (Chicago: 1940), p. 146, and a glancing reference in the recent Kansas study which has been cited, Kenneth E. Beasley, \textit{op. cit.}, p. 199.
consider the extent and manner in which they might desirably make use of this approach to regulate local government borrowing.

(2) We anticipate that there may be a considerable variety of State determinations on this score, as a result of interstate diversity in numbers and types of local governments, traditions of financial practice, State-local relationships, and numerous other factors.

(3) Above all, we do not intend this recommendation to condition or qualify our conclusion that the States should, as promptly and completely as possible, eliminate their traditional types of percentage limits on local indebtedness and debt service. As now widely applied, such limitations mainly have had harmful rather than desirable effects. Their elimination should not await nor be made contingent upon the application of a system for "screening" of some prospective local bond issues, however useful such a system may turn out to be.

5. The Commission recommends that States make available technical and advisory assistance to local governments with regard to the issuance of long-term debt; and that the State agency responsible for this function be empowered to prescribe the minimum content of official statements prepared by local governments in connection with their issuance of long-term debt, in order to provide prospective investors with data needed to evaluate the security offerings.

The Commission believes this recommendation has major potential value for relatively small local governments. These issue bonds less frequently than major units and are often less well equipped, through their own financial staff and locally available advisers, to deal with the complexities of long-term borrowing. Local governments would benefit materially from the information and advice that could be supplied by a State office with a continuing responsibility for providing such service.

As expressed, the Commission's proposal emphasizes assistance rather than control or detailed supervision. This is delib-
erate. We are not recommending that a State agency be broadly empowered to appraise, and prospectively to disapprove, on grounds of policy or expediency, bond issues being considered by local governments. We believe any such pattern of control would be undesirable, at least in many or most States. This is not to disparage progress made in certain individual States toward better local accounting and reporting, as well as improved debt practices, in some instances through agencies that have potentially harsh coercive powers. It is our impression, however, that the main continuing value of such agencies with regard to municipal debt has come from their provision of advice and assistance to local governments, rather than from their power to control particular borrowing actions.\textsuperscript{82}

The one form of direct State regulation we do suggest here concerns the content of official statements prepared by local governments in connection with their issuance of long-term debt. Professional and underwriting organizations have developed valuable recommended standards, and the credit standing of numerous individual governments has been aided by their voluntary application of such recommendations. However, many local units are still penalized in their issuance of debt by inadequate official statements, which fail to provide the background needed by underwriters and investors in evaluating the securities involved. State action to set minimum standards for such statements should benefit the prospective borrowing units themselves and tend broadly to improve the market for local government bonds.

We offer no suggestions concerning the placement of these responsibilities within the State government structure. The technical problems involved might suggest their location with the Treasurer or another financial office. On the other hand, they could be assigned to an agency which assembles financial data concerning local governments or—where such exists—to an agency exercising a broad advisory role with respect to local government affairs.

The Commission intends to develop, in collaboration with

\textsuperscript{82} The advisory role is emphasized in a recent article on North Carolina activities in this field—W. Ewart Easterling, "State Control of the Debt Contracting Powers of Local Governments," \textit{The Daily Bond Buyer}, June 5, 1961. pp. 14 ff.
organizations of State and local officials and with investment and legal authorities, draft legislation embodying the foregoing proposal, for consideration by State legislatures and the Governors' Conference.

C. Ameliorative or Interim State Action

The Commission has urged vigorous efforts to eliminate the undesirable restrictions on borrowing power of local governments which are to be found in the constitutions and statutes of most States. We recognize, however, that accomplishment of this objective will at best be difficult and time-consuming, and that barriers to constitutional change in some instances may seem insurmountable. Therefore, where fundamental changes appear out of reach or likely to involve extended delays, the States may profitably aim at various types of ameliorative action. The nature of such action has been substantially indicated in previous portions of this report.

One important possibility is illustrated by the constitutional debt limits of New York State (and the statutory limits of New Jersey, as well as the provisions of the model bond law of the National Municipal League). These refer to a “full value” base of taxable realty, rather than to assessed valuations as determined locally; and they exempt full faith and credit debt which is for self-financing projects, rather than merely excluding revenue bond issues.

Again, it would be possible to curtail the biasing influence on form of local debt which often results from existing restrictions by specifically broadening their application to cover types of borrowing which are now exempt; in some few States already, referendum requirements are similar for revenue bonds as well as full faith and credit bonds, contrary to the usual discrimination against the latter type of debt. This course of action is not likely to be widely palatable, other than perhaps to close certain especially abusive loopholes in existing restrictions.

In some instances where more basic change is out of reach, it may still be possible to adjust prescribed percentage limits to take better account of the differing debt requirements of various types and sizes of local governments.
As a minimum, and an essential starting point for various other efforts, most States could benefit by an intensive effort to assemble and codify existing statutory provisions that pertain to the indebtedness and borrowing power of local governments. Such action alone would expose more fully the widespread existence of overlapping and contradictory provisions which have tended to hamper sound financial administration by local governments and to limit the ability of State legislatures to deal intelligently with this subject.

In those States where broad changes can be achieved and onerous restrictions eliminated, clear and up-to-date codification of the modified statutory provisions will also be extremely helpful—perhaps absolutely essential. Efforts in this direction are therefore urged, not merely as having some ameliorative value, but as part of the task which the States generally should undertake to improve their oversight of local government indebtedness.
Appendix A

DEBT RESTRICTIONS IN 46 STATES

1. Coverage

This is a report of findings from a survey undertaken by the Council of State Governments on behalf of the Advisory Commission on Intergovernmental Relations. The Washington Office of the Council sent a questionnaire to each Governor, asking that it be referred to the official or agency best able to provide summary information about the State’s limitations on local government debt. The inquiry focused mainly on State provisions that bear upon full faith and credit bonds, in view of the great diversity of provisions, practices, and judicial rulings with respect to “revenue” bonds. The following summary is based upon the 46 State reports which were received in time for use in this report.

The information summarized here relates only to debt provisions concerning the three predominant types of local governments—counties, municipalities, and school districts. Special districts are excluded in view of the tremendous variety of State laws concerning them. Town or township governments are also omitted from this summary; while such units are important in New England and the North Atlantic area, they are of limited consequence in most of the dozen other States where they exist. Of the 46 States covered, 10 have no independent school districts (or relatively few), so “school district” information is being reported only for 36 States. Also, since Honolulu city-county is treated here as a county, information for “municipalities” is shown for only 45 States. Besides Alaska, Connecticut, and Rhode Island, which entirely lack county governments, there are 3 others of the reported States where this type of government has relatively limited responsibility or debt-incurring need, so county government information is shown only for 40 States.

2. Debt-authorizing methods.

State laws empower local governments to authorize full faith and credit bonds in various ways. Often two or more alternative methods are available to the same government. Where this is the case, an effort has been made in the present survey to determine the predominant or most widely applicable bond authorizing method, for each of the three
major types of local governments. The results are summarized in the tabulation below. They indicate that only relatively few of these States permit local governing bodies to authorize long-term full faith and credit debt without a specific referendum—i.e., the States counted in the tabulation as using “Method A.” Several others of the States which are classed as mainly requiring a referendum do empower governing bodies to issue bonds for some limited purposes or in minor amounts. These include at least Kansas, Ohio, Pennsylvania, Washington, and Wisconsin.

The next most flexible arrangement involves authorization by a referendum requiring only a simple majority of those voting on the proposition, and with all electors eligible to participate—Method B1 in the tabulation. This is the prevailing pattern in about one-third of the States.

More onerous requirements apply elsewhere—altogether, in about half of the States. The additional requirements are extremely diverse. Under Method B2, for example, in California a two-thirds majority of those voting on the question is required (in Tennessee, a 75% majority), but all local electors can participate. In such States as Colorado and Michigan, as well as some half-dozen others, the requirement is a majority of the property-owners voting on the question (Method C1). Three States (with Method C2) go beyond the simple property-owning majority; Nevada and Wyoming require favorable action by both property-owning and other voters, recorded separately; and Louisiana requires that the favorable majority of property owners on the question also account for more than half of the total property tax base. In Georgia and South Dakota, bonds must be approved by a majority of all the eligible voters.

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1 Generalization has not been attempted for Maryland. To quote from the Maryland report: “... the State does not impose any legal limit on the debt of county and municipal government at the State level ... (there are no independent school districts). The State does require that authority to issue bonds for most county governments be granted by the General Assembly; however, two counties having home rule authority under their county charters do not require authority from the General Assembly to issue bonds, and do have a locally imposed debt limit which requires a local referendum for change. All municipalities enjoy home rule and under this form of government have authority to vote to incur debt locally. Some have locally imposed debt limitations. It would be difficult to ascertain which ones do have debt limitations and in what percentage. ...”

The extensive use of special local laws in some other States, such as Delaware, Georgia, Rhode Island, and South Carolina, may also make questionable the generalized treatment of those States in this summary.

2 This presentation takes no account of another kind of provision which applies in at least a few States—a requirement that the vote cast on a bond proposition must represent at least some minimum proportion (such as 40 or 50 percent) of the vote at the most recent general election. In some instances this has reportedly been an even more serious barrier than special-plurality requirements.
in the jurisdiction (Method D). (A similar requirement applies in North Dakota on propositions for debt issuance beyond the limit within which governing bodies themselves can act.)

**Distribution of Selected States According to Predominant Method for Counties, Municipalities, and School Districts to Authorize Full Faith and Credit Bonds**

<table>
<thead>
<tr>
<th>Predominant method of authorizing full faith and credit bonds</th>
<th>Counties</th>
<th>Municipalities</th>
<th>School districts</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. By action of local governing body...........................</td>
<td>7</td>
<td>11</td>
<td>4</td>
</tr>
<tr>
<td>B. By referendum, with all electors eligible to vote:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. With simple majority in favor .............................</td>
<td>11</td>
<td>11</td>
<td>12</td>
</tr>
<tr>
<td>2. Requiring special majority on the question (60%, 67%, 75%, etc.)...</td>
<td>9</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>C. By referendum involving property ownership qualification:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. With simple majority (or property-owning voters) in favor...</td>
<td>7</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>2. Requiring special type of majority..........................</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>D. By referendum requiring favorable vote by majority of all eligible voters in jurisdiction...........</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>E. Varied; not subject to generalization (Maryland)............</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Totals (for States reported)....................................</td>
<td>40</td>
<td>45</td>
<td>36</td>
</tr>
</tbody>
</table>

The list below shows how each of the 46 States has been classified in the foregoing table, in terms of the various types of bond-authorizing methods. Except where otherwise indicated, the classification pertains to all three of the principal types of local governments—counties, municipalities, and school districts.

Alabama:

B1 Counties and municipalities
A School districts
C1 Alaska (municipalities and school districts)

B1 Arkansas
B2 California
C1 Colorado
A Connecticut (municipalities)

Delaware:

A Counties and municipalities
B1 School districts
C1 Florida
D Georgia
A Hawaii (counties)
B2 Idaho
B1 Illinois
A Indiana
B2 Iowa
B1 Kansas
B2 Kentucky

C2 Louisiana
A Maine (municipalities)
E Maryland (counties and municipalities)
B2 Massachusetts (municipalities)
C1 Michigan
B1 Minnesota
B2 Missouri

Montana:

A Counties and municipalities
B1 School districts
C2 Nevada

New Hampshire:

A Municipalities
B2 Counties and school districts

C1 New Mexico
A New Jersey

New York:

A Counties and municipalities
B1 School districts
3. Prevalence of percentage debt limitations

Aside from Maryland (discussed in footnote 1), each of these States has some widely applicable legal provisions that set a limit on local full faith and credit debt in relation to the property tax base. In 14 of these States, however, (Alaska, California, Connecticut, Delaware, Kansas, Massachusetts, Minnesota, Nevada, New Hampshire, New Jersey, North Carolina, Rhode Island, Tennessee, and Vermont) such limitations are solely statutory, not constitutional.

In most instances, percentage limits are legally set for each of the several major types of local governments, but this is subject to the following exceptions:

Tax rate-limits for debt service apparently have been used in lieu of specific tax-base limitations on debt for counties in Arkansas; municipalities in Arkansas and Texas; and school districts in Alabama and Michigan.

Delaware counties have debt limits expressed in dollar amounts rather than as tax-base percentages.

The only other general exceptions to State application of percentage limits on debt which have been found involve the county governments of Florida, Idaho, and Virginia.

4. Variety of prescribed percentages

Many of the States reporting for this survey emphasize that no particular percentage can be identified as the "prevailing" debt limit for governments of a particular type, in view of legal provisions for classification of governmental units, numerous special provisions by purpose of debt, and in some cases exceptional charter provisions. Taking account only of those instances where some particular limiting percentage is said to be common, a wide interstate range appears—for example, for county governments from 2 percent in Indiana to 20 percent in Minnesota; for municipalities from 1% percent in New Hampshire to 15 percent in California and 20 percent in Minnesota; and for school districts from 2 percent in Indiana and Kentucky to 50 percent in Minnesota. (This Minnesota limit relates to an assessed value base which is a very minor fraction of full value; an alternative equal to 7½ percent of the State-determined "full and true" value is provided.)
It is nearly universal for the prescribed percentage to refer to the most recent year's assessed valuation for local property taxation. Three exceptions appear to the use of a single-year's base for computation of the debt limit. A 3-year average applies in Massachusetts and New Jersey, and a 5-year average in New York. A more important departure from the prevailing pattern involves those instances where the controlling percentage applies to a State-expanded multiple of local assessed values, in order to accomplish an approach to market value. Only New York's limitations have been of this nature for an extended period, but some Oregon limitations have been recast in this direction within the past two or three years. Corresponding shifts to something like a "full-value" base were sought by 1961 enactments in Indiana, New Jersey and Pennsylvania — none of which, apparently, has yet been fully tested in the courts.

5. Allowable exemptions from limitations

State agencies were asked to indicate whether any local full faith and credit debt is legally exempt from the coverage of percentage limitations. Such exempting provisions (or perhaps, in some instances, legal interpretations) are reported by only 15 of these States. The common exclusion pertains to municipal utilities, with the range of specification ranging from debt for water supply only (e.g., Colorado and Wyoming) through water supply and sewers (Montana) to a relatively broad version of debt for "revenue-producing facilities" or "self-sustaining improvements" in such States as New Jersey, New York, and Virginia.

It thus appears that, for two-thirds of these 46 States, no full faith and credit debt falls outside the strictures of whatever percentage limits are imposed by the State. At least by judicial ruling, on the other hand, nonguaranteed "self-financing" debt is commonly exempt from any such percentage restrictions.

6. Debt-controlling tax rate limits

In a few of the States being reported, restrictions on local debt take the form of limits on property tax rates rather than, or in addition to, restrictions on the total amount of debt. In four instances, these are said to involve rate limits specifically on property taxes for the servicing of debt: Arkansas, for counties and municipalities; Colorado, for municipalities; Iowa, for school districts; and Kentucky, for county road and bridge bonds only. In Alabama, Michigan, Nevada, Ohio, and West Virginia, all types of property-taxing governments are reportedly subject to tax-rate limits within which debt servicing as well as other tax-supported expenditures must be financed; this approach is reported also with respect to Hawaii and Illinois counties, and West Virginia counties and municipalities.
Appendix B

COMPARISON OF SELECTED GOVERNMENT FINANCE ITEMS FOR TWO GROUPS OF STATES

Of the 48 States for which relatively detailed data on local government finances were reported by the 1957 Census of Governments, there are 14 whose constitutions make little or no reference to local government debt. In these 14, any State control or regulation of local debt has been provided by statute rather than through specific constitutional provisions. In the other 34 States, central control of local debt has been based not only upon statutes but also upon constitutional provisions, which in most but not all instances specify limitations on local debt.

Various government finance items from the 1957 Census of Governments have been examined to see whether these two groups of States differ in ways that might be related to this difference in the nature of State provisions for control of local debt. The results are summarized below, focusing on the "middle half" of each group of States to avoid distortion by extremes. Severe limitations of analysis are imposed by the small number of States subject to comparative ranking, and the impact of many other factors upon local government finances.

Because of the strong effects of urbanization and population growth on local government debt, data from the 1960 Census of Population were examined to see how the two groups of States compared in these respects. As indicated by items A and B in the tabulation below, general similarity was found between the two groups. As a matter of fact, when all 48 States are ranked according to degree of urbanization in 1960 and according to rate of population growth between 1950 and 1960, exactly half of each of the two groups of States compared here are found to fall above the 48-State mid-point in these two rankings.

The States without constitutional debt provisions appear typically to have had, in 1957, somewhat more local long-term debt for general government purposes than other States (Item C). The difference was

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1 The 14 States are as follows: Connecticut, Delaware, Kansas, Maryland, Massachusetts, Minnesota, Mississippi, Nebraska, Nevada, New Hampshire, New Jersey, Rhode Island, Tennessee, and Vermont.
2 The data exclude debt for local utilities—by Census definition, water, electric, gas, and transit systems. Although public water supply systems are widespread, there is great variation in the incidence of public ownership for the other types of utilities.
concentrated in local debt that was full faith and credit in nature (Item D). This fact is reinforced by the next two items, specifically concerning the percentage of local general debt that was nonguaranteed — typically much lower among the “free” States. Housing debt is omitted from the calculation in each instance because it is a special type of nonguaranteed debt, yet is included in the Census concept of debt for general government purposes. Leaving school debt out of the calculation also (in Item F), the proportion of other long-term general debt that was nonguaranteed ranged from 20% to 47% among the middle half of the States with constitutional debt restrictions — far higher than among the “free” States.

From Item G, it is evident that the debt-controlling States typically had somewhat less local property tax revenue in 1957 than the other 14 States. However, they ran somewhat above the 14 “free” States in total State-and-local general revenue relative to personal income (Item H). As would therefore be expected, Item I shows a generally lower level of general revenue from non-property tax sources for the “free” States than for the others. Thus, while the cause-and-effect relationships may be

<table>
<thead>
<tr>
<th></th>
<th>14 States without specific constitutional provisions on local government debt</th>
<th>34 States having specific constitutional provisions on local government debt</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Median</td>
<td>Range of middle half</td>
</tr>
<tr>
<td>A. Percent of population urban, 1960</td>
<td>63.9%</td>
<td>54.3% to 78.3%</td>
</tr>
<tr>
<td>B. Percent of population increase, 1950—1960</td>
<td>14.0%</td>
<td>8.4% to 26.3%</td>
</tr>
<tr>
<td>C. Long-term general debt of local governments per $1,000 personal income, 1957</td>
<td>$82.28</td>
<td>$53.39 to $92.33</td>
</tr>
<tr>
<td>D. Full faith and credit long-term general debt of local governments per $1,000 personal income, 1957</td>
<td>$63.16</td>
<td>$47.88 to $79.98</td>
</tr>
<tr>
<td>E. Percentage nonguaranteed of all local long-term general debt other than housing debt, 1957</td>
<td>6.8%</td>
<td>0.6% to 11.4%</td>
</tr>
<tr>
<td>F. Percentage nonguaranteed of all local long-term general debt other than housing and school debt</td>
<td>13.4%</td>
<td>2.0% to 24.0%</td>
</tr>
<tr>
<td>G. Local government revenue from general property tax per $1,000 personal income, 1957</td>
<td>$40.38</td>
<td>$29.63 to $46.89</td>
</tr>
<tr>
<td>H. All State and local government general revenue, other than from Federal grants, per $1,000 personal income, 1957</td>
<td>$97.59</td>
<td>$84.34 to $116.23</td>
</tr>
<tr>
<td>I. State and local government general revenue other than from Federal grants and local general property tax, per $1,000 personal income, 1957</td>
<td>$57.66</td>
<td>$48.76 to $70.99</td>
</tr>
<tr>
<td>J. Average assessment ratio, locally assessed real property, 1956</td>
<td>29.7%</td>
<td>23.6% to 46.2%</td>
</tr>
<tr>
<td>K. Coefficient of dispersion of assessment ratios for single family houses within major assessment areas, 1956</td>
<td>29.2%</td>
<td>21.6% to 37.0%</td>
</tr>
<tr>
<td>L. Coefficient of dispersion between major assessment areas in assessment ratios for single-family houses, 1956</td>
<td>21.8%</td>
<td>14.0% to 25.7%</td>
</tr>
</tbody>
</table>
obscure, the existence of constitutional provisions restricting local debt seems to be definitely correlated with the composition of State and local general revenue, as well as with the composition of local government indebtedness.

The "free" States also typically run somewhat above the others in average level of assessment (Item J). However, no marked difference between the two groups is evident in the last two factors shown, which report the amount of variation in assessment level for residential property within major assessment areas (Item K) and among such areas (Item L).³

³ The size of these measures is inversely correlated with the quality of the assessment job locally (Item K) and statewide (Item L); i.e., the lower the coefficient, the less diversity in levels of valuation. These several assessment ratio measures are based on tables 12, 18, and 19 of Taxable Property Values in the United States (1957 Census of Government, Vol. V).
INTEREST RATES FOR STATE AND LOCAL GOVERNMENT SECURITIES

The tables and charts which follow are intended to illustrate two familiar characteristics of the municipal bond market which are relevant to the type of control over local borrowing that is being suggested for consideration by State governments: (1) Some "municipal" bond issues— but a relatively minor proportion—are sold at a considerably higher interest cost than the rates at which most sales take place; and (2) There is a close parallel between the trend of yield on municipal securities outstanding and of interest cost for new issues of a uniform type.

Table 1 and Figures 1 and 2 show the distribution of bonds issued by State and local governments during the first quarter of 1961, in terms of their net interest cost. About half of all issues were sold at less than 3.45%. Only 0.7 percent of all cost-reported issues, as indicated in Figure 1, were sold at a net rate of over 5%, and only 0.7 percent at 4.876 to 5.000%. There is a general correspondence between the two cumulative distributions in Table 1, relating respectively to number of issues and value of issues. This suggests the absence of any strong or widespread effect of issue-size upon the interest rate.

Figure 2 indicates that 80 percent of all cost-reported issues were sold at less than 3.9% interest, and 90 percent at less than 4.03%. This chart also shows the average yield indicated by Moody's Investors Service for Aaa municipal bonds during the first quarter of 1961, i.e., 3.17%. Only about one-fourth of all cost-reported bonds were sold at a net interest cost below that rate. However, when the Aaa average is multiplied by 1.25, the result is about 3.96%, and Figure 2 shows that all but about 15 percent of the cost-reported issues were marketed at a rate less than this. If the factor for multiplying the Aaa yield average is made 1.3, all but 8 percent of the cost-reported issues come within the resulting test rate. Less than 4 percent of the total number of issues were sold at more than 1.4 times the Aaa average yield rate.

Table 2 brings together, for convenient comparative reference: two long-established and familiar series of data on yield rates of municipal securities outstanding; two series on reoffering interest rates for specified
classes of new issues; and a set of figures for the same 24-month period from a recent special study of the U.S. Office of Education.¹ This latter series shows, for each month, the rate of net interest cost above which the highest-cost one tenth of public school bond sales took place. Each of the other four sets of data pertains to bonds of unchanging nature throughout the period reported. The school-bond series, on the other hand, is based on a composite of issues, subject to diversity in composition as to type, term, and quality among the various months reported.

The second part of Table 2 translates these several interest rate series into a set of index numbers, with the 24-month average equal to 100 in each instance. Marked correspondence is to be seen among the indexes for the several standard series, and even the school bond “highest rate” index, despite its composite character, follows a generally parallel course. It thus appears that in the Nation as a whole during this two-year period, the interest rate above which the most costly 10 percent of school bonds were sold moved rather consistently with the general market for “municipals.”

Table 1.—Distribution of Bonds Issued by State and Local Governments, January through March 1961, by Net Interest Cost

<table>
<thead>
<tr>
<th>Net interest cost (percent)</th>
<th>Number of issues</th>
<th>Value of issues</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percent</td>
<td>Cumulative percent</td>
</tr>
<tr>
<td>3.000 or less..............</td>
<td>15.9</td>
<td>15.9</td>
</tr>
<tr>
<td>3.001 to 3.125.............</td>
<td>7.8</td>
<td>23.7</td>
</tr>
<tr>
<td>3.126 to 3.250.............</td>
<td>10.2</td>
<td>35.9</td>
</tr>
<tr>
<td>3.251 to 3.375.............</td>
<td>8.2</td>
<td>42.1</td>
</tr>
<tr>
<td>3.376 to 3.500.............</td>
<td>11.5</td>
<td>53.6</td>
</tr>
<tr>
<td>3.501 to 3.625.............</td>
<td>10.8</td>
<td>64.4</td>
</tr>
<tr>
<td>3.626 to 3.750.............</td>
<td>8.3</td>
<td>72.7</td>
</tr>
<tr>
<td>3.751 to 3.875.............</td>
<td>7.4</td>
<td>80.1</td>
</tr>
<tr>
<td>3.876 to 4.000.............</td>
<td>8.6</td>
<td>88.7</td>
</tr>
<tr>
<td>4.001 to 4.125.............</td>
<td>5.6</td>
<td>92.3</td>
</tr>
<tr>
<td>4.126 to 4.250.............</td>
<td>2.5</td>
<td>94.8</td>
</tr>
<tr>
<td>4.251 to 4.375.............</td>
<td>1.2</td>
<td>96.0</td>
</tr>
<tr>
<td>4.376 to 4.500.............</td>
<td>1.0</td>
<td>97.0</td>
</tr>
<tr>
<td>4.501 to 4.625.............</td>
<td>0.5</td>
<td>97.5</td>
</tr>
<tr>
<td>4.626 to 4.750.............</td>
<td>0.6</td>
<td>98.1</td>
</tr>
<tr>
<td>4.751 to 4.875.............</td>
<td>0.5</td>
<td>98.6</td>
</tr>
<tr>
<td>4.876 to 5.000.............</td>
<td>0.7</td>
<td>99.3</td>
</tr>
<tr>
<td>Over 5.000................</td>
<td>0.7</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Based on an unpublished tabulation of issues reported to the Investment Bankers Association. The figures above pertain to 1,658 issues, with a dollar volume of $2.024 million. Interest cost information was not available for 239 additional issues, amounting to $89 million.

FIGURE 1.—Percent Distribution of Bond Issues of State and Local Governments, by Net Interest Cost, January through March 1961

Interest cost 3% or less, 15.9 percent of issues

Interest cost over 5%, 0.7 percent of issues

Source: See Table 1, p. 95.
FIGURE 2.—Cumulative Percent Distribution of Bond Issues of State and Local Governments, by Net Interest Cost, January through March 1961

(Showing also the average yield of Aaa-grade Municipal Bonds Outstanding, and certain multiples of that yield rate)

Source: See Table 1, p. 95.
### TABLE 2.—Selected Series on Interest Rates of State and Local Government Securities, by Months, July 1957 through June 1959

<table>
<thead>
<tr>
<th>Month</th>
<th>Yield of securities outstanding</th>
<th>Median yield of new issues, 20-year general obligation bonds (IBA)</th>
<th>Net interest cost, 90th percentile of new school bonds issued</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Moody's Aaa grade (general obligation bonds)</td>
<td>Bond Buyer's average, 20-year bonds (average, 4 top grades)</td>
<td>Aaa grade</td>
</tr>
<tr>
<td>1957</td>
<td>Interest Rates, in Percent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>July</td>
<td>3.17</td>
<td>3.40</td>
<td>3.15</td>
</tr>
<tr>
<td>August</td>
<td>3.37</td>
<td>3.47</td>
<td>3.30</td>
</tr>
<tr>
<td>September</td>
<td>3.43</td>
<td>3.55</td>
<td>3.15</td>
</tr>
<tr>
<td>October</td>
<td>3.31</td>
<td>3.45</td>
<td>3.10</td>
</tr>
<tr>
<td>November</td>
<td>3.24</td>
<td>3.43</td>
<td>3.00</td>
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<tr>
<td>December</td>
<td>2.92</td>
<td>3.16</td>
<td>2.70</td>
</tr>
<tr>
<td>1958</td>
<td>January</td>
<td>2.75</td>
<td>2.97</td>
</tr>
<tr>
<td>February</td>
<td>2.72</td>
<td>2.97</td>
<td>2.63</td>
</tr>
<tr>
<td>March</td>
<td>2.79</td>
<td>3.05</td>
<td>2.70</td>
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<tr>
<td>April</td>
<td>2.70</td>
<td>3.02</td>
<td>2.70</td>
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<tr>
<td>May</td>
<td>2.69</td>
<td>2.91</td>
<td>2.65</td>
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<tr>
<td>June</td>
<td>2.74</td>
<td>2.92</td>
<td>2.73</td>
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<tr>
<td>July</td>
<td>2.79</td>
<td>3.05</td>
<td>2.88</td>
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<tr>
<td>August</td>
<td>3.07</td>
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<td>September</td>
<td>3.28</td>
<td>3.59</td>
<td>3.10</td>
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<td>3.23</td>
<td>3.54</td>
<td>3.00</td>
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<td>November</td>
<td>3.17</td>
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<td>2.85</td>
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<tr>
<td>December</td>
<td>3.12</td>
<td>3.30</td>
<td>3.00</td>
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<tr>
<td>1959</td>
<td>January</td>
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<td>3.40</td>
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<tr>
<td>February</td>
<td>3.16</td>
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<td>3.26</td>
<td>3.05</td>
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<td>3.33</td>
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<td>May</td>
<td>3.29</td>
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<tr>
<td>June</td>
<td>3.37</td>
<td>3.64</td>
<td>3.38</td>
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<tr>
<td>1957</td>
<td>Index of Interest Rates (24-months average = 100)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>July</td>
<td>103</td>
<td>103</td>
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<td>August</td>
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<td>June</td>
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