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Everett H. Falk

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Some Legal and Economic Aspects of Industrial Development Financing

I. INTRODUCTION

A. *The Stages of Economic Growth*

The economic growth and industrial expansion of the United States has been both dramatic and pervasive. Within the period of a single century the United States experienced a metamorphosis from a traditional society to a society of high mass consumption.¹ Aided by the industrial revolution, the United States achieved the pre-conditions for economic "takeoff"² during the middle of the nineteenth century and began its transition from a predominantly agricultural to a highly industrialized society. This transition encompassed the economic, social, and political structures of the various sectors of the country and involved the accumulation, mobilization, and outlay of capital,³ the development of productive investments having a high growth rate, the emergence of dynamic political and social leadership, and an orientation toward national and international commerce.⁴ This transitional period—encompassing the pre-conditions for take-off, take-off, and the drive to economic maturity⁵—lasted until the early part of the twentieth century, when economic maturity was achieved and a period of steady, but rapid, economic growth was experienced.

B. *The Historical Context*

The emergence of industry as the energizing force behind economic expansion in the United States created a healthy appetite for capital. In the colonial period the major sources of capital were land and commerce,⁶ necessitating a reliance on agriculture as a supplier of the funds required to finance the industrial activities of the colonies. Colonial governments also responded by providing direct financial assistance to selected manufacturers in the form of bounties, premiums,

1. W. W. Rostow identifies five stages of economic growth: the traditional society, the pre-conditions for take-off, the take-off, the drive to economic maturity, and the age of high mass consumption. W. ROSTOW, *THE STAGES OF ECONOMIC GROWTH* 4 (1960). The transition in the United States was achieved primarily in the period from 1840 to 1920. *Id.* at xii.

2. Rostow describes "take-off" as a period of substantial economic growth, compound interest, and rapid industrial expansion. *Id.* at 6-9, 57.

3. *Id.* at 24-25.

4. *Id.* at 18-19, 39.

5. The drive to maturity is characterized by Rostow as "the period when a society has effectively applied the range of then modern technology to the bulk of its resources." *Id.* at 59.

6. G. SOULE & V. CAROSSO, *AMERICAN ECONOMIC HISTORY* 130 (1957).

and subsidies.⁷ However, the pressing need to develop transportation systems and other "social overhead capital,"⁸ coupled with the techniques of mass production introduced by Eli Whitney in 1799,⁹ required the accumulation and mobilization of large sums of capital. Thus, it became necessary to divert funds in excess of consumption levels into the control of individuals and organizations which would utilize such capital to develop the needed systems and facilities.¹⁰ Three main methods emerged as means of securing this capital: (1) the introduction and use of the corporate form of doing business; (2) the encouragement of foreign investment; and (3) governmental financial assistance.¹¹ With the exception of foreign investment, however, the primary sources of capital still remained land and commerce. Consequently, an agriculturally-oriented commerce provided the financial support for the industrial take-off of the United States. This take-off was achieved largely through the use of the corporation, which diverted necessary funds into the control of those investing in primary growth sectors.¹² However, in certain areas, private mobilization of capital proved to be inadequate, and it became necessary for government to lend its financial assistance. This was apparent in public expenditures for transportation, since the capital expended in constructing transportation systems was unlikely to yield quick financial returns to private investors.¹³ Railroads, particularly those built in sparsely settled regions, could not expect initially to achieve financial success. Consequently, such railroads sought and received financial assistance in the form of state and local governmental subscriptions for railroad bonds or stock,¹⁴ governmental

7. *E.g.*, Virginia, in 1662, granted a tobacco bounty of five pounds for each yard of woolen cloth. Maryland, in 1719, offered 100 acres of land to any citizen establishing iron furnaces and forges in Maryland. E. HAWK, *ECONOMIC HISTORY OF THE SOUTH* 105 (1934). *See generally* Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach*, 111 U. PA. L. REV. 265, 266 n.4 (1963).

8. Such social overhead capital would include roads, canals, schools, and communications systems. *See* W. ROSTOW, *supra* note 1, at 19.

9. G. SOULE & V. CAROSSO, *supra* note 6, at 114.

10. *See* W. ROSTOW, *supra* note 1, at 19.

11. *See* C. WRIGHT, *ECONOMIC HISTORY OF THE UNITED STATES* 312 (2d ed. 1949).

12. Rostow groups the sectors of an economy into three categories: primary growth sectors, supplementary growth sectors, and derived-growth sectors. The primary growth sectors are "where possibilities for innovation or for the exploitation of newly profitable or hitherto unexplored resources yield a high growth-rate and set in motion expansionary forces elsewhere in the economy." The other two sectors derive their growth in varying degrees from the primary sectors. W. ROSTOW, *supra* note 1, at 52.

13. One of the characteristics of capital invested in transportation or social overhead capital is a long period of gestation. Additionally, such investment is likely to pay off indirectly, as by inducing economic growth in a supplementary or derived-growth sector. *Id.* at 25.

14. *E.g.*, Ohio, in 1837, promised that state subscriptions to railroad stock would equal one-

loans,¹⁵ and land grants.¹⁶ Similar assistance was made available to select industries through tax concessions designed to encourage development in areas in which immediate profits were not anticipated.¹⁷

The early financial assistance to the railroads resulted in liberal extensions of credit and heavy stock subscription commitments by state and local governmental units. When this activity was challenged in the courts on grounds that the public taxing power was being used to assist private interests, most courts initially upheld the legality of the expenditures on the theory that the ancillary benefits accruing to the respective communities promoted a public purpose.¹⁸ The courts began to scrutinize these financial assistance programs, however, when abuses, improprieties, and outright frauds—which had serious, if not disastrous, consequences upon the credit of the governmental units involved—began to occur.¹⁹ In repudiating these abuses, some courts held that such financial assistance did not come within the ambit of the public purpose doctrine.²⁰ Also in response to these abuses, a trend manifested by a growing wariness of government to assist railroads began to develop, which culminated in the formulation of state constitutional safeguards designed to protect state governmental units from the undesirable effects of the railroad financing ventures. Governmental power to engage in this type of economic activity was greatly restricted.²¹ These constitutional provisions, written during a period of economic expansion and take-off,

half of the private subscriptions. Virginia purchased three-fifths of the stock of several railroads and guaranteed the bonds of others. C. WRIGHT, *supra* note 11, at 281.

15. *E.g.*, New York loaned over \$6 million to the New York and Erie Railroad to build a line from New York City to Lake Erie through the southern counties of New York. *Id.*

16. Land grants were of federal origin. However, in order to avoid constitutional problems, land grants were made to the states which then made them to the railroads. The railroads, in turn, utilized the land to obtain the necessary funds. *Id.*

17. Historically, tax exemption legislation with respect to industry has been associated primarily with war periods. Stimson, *The Exemption of Property from Taxation in the United States*, 18 MINN. L. REV. 411, 417 (1934).

18. Note, *State Constitutional Limitations on a Municipality's Power to Appropriate Funds or Extend Credit to Individuals and Associations*, 108 U. PA. L. REV. 95, 97 (1959).

19. *E.g.*, *People ex rel. Detroit & H.R.R. v. Township Bd.*, 20 Mich. 452 (1870) suggested the potential danger of powerful interest groups exerting influence on financial assistance legislation. See Note, 108 U. PA. L. REV., *supra* note 18, at 97-98. One example of fraud occurred in the South during reconstruction. Carpetbaggers, financed by Wall Street, bought up the stocks of southern railroads. Members of state legislatures, who had been bribed, voted millions in financial assistance, ostensibly to help reconstruct the damaged railroads. Most of this money found its way into the pockets of the legislators and the carpetbaggers. E. HAWK, *supra* note 7, at 490.

20. *E.g.*, *People ex rel. Detroit & H.R.R. v. Township Bd.*, 20 Mich. 452 (1870) (no difference discernible between railroads and other private business).

21. Note, *supra* note 18, at 98. See generally Note, *County Subscriptions to Railroad Corporations*, 11 AM. L. REGISTER 737 (1872).

form much of the basis for the opposition to industrial financial assistance in the present period of economic maturity and high mass consumption.

C. *Economic Development Factors*

The preconditions for take-off, the transitional period, and the realization of economic maturity were not achieved uniformly throughout the country. Even in a mature economy of generally high mass consumption regional economic take-off is dependent upon the growth rate of the particular sector of the economy present in the region. One leading economist notes that the momentum of economic growth "is maintained as the result of rapid expansion in a limited number of primary sectors, whose expansion has significant external economic and other secondary effects."²² Thus, certain regions of the country are likely to lag behind the economic development of the nation as a whole if their economic bases are not oriented to the then leading primary growth sectors.

Under the economic base theory of regional development it is essential for a growing region to export goods and services to other regions in order to receive "outside" money for use in local development.²³ Consequently, "basic" industries which sell to individuals and firms outside of the region provide the real basis of regional economic growth²⁴ by causing, either directly or indirectly, related growth in response to their own activity. Such response is likely to be in the form of an impetus given to "service" industries whose output or services are consumed within the region²⁵ by the basic industries, their employees, and other service industries. The economic base theory also suggests a correlation between employment in basic industries and employment in service industries. Through the use of empirically derived "regional employment multipliers"²⁶ reasonably reliable predictions can

22. W. ROSTOW, *supra* note 1, at 53. Rostow further states that "the behavior of sectors during the take-off is merely a special version of the growth process in general; or, put another way, growth proceeds by repeating endlessly, in different patterns, with different leading sectors, the experience of the take-off." *Id.*

23. WEISS & GOODING, ESTIMATION OF DIFFERENTIAL EMPLOYMENT MULTIPLIERS IN A SMALL REGIONAL ECONOMY, RESEARCH REPORT TO THE FEDERAL RESERVE BANK OF BOSTON, No. 37, Nov. 1966, at 8.

24. *Id.* at 2. See also W. ROSTOW, *supra* note 1, at 52.

25. Service industries include: retailing, local government, local utilities, construction, professional and business services. WEISS & GOODING, *supra* note 23, at 8.

26. The economic base theory assumes that there is a stable relationship between basic employment and service employment. The sum of the two types of employment equals the total regional employment. For example, if empirical data suggests that 100 new basic jobs would bring

be made of the short-range impact on total employment caused by changes in basic industry employment.²⁷ Thus it can be concluded that the most effective means of developing lagging regional economies is to invest in the basic industries of the region which are involved in the primary growth sectors. This type of investment should induce activity in supplementary and derived-growth sectors and, thus, create employment opportunities beyond those directly associated with the investment.

D. *Economic Stimulation Factors*

Before a plan of economic stimulation through financial assistance to industry is devised, the primary and secondary objectives sought through the stimulation process must be clarified. In addition to the primary objective of achieving regional pre-conditions for take-off through the promotion of basic industries, several corollary objectives may be sought. Perhaps the most important of these is the alleviation of unemployment and underemployment. To a large degree such alleviation automatically follows basic industry stimulation due to the effects of the regional employment multiplier. However, once the local labor force is fully employed at a given average wage rate, any increase in that wage rate (through minimum wage legislation or otherwise) results in a corresponding reduction in the employment level of the local labor force. Theoretically, if a subsidy of some kind equal to the wage rate increase is received by local industry and is wholly applied to reduce labor cost, the local labor force should return to its former full employment level.²⁸ Other secondary objectives of economic stimulation include the acceleration of market adjustments (by assisting industries which will utilize locally available raw materials) and the increase of competition (by helping industry to overcome high fixed costs, by reducing the element of risk in the calculation of profits, or by providing industry with extra liquidity).²⁹ Secondary objectives of economic stimulation

in 200 new service jobs, total employment would be increased by 300. The regional employment multiplier would be 3.0. The multiplier is not the same for all regions. *Id.* at 2.

27. *Id.* Some criticism of the use of regional employment multipliers has been voiced on the grounds that service employment may actually grow independently of basic employment for a variety of reasons. *See id.* at 3.

28. For a graphic description of this theoretical employment model under perfect competition conditions, see Cumberland & Van Beek, *Regional Economic Development Objectives and Subsidization of Local Industry*, 43 *LAND ECON.* 253, 255 (Aug. 1967). For a similar presentation of the full-employment equilibrium condition using the Keynes model, see L. KLEIN, *THE KEYNESIAN REVOLUTION* 82 (1947).

29. Laird & Rinehart, *Neglected Aspects of Industrial Society*, 43 *LAND ECON.* 25, 31 (Feb. 1967).

indirectly related to economic growth include the rejuvenation of slum areas³⁰ and the inducement of additional industrial development in selected auxiliary industries.³¹

Once the primary and secondary economic objectives are formulated with a view toward the effective utilization of infused capital, it becomes necessary for economic planners to consider carefully a number of locally induced effects of economic stimulation. Foremost in this area is the effect of added population on local facilities. As basic industry is developed in an underdeveloped area, labor and management personnel will immigrate to the area in response to the needs of both the new basic industries and the increased demands on the service industries. Such immigration could tax the capacity of existing facilities in housing, sanitation, education, police and fire protection, recreation, and transportation.³² The effective solution of problems such as disposal of industrial wastes, pollution, congestion, and noise control could require large capital outlays from both public and private sectors. Thus, increased demands on the public sector could place severe strains on inelastic revenue sources if the incoming industries fail to employ locally taxable factors of production while utilizing a wide range of public services.³³ In order to avoid serious tax distortions, a re-examination of the local tax system with a view toward taxing the potential users of the additional services may be required.³⁴ In addition to the economic effects of stimulation, significant psychological tensions may develop in a rapidly expanding community. This could occur if a substantial disparity between the average income level of the immigrating labor force and the local per capita income developed, or if the new industries tended to dominate the political and social structure of the community.³⁵

30. *Municipal Bond Dealers Rebut IBA Committee on Industrial Aid Bonds*, *The Commercial and Financial Chronicle*, Aug. 11, 1966, at 12, col. 1. See *N.Y. Times*, Jan. 7, 1959, at 1, col. 7, for the proposal that an industrial development plan be combined with a slum clearance program.

31. Laird & Rinchart, *supra* note 29, at 30.

32. Note, *The "Public Purpose" of Municipal Financing for Industrial Development*, 70 *YALE L.J.* 789, 802 (1961). See also Cumberland & Van Beek, *supra* note 28, at 260-61.

33. *Id.* at 260.

34. *Id.* at 261. It could result that if the tax systems are not restructured, persons and property located in one area will be heavily taxed to support various facilities and services in another. See Walker, *Fiscal Considerations Involved in Patterns of Industrial Development*, 31 *TAX POLICY* 3 (March 1964).

35. Cumberland & Van Beek, *supra* note 28, at 261.

II. INDUSTRIAL DEVELOPMENT FINANCING PLANS

A. History

The history of public industrial financing at the state and local levels began with the early subsidies, bounties, and premiums paid by the colonies to selected manufacturers to encourage the production of needed products. Governmental assistance to private companies reached a peak during the mid-nineteenth century with the financing of railroad construction. Public reaction to abuses and improprieties involved therein, however, led to the adoption of constitutional restrictions which curtailed such activity in many states. While some governmental financial assistance to industry continued into the twentieth century, largely in the form of tax concessions,³⁶ the next major development occurred in 1936 when the Mississippi legislature enacted the Balance Agriculture With Industry (BAWI) plan³⁷ in order to stimulate a balanced economic development of the state for the prospective general welfare of its citizens.³⁸ In essence, this plan gave municipalities the authority to issue general obligation bonds for the purpose of financing the construction of industrial facilities which would be leased to private industries establishing or expanding operations in the area.³⁹ This plan and its variations gained popularity in the South and began proliferating throughout the nation.

Today a substantial majority of states utilize some type of plan for the lending of governmental financial assistance to industries. Generally, five basic financing programs are in use today: (1) municipally owned industrial plants financed through the issuance of bonds; (2) second mortgage loans for industrial plant construction made from appropriations of out of state revenues; (3) governmental insurance of first mortgages; (4) bonds issued by local development corporations; and (5) state and local tax exemptions and concessions.⁴⁰ Each of these plans has the same goals—to attract and keep basic industries by reducing industrial costs, to provide funds to industrial concerns which could not easily obtain financing through other means, to bring the potentials of

36. The tax exemption has managed to survive court scrutiny, even where a direct subsidy to the industry would be denied. It appears that a more liberal construction of "public purpose" has been applied to tax exemptions—even though a tax exemption is an indirect subsidy—probably on the theory that the power to tax (and the power to exempt from taxation) is inherent in the government. Stimson, *supra* note 17, at 418-19.

37. Pinsky, *supra* note 7, at 266.

38. MISS. CODE ANN. § 8936-51 (Supp. 1966).

39. MISS. CODE ANN. § 8936-52 to -61 (Supp. 1966).

40. Pinsky, *supra* note 7, at 266-72. See also Abbey, *Municipal Industrial Development*

respective regions to the attention of business leaders, and to improve regional images.⁴¹

B. Public Financing Plans

1. *The Bond Plans.*—Perhaps the most significant and widely used financial assistance program is the municipal industrial development bond plan. This plan was conceived by the Mississippi legislature in 1936 as a response to the state's immediate and long-range economic problems. Typical of these problems were acute unemployment, low per capita income, and a failure to achieve regional economic take-off.⁴² Consequently, the entire economic situation called for a program of economic stimulation. The legislative response to these problems was the BAWI plan, which subsequently became the model for financing plans enacted in areas similarly affected. Under the BAWI plan any municipality was authorized to issue general obligation bonds for the purpose of financing industrial plant construction. Once constructed, the industrial facilities would be leased by the municipality to private industrial enterprises as an inducement to locate or to expand operations in the community.⁴³ Theoretically the rentals paid by the industry under the terms of the lease would be sufficient to amortize the bond issue.⁴⁴ Consequently under the objectives of the BAWI plan, the industry would obtain the benefit of low-cost facilities, the community would receive the economic benefit of the industry, and the bondholders would realize a return on their investment.

In 1938, however, the BAWI plan was challenged in *Albritton v. City of Winona*,⁴⁵ on the ground that it violated the public credit requirements of the state constitution.⁴⁶ The Supreme Court of

Bonds, 19 VAND. L. REV. 25 (1965); Bridges, *State and Local Inducements for Industry* (Part I), 18 NAT'L TAX J. 1 (1965); Stimson, *supra* note 17.

41. Bridges, *State and Local Inducements for Industry* (Part II), 18 NAT'L TAX J. 175 (1965).

42. Pinsky, *supra* note 7, at 267.

43. MISS. CODE ANN. §§ 8936-52 to -61 (Supp. 1966). The BAWI statute required approval of any project by both the municipal electorate and by the state Agricultural and Industrial Board. Board approval, after a substantial investigation into the economic feasibility of the project, resulted in the issuance of a certificate of public convenience and necessity. Pinsky, *supra* note 7, at 267.

44. Initially the rentals were set at nominal rates so that the BAWI plan amounted to direct subsidization. Later the rental rates were raised so that amortization became possible. *Id.* See generally Jones, *Federal Income Tax Deductions of BAWI Leasehold Payments*, 30 MISS. L.J. 10 (1958).

45. 181 Miss. 75, 178 So. 799 (1938). The case arose when a certificate of public convenience and necessity was issued to the city authorizing the issuance of \$35,000 of general obligation bonds to finance the acquisition of a knitting plant.

46. *Id.* at 92, 178 So. at 801.

Mississippi upheld the BAWI legislation on the theory that the overall economic benefits accruing to the communities through increased industrial activity promoted the general welfare of the state's citizens⁴⁷ and, thus, constituted a public purpose.

Having passed its court test in *Albritton*, the BAWI plan stimulated considerable interest among other southern states experiencing economic conditions similar to those of Mississippi. Although differing in form, subsequent municipal industrial development bond financing plans were similar to BAWI in theory and in purpose.⁴⁸ During the 1950's such plans became established in the South; but their real growth in national popularity did not occur until the 1960's,⁴⁹ when the proliferation of industrial development bonds reached exponential proportions. It is estimated that approximately forty states issued over one billion dollars of bonds in 1967.⁵⁰

Basically two types of bonds are utilized in municipal industrial development bond financing—general obligation bonds and revenue bonds. General obligation bonds are backed by the full faith and credit of the community. As such, they are subject to payment out of tax or general revenues and they represent debt obligations for which the municipality is directly liable.⁵¹ Revenue bonds, on the other hand, are payable solely out of revenues derived from the project financed by their issuance.⁵² They do not represent general debt obligations, have no claim upon municipal revenues, and consequently are more compatible with state constitutional restrictions on the lending of public credit. Furthermore, revenue bonds may not be subject to state debt limitations under the “special fund” doctrine.⁵³ As a result, they tend to be somewhat

47. *Id.* at 99, 178 So. at 805.

48. Some states, *e.g.*, Kentucky, utilize only revenue bonds for industrial development financing. Other states, *e.g.*, Tennessee, utilize both general obligation and revenue bonds for such purposes. See Abbey, *supra* note 40, at 28-29, 69, 70.

49. In 1963, for example, approximately \$400 million in industrial development bonds were issued. *Business Week*, Dec. 14, 1963, at 49. For an indication of the increased use of such bonds during the period 1951-63, see *id.* at 45.

50. *The Wall Street Journal*, Dec. 4, 1967, at 26, col. 1. For a compilation of the enabling acts of most of these states, see Abbey, *supra* note 40, at 67-71.

51. *E.g.*, *Rivers v. City of Owensboro*, 287 S.W.2d 151, 154 (Ky. 1956) (difference between special assessment and general obligation bonds noted). All conceivable tax sources need not be pledged, however. *Walton v. Carter*, 337 S.W.2d 674, 677 (Ky. 1960) (“Certain tax sources or portions thereof may be excluded or excepted . . . still leaving under pledge the remainder of the comprehensive taxing power.”).

52. *E.g.*, *Zeigler v. Witherspoon*, 49 N.W.2d 318, 325 (Mich. 1951) (credit of state not pledged nor does taxpayer pay for facilities financed through revenue bonds).

53. “In many states, the state courts subscribe to the Special Fund doctrine which holds that bonds serviced from special funds are not debts in the constitutional sense.” Ratchford, *Revenue Bonds and Tax Immunity*, 7 NAT'L TAX J. 40, 41 (1954).

more popular than general obligation bonds for industrial development financing and are generally hampered with fewer issuance restrictions.⁵⁴

2. *The Pennsylvania Plan.*—This type of industrial development financing program was devised to remedy adverse employment conditions that developed when labor surplus regions began to materialize in areas where certain basic industries underwent extensive modernization and automation.⁵⁵ This plan involves the making of second mortgage loans for plant construction. These loans are made by a state Industrial Development Authority to local non-profit development corporations established for this purpose in labor surplus areas. The development corporations apply these funds to the construction of industrial facilities, which are then leased to the participating industries upon completion.⁵⁶ The first mortgage funds, which often constitute the major part of the financing, are obtained from private lending institutions.⁵⁷ Although the BAWI influence on this type of financing is apparent, the interposition of the local development corporation was designed to avoid state constitutional limitations on the direct lending of the state's credit to private interests.⁵⁸ Furthermore, the BAWI plan contemplates complete financing through public means, whereas the Pennsylvania plan encourages maximum participation from the private sector.⁵⁹

3. *The New England Plan.*—A plan similar to that of Pennsylvania was developed in New England in an effort to revitalize

54. For example, the Tennessee enabling legislation requires agency approval before general obligation bonds can be issued. No such requirement exists for revenue bonds. Compare TENN. CODE ANN. § 6-2905 (Supp. 1968), with TENN. CODE ANN. § 6-1705 (Supp. 1968). See U.S. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, INDUSTRIAL DEVELOPMENT BOND FINANCING, Report A-18, at 47-51 (June 1963).

55. Pennsylvania, which devised this plan, experienced conditions of underemployment and labor surplus during the post-World War II period. The labor surplus areas developed primarily due to the modernization of the steel and coal industries. In 1958, for example, Pennsylvania had more than one-fourth of the areas classified as "chronic labor surplus" by the Department of Labor. Davlin, *State Development Corporations: The Pennsylvania Experience*, 24 LAW & CONTEMP. PROB. 89, 90 (1959).

56. The Pennsylvania Industrial Development Authority, for example, is "authorized to make loans to industrial development agencies in an amount not in excess of 40% of a project cost in areas of the Commonwealth having an average rate of unemployment of 6% or higher for any five years of the preceding ten years and to make loans not in excess of 30% of a project cost in areas having an average rate of unemployment of between 4% and 6% for any five years of the preceding ten years." PA. STAT. ANN. tit. 73, § 302.1 (Supp. 1967).

57. Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach*, 111 U. PA. L. REV. 265, 270 (1963). The non-profit local development corporation may also participate financially. *Id.*

58. *E.g.*, PA. CONST., art. 9, §§ 6, 7.

59. Pinsky, *supra* note 57, at 271.

weak economic sectors occasioned by the migration of various industries, especially textiles, to other regions.⁶⁰ The New England plan also approaches the problem of industrial development financing from the standpoint of encouraging maximum participation by private lending institutions. Essentially, this plan makes the state a first mortgage guarantor, so that the full faith and credit of the state is available to insure payments on mortgage loans totalling up to 90 per cent of the cost of the new industrial facilities.⁶¹ Such loans are obtained from commercial financial institutions.⁶² Where state constitutions prohibit the use of state funds or credit to finance private projects, title to the new industrial facilities is vested in local development corporations which lease the plants to the participating industries.⁶³ The remaining 10 per cent or so of the funding is often provided by the industries. These funds are, however, often available on a second mortgage basis from business development companies established to provide private financing for industry when commercial banks are reluctant to assume the higher risks involved.⁶⁴ Characteristic of the New England plan is a high degree of coordination and cooperation between public and private agencies.

4. *Development Corporation Bond Plans.*—A variant of the BAWI plan utilizing local development corporations was enacted by Alabama in 1949.⁶⁵ Under this program, local development corporations issue revenue bonds to finance the construction of industrial facilities which, in turn, are leased to participating industries. The corporations apply the rentals received to the amortization of the bonds⁶⁶ and any remaining earnings are disbursed to the municipalities, since these corporations are non-profit by legislative definition.⁶⁷ Once a local development corporation is formed in accordance with the provisions of the legislative enactment,⁶⁸ it alone has the discretionary authority to determine its own course of participation in industrial development financing.⁶⁹

60. *Id.* at 270-71 n.29.

61. *Id.* at 271. *See, e.g.*, R.I. GEN. LAWS ANN. § 42-34-10(2) (Supp. 1967).

62. *See, e.g.*, RHODE ISLAND INDUSTRIAL BUILDING AUTHORITY, RHODE ISLAND FINANCING PLANS 6 (undated).

63. *E.g.*, R.I. GEN. LAWS § 42-34-6 (Supp. 1967).

64. *See, e.g.*, RHODE ISLAND INDUSTRIAL BUILDING AUTHORITY, *supra* note 62, at 15.

65. Abbey, *supra* note 40, at 28.

66. The bonds may be secured by mortgages or trust deeds on the industrial facilities. ALA. CODE tit. 37, § 824 (1958).

67. ALA. CODE tit. 37, § 827 (1958).

68. ALA. CODE tit. 37, §§ 817-22 (1958).

69. The industrial development corporation needs no prior approval from state agencies or from the municipal electorate in order to undertake industrial development financing projects, ALA.

The Oklahoma industrial development financing plan, adopted in 1949,⁷⁰ is also centered around the development corporation. Under the Oklahoma plan a state industrial finance authority is empowered to sell general obligation bonds backed by the full faith and credit of the state. The funds thus obtained are loaned by the authority to local development corporations.⁷¹ The amount of such loans is limited to 25 per cent of the estimated cost of the project, and the local development corporations must be able to show that they hold funds equal to an additional 25 per cent of the estimated cost. This participation requirement may be reduced pro tanto when the development corporation has received from responsible commercial lending institutions firm commitments of funds exceeding 50 per cent of the estimated cost.⁷² However, the development corporation must have firm commitments for all funds in excess of the loan from the state industrial authority as a condition precedent to obtaining the loan.⁷³

5. *Tax Exemptions and Concessions.*—The history of tax exemptions given to industry as a means of affording financial assistance dates from the colonial period when property tax exemptions were granted to certain manufacturing enterprises.⁷⁴ Whenever it was deemed advisable to encourage manufacturing—during war years or during reconstruction periods, for example⁷⁵—tax exemptions, as well as subsidies, were employed. Consequently, the history of tax exemptions is directly related to the history of early economic development.⁷⁶

Since the power to tax is a power inherent in sovereign states, state legislatures have the implied power to grant tax exemptions to industrial enterprises, subject only to constitutional limitations on the exercise of

CODE tit. 37, § 822 (Supp. 1967), or to issue bonds therefor. ALA. CODE tit. 37, § 823 (Supp. 1967). See generally Abbey, *supra* note 40, at 28-29.

70. Pinsky, *supra* note 57, at 272.

71. OKLA. STAT. ANN. tit. 74, §§ 856-60 (1965). The development corporation need not be non-profit. OKLA. STAT. ANN. tit. 74, § 853(d) (1965).

72. OKLA. STAT. ANN. tit. 74, § 857(1)(A)(1)-(2) (1965) (Supp. 1968).

73. OKLA. STAT. ANN. tit. 74, § 857(1)(A)(2) (Supp. 1968).

74. In 1649, Connecticut granted the first property tax exemption for commercial reasons. Alyea, *Property Tax Inducements to Attract Industry*, in PROPERTY TAXATION USA 139, 140 (R.W. Lindholm ed. 1967). In 1783, Connecticut provided for a two-year exemption for the manufacture of flax seed oil. *Id.*

75. Stimson is of the view that industrial tax exemption legislation proliferates during war years. Stimson, *The Exemption of Property From Taxation in the United States*, 18 MINN. L. REV. 411, 417 (1934). Tax exemptions were equated with subsidies in the South after the Civil War. "Anyone who employed capital in the manufacture of cotton, wool, or paper, fabrics, iron, lime or agricultural implements was entitled to receive, from the state treasury, a subsidy equal to his total state taxes (except the 2-mill school tax) for a period of ten years." Alyea, *supra* note 74, at 141.

76. Stimson, *supra* note 75, at 416-17.

this power.⁷⁷ At the discretion of the legislatures, this power may be delegated to local governmental units.⁷⁸ Generally, statutory tax exemptions are granted to new or expanding industrial enterprises for the same economic purposes as those underlying other industrial development programs. Once granted, tax exemptions cannot be rescinded, unless forfeited,⁷⁹ within the term of the exemption even though the tax rate rises or an attempt is made to rescind by the appropriate governmental unit.⁸⁰

Generally, tax exemptions fall into two categories: those authorized by statutory enactments and those granted by negotiation without legislative authorization. Thirteen states specifically authorize direct property tax exemptions for new and expanded industrial facilities.⁸¹ These exemptions may be comprehensive, optional with the local governments involved, or contractual with the participating industries.⁸² Those states utilizing industrial development bond financing usually provide for the exemption of the municipally-owned industrial facilities, although this does not necessarily follow from municipal ownership itself.⁸³ Twenty-four states either grant an exemption from or a reduction of property taxes on business personal property.⁸⁴ In addition, certain

77. Alyea, *supra* note 74, at 141; Stimson, *supra* note 75, at 418. See *Duke Power Co. v. Bell*, 156 S.C. 299, 309, 152 S.E. 865, 869 (1930), holding that "[T]he power of taxation is legislative power, and knows no limitations, except those imposed expressly or by plain implication in the State or Federal Constitutions."

78. See, e.g., *Crow v. Gen. Cable Corp.*, 223 Ala. 611, 137 So. 657 (1931) (the legislative power to exempt industrial plants from taxation may be delegated to local governmental units absent constitutional restrictions).

79. Forfeiture may be accomplished by abandonment of the enterprise. E.g., *Edison Phonograph Co. v. State Bd. of Assessors*, 55 N.J.L. 55, 25 A. 329 (1892) (active carrying on of business within the state is an essential requirement for a tax exemption).

80. E.g., *Rixford Mfg. Co. v. Highgate*, 102 Vt. 1, 144 A. 680 (1929). The granting of the exemption was viewed as a contract, the consideration being the establishment of industrial operations in the area. Once the industry relied on the exemption by establishing operations, the exemption could not be unilaterally rescinded.

81. These states include: Alabama, Alaska, Arkansas, Hawaii, Kentucky, Louisiana, Maryland, Mississippi, Montana, Oklahoma, Rhode Island, South Carolina and Vermont. A brief description of each of these statutory provisions is provided in ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, STATE-LOCAL TAXATION AND INDUSTRIAL LOCATION, Report A-30 (April 1967), at 109-10 [hereinafter cited as ADVISORY TAX REPORT]. See, e.g., R.I. GEN LAWS § 44-3-9 (Supp. 1967) (10 year exemption at discretion of municipality); S.C. CODE ANN. §§ 65-1524-72 (1962) (5 year exemption not including school taxes, conditions varying with the counties); VT. STAT. ANN. tit. 32, § 3834 (1959) (10 year exemption at discretion of municipality).

82. Alyea, *supra* note 74, at 141. Some states, e.g., Vermont, give municipalities discretion to grant exemptions to industry. VT. STAT. ANN. tit. 32, § 3834 (1959).

83. This exemption may be authorized by state constitutions under the public purpose doctrine, or it may be authorized by statute. Absent such provisions, the facilities have still been treated as tax exempt. Pinsky, *supra* note 57, at 319.

84. These states include: Arizona, Colorado, Connecticut, Florida, Idaho, Illinois, Indiana,

property tax characteristics are such that they can amount to partial exemptions, or, at least, to concessions favoring industry. Such characteristics include: (1) favorable property tax classification; (2) low effective rates in industrial areas; and (3) "long-term stability in assessed valuation" causing, in effect, immutability of future tax bills.⁸⁵ When the tax structures of the states are considered in their entirety, including sub-rosa exemptions and concessions, there are few states which do not give favorable tax treatment of some kind as an inducement to industrial expansion. Although the total tax revenue lost through industrial exemptions is not ascertainable due to insufficient data, a recent study has estimated that an annual revenue loss of 40 million dollars results from the exemption of approximately 3.6 billion dollars in industrial property.⁸⁶

C. *A Comparison of the Plans*

The influence of the BAWI plan on the other methods of industrial development financing is apparent, since other plans typically involve long-term financial and contractual commitments for both industry and government, with the dual objectives of stimulating regional economic development while providing industry with needed capital. Manifest differences are apparent, however, in scope and in application. For example, the industrial development assistance programs of the various states range from complete public financing of industrial projects, as in the municipal bond plans, to encouragement of a high degree of private participation, as in the New England and Oklahoma plans. Furthermore, there is a wide variation in the degree of overall economic planning, coordination, and supervision between state, local, and private agencies. Those plans requiring a high degree of private financial participation necessarily require close coordination between the various interests involved, while those providing 100 per cent financing require overall economic planning and supervision by state agencies.⁸⁷ Moreover, the states are not uniform in the application and supervision

Iowa, Kansas, Kentucky, Maryland, Michigan, New Hampshire, New Jersey, New Mexico, North Dakota, Oklahoma, Oregon, Rhode Island, South Dakota, Texas, Utah, Wisconsin and Wyoming. ADVISORY TAX REPORT 107-08.

85. Alyea, *supra* note 74, at 142. For a comprehensive analysis of state and local tax policies designed as inducements to industry, see ADVISORY TAX REPORT 43.

86. Bridges, *supra* note 40, at 9. Reasonably sufficient information is available for Alabama, which has \$77.8 million in assessed industrial exemptions resulting in an annual revenue loss of from \$0.5 to \$1.0 million. ADVISORY TAX REPORT 47.

87. Compare R.I. GEN. LAWS §§ 42-34-2 to -10 (Supp. 1967), with MISS. CODE ANN. § 8939-01 (Supp. 1967).

of similar plans. Alabama, for example, allows local development corporations wide discretion in determining their participation in industrial development projects, although 100 per cent financing is involved.⁸⁸

The size of the industry attracted to a region is influenced by the type of financing plan employed by the area. Generally, the larger industrial projects are apt to be financed by the municipal industrial development bond method.⁸⁹ This type of financing is particularly adapted to raising the large sums of money necessary to construct major plant facilities. Consequently, blue chip companies with national operations are more likely to use such financing. On the other hand, the small-to-medium sized firm is better suited to the Pennsylvania or New England plan, since, although the capacity of these plans to make funds available on a large scale is somewhat limited, the mechanisms involved are less cumbersome than the bond methods. Some states have enacted more than one of the basic industrial development programs in an effort to attract a wider range of industrial enterprises or to make their areas more competitive by providing a choice in methods of plant financing.⁹⁰

Perhaps the most flexible method of providing financial assistance to industry is the use of tax concessions and exemptions. Often municipalities are vested with discretionary control over the granting of tax exemptions.⁹¹ However, there are two reasons why exemptions may not be as effective in stimulating economic growth as the more direct forms of financial assistance. First, tax provisions granting exemptions are premised on the ability of industry to provide its own capital for new facilities; second, the economic benefits of tax exemptions are of relatively short duration.⁹² When the exemption takes the form of an exemption from property taxation, the amount of financial assistance received by the industry is directly related to the value of the property held by the industry rather than to its actual need. Thus, it is more difficult to determine extent of economic benefit and its relation to regional development when exemption plans are used.⁹³

88. ALA. CODE tit. 37, § 823 (Supp. 1967).

89. *E.g.*, Mississippi made a \$130 million bond issue to construct facilities to be leased to Ingalls Shipbuilding Corporation. *The Wall Street Journal*, Nov. 15, 1967, at 21, col. 1.

90. *See, e.g.*, RHODE ISLAND INDUSTRIAL BUILDING AUTHORITY, *supra* note 62, at 19, where it is stated that Rhode Island's adoption of revenue bond financing in addition to its first mortgage insurance plan was designed to serve a two-fold purpose: (1) to provide a choice in the methods of plant financing, and (2) "to accommodate the blue chip customer who wished to build a multi-million dollar facility on the best possible terms." The first mortgage insurance plan had been particularly effective with small-to-medium sized industrial facilities.

91. *E.g.*, VT. STAT. ANN. tit. 32, § 3834 (1959).

92. Generally, exemptions run from 2-10 years. *See* Alyea, *supra* note 74, at 142; ADVISORY TAX REPORT 109-10.

93. Stimson, *supra* note 75, at 423-24.

D. Legal Challenges to Industrial Development Financing

1. *Historical Background.*—Legal challenges to industrial development financing were based upon the constitutional limitations formulated during the nineteenth century era of rapid industrial expansion. Generally those limitations assumed two basic forms: prohibitions against the lending of credit by state governmental units to private individuals or associations, and prohibitions against the holding of stock in private corporations by such governmental units.⁹⁴ Thus,

the nineteenth-century experience which gave rise to the public aid limitations demonstrates that if public funds are to be risked, the risk must flow from public rather than private decision. Adequate protection of the public financial interest necessitates public control consonant with public financial risk.⁹⁵

A judicial doctrine analogous to, but distinct from, the early constitutional limitations emerged in the nineteenth century and further restrained governmental activity in the private financial sector. Under this doctrine it was contended that taxes levied by state governmental units must be used for public purposes.⁹⁶ This "public purpose" doctrine was first stated, by way of dictum, in *Sharpless v. Mayor of Philadelphia*⁹⁷ and was applied by the Supreme Court to the use of municipal bonds in the landmark case of *Loan Association v. Topeka*.⁹⁸ In the *Loan Association* case, the city donated 100 thousand dollars of its municipal bonds to a private industrial corporation to encourage the establishment of a manufacturing plant in Topeka. Since it would have been necessary to levy taxes to pay the interest on the bonds, the Court was faced squarely with a public purpose problem. Although no state or federal constitutional provisions expressly prohibited the bond donation in question, a majority⁹⁹ of the Court viewed the public purpose criterion as an inherent limitation on the power to tax.¹⁰⁰ The Court recognized

94. Pinsky, *supra* note 57, at 278. See, e.g., MISS. CONST. art. 14, § 258, "The credit of the state shall not be pledged or loaned in aid of any person, association, or corporation; and the state shall not become a stockholder in any corporation or association . . ." See also PA. CONST. art. 9, §§ 6, 7. Section 6.—"The credit of the Commonwealth shall not be pledged or loaned to any individual, company, corporation or association, nor shall the Commonwealth become a joint owner or stockholder in any company, association or corporation." Section 7.—"The General Assembly shall not authorize any county, city, borough, township or incorporated district to become a stockholder in any company, association or corporation, or to obtain or appropriate money for or to loan its credit to, any corporation, association, institution or individual."

95. Pinsky, *supra* note 57, at 281.

96. *Id.*

97. 21 Pa. 147 (1853).

98. 87 U.S. (20 Wall.) 655 (1874).

99. Clifford, J., dissented on the grounds that no state or federal constitutional limitations restricted the activity under consideration. 87 U.S. at 667.

100. The majority reasoned that since a lawful taxing power is, by nature, unlimited in scope,

that a definition of public purpose would be difficult to formulate, but it was suggested that “the objects for which taxes have been customarily and by long course of legislation levied [and] what objects or purposes have been considered necessary to the support and for the proper use of the government” would be highly persuasive.¹⁰¹

While the *Loan Association* case signalled the adoption of the public purpose doctrine by the Supreme Court, the decision was not based on the due process clause of the fourteenth amendment.¹⁰² Incorporation of the public purpose doctrine into fourteenth amendment substantive due process was not manifested until the later case of *Fallbrook Irrigation District v. Bradley*,¹⁰³ where special annual assessments were levied on property located within irrigation districts formed pursuant to a California statute. The issue there was stated in terms of the fourteenth amendment:

In the Fourteenth Amendment the provision regarding the taking of private property is omitted, and the prohibition against the State is confined to its depriving any person of life, liberty or property, without due process of law. It is claimed, however, that the citizen is deprived of his property without due process of law, if it be taken by or under state authority for any other than a public use, either under the guise of taxation or by the assumption of the right of eminent domain. In that way the question whether private property has been taken for any other than a public use becomes material in this court, even where the taking is under the authority of the State instead of the Federal government.¹⁰⁴

In applying the public purpose criterion to the state enactment, the Court upheld the statute on the ground that the public would be benefited by the addition of productive sectors to the state.¹⁰⁵ Considerable weight was given by the Court to findings of public purpose by the California courts,¹⁰⁶ suggesting a trend toward allowing the states to make their own determinations of public purpose. This trend became apparent with

an unrestricted application of the taxing power for purposes not public in character would result in unlimited government power. The federal system of government being one of limited powers suggests inherent limitations in the area of taxation. “To lay with one hand the power of the government on the property of the citizen, and with the other to bestow it upon favored individuals to aid private enterprises and build up private fortunes, is none the less a robbery because it is done under the forms of law and is called taxation. This is not legislation. It is a decree under legislative forms.” 87 U.S. at 663-64.

101. 87 U.S. at 665.

102. McAllister points out that the opinion of Miller, J., in *Loan Association* did not mention due process at all. McAllister, *Public Purpose in Taxation*, 18 CALIF. L. REV. 137, 147 (1930).

103. 164 U.S. 112 (1896).

104. 164 U.S. at 158.

105. 164 U.S. at 161.

106. 164 U.S. at 160.

the decisions in *Jones v. City of Portland*¹⁰⁷ and *Green v. Frazer*.¹⁰⁸ In both cases the Court, while recognizing that the public purpose criterion was a fourteenth amendment due process requirement, acknowledged the right of the states to make their own public purpose determinations and indicated that such determinations were entitled to the highest respect.¹⁰⁹ These decisions suggest that state legislative and judicial determinations of public purpose will be upheld if reasonably related to some public benefit. As a result, the public purpose requirements of the fourteenth amendment provide only broad overall limitations on state taxing and spending power.

The public purpose doctrine has found widespread judicial approval at the state level,¹¹⁰ and in some states it has been translated into express constitutional provisions.¹¹¹ In such states, the public purpose criterion is likely to provide more specific limitations than the broad requirements of due process as interpreted by the Supreme Court. The nature of the public purpose test, however, is neither uniform nor clear. Some states take a restrictive view of public purpose and require the primary benefit of the public expenditures to accrue to the public,¹¹² while other more liberal jurisdictions require no more than an incidental public benefit.¹¹³

107. 245 U.S. 217 (1917) (challenge to enabling act authorizing a municipality to establish a fuel yard for the purpose of selling fuel at cost to residents).

108. 253 U.S. 233 (1920) (bond issues authorized to finance business activities of a state industrial commission).

109. The *Jones* decision recognized that the superior quality of information available to state legislatures enables them to make informed decisions on public purpose. 245 U.S. at 221. The *Green* decision, on the other hand, based its decision upholding the state action on presumptive validity, stating: "When the constituted authority of the State undertakes to exert the taxing power, and the question of the validity of its action is brought before this court, every presumption in its favor is indulged, and only clear and demonstrated usurpation of power will authorize judicial interference with legislative action." 253 U.S. at 239. See generally, *Abbey, Municipal Industrial Development Bonds*, 19 VAND. L. REV. 25, 34 (1965).

110. E.g., *Newberry v. City of Andalusia*, 257 Ala. 49, 57 So. 2d 629 (1952) (promotion of public welfare is a public purpose); *People ex rel. Bay City v. State Treasurer*, 23 Mich. 499 (1871) (railroads not a public purpose).

111. E.g., KY. CONST. § 171, providing that "taxes shall be levied and collected for public purposes only . . ." See also S.C. CONST. art. 8, § 3, providing that "the General Assembly shall restrict the powers of cities and towns to levy taxes and assessments, to borrow money and to contract debts, and no tax or assessment shall be levied or debt contracted except in pursuance of law, for public purposes specified by law."

112. E.g., *Wayland v. Snapp*, 232 Ark. 57, 334 S.W.2d 633 (1960) (main benefits must accrue to the public); *State v. Town of North Miami*, 59 So. 2d 779 (Fla. 1952) (every new business benefits the public to some extent, but is not conclusive of public purpose). Cf. *Polanski v. Town of Eagle Point*, 30 Wis. 2d 507, 141 N.W.2d 281 (1966) (public purpose is a matter of law, not fact).

113. E.g., *City of Gaylord v. Beckett*, 378 Mich. 273, 144 N.W.2d 460 (1966) (promotion of general public welfare); *Dyche v. City of London*, 288 S.W.2d 648 (Ky. 1956) (existing economic conditions determine public purpose); *Village of Deming v. Hosdreg Co.*, 62 N.M. 18, 303 P.2d 920 (1956) (significant balance of public advantages over disadvantages).

Consequently, while the public purpose test has the advantage of providing an overall limitation on the taxing and spending power of governmental units, the scope of this limitation varies with different jurisdictions and the economic conditions existing therein. In the area of industrial development financing the public purpose test has been used in conjunction with constitutional restrictions to test the validity of financing plans.¹¹⁴ Where the constitutional credit limitations do not apply, as for example, to loans financed from current revenues,¹¹⁵ the public purpose test provides the only touchstone of validity.

2. *The Albritton Case.*—In the legal challenge to the BAWI program in *Albritton v. City of Winona*,¹¹⁶ the Mississippi Supreme Court was faced squarely with the issue of determining state constitutional credit limitations.¹¹⁷ Although it had been generally presumed by writers and commentators that the public purpose doctrine would be violated per se by direct financial assistance, the lending of a state's credit to private industrial corporations,¹¹⁸ the court upheld the constitutionality of the BAWI plan while purporting to recognize the public purpose doctrine. To do so the court first had to satisfy the credit clause limitation. This was accomplished by noting that the BAWI drafters had authorized municipalities not only to own and lease industrial facilities, but also to operate them.¹¹⁹ The court reasoned that if a municipality could constitutionally operate industrial enterprises, it could contract with private interests to undertake the operations without violating the credit limitations. The court then applied a broad public purpose test to determine if municipal operation of industrial facilities would be in the public interest. By analogizing the BAWI plan to state ownership of convict farms, the court concluded that municipal ownership and operation of industrial facilities could be a reasonable

114. Generally, financing plans are first tested by state constitutional limitations. If the plans comport with these provisions, the public purpose test is applied. Where the plan fails to pass the constitutional test, the public purpose question may never be reached. *See* *Development Credit Corp. of Md. v. McKean*, 248 Md. 572, 237 A.2d 742 (Ct. App. Md. Feb. 6, 1968) (since act clearly violated constitutional credit prohibitions, there was no need to make a public purpose determination). *Cf.* *Button v. Day*, 208 Va. 494, 158 S.E.2d 735 (Sup. Ct. App. Va. Jan. 15, 1968) (even if there is a public purpose, everything done to further it is not necessarily a proper governmental function).

115. Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach*, 111 U. PA. L. REV. 265, 279 n.76 (1963).

116. 181 Miss. 75, 178 So. 799 (1938).

117. Miss. CONST. art. 14, § 258. *See* note 94 *supra*.

118. *E.g.*, 15 McQUILLIN, MUNICIPAL CORPORATIONS §§ 43.29-.30, at 516-20 (3d ed. 1950).

119. *Albritton v. City of Winona*, 181 Miss. 75, 98, 178 So. 799, 804 (1938). *See also* Pinsky, *supra* note 115, at 294.

means of accomplishing legitimate public objectives.¹²⁰ Given the depressed economic conditions existing in Mississippi at the time, the court determined that the public interest required the government to provide for the general welfare by any means that the legislature deemed prudent, the only limitation being "that the means chosen must not be so far beyond the necessity of the case as to be an arbitrary exercise of governmental power."¹²¹ Thus, the court had little difficulty with the public purpose doctrine, since the BAWI act was carefully drafted to incorporate such valid public purposes as the relief of unemployment and the development of regional resources.¹²² In holding that public *purpose* did not mean public *necessity*, the court quoted from an earlier Michigan case:

Necessity alone is not the test by which the limits of State authority in this direction are to be defined, but a wise statesmanship must look beyond the expenditures which are absolutely needful to the continued existence of organized government, and embrace others which may tend to make that government subserve the general well-being of society, and advance the present and prospective happiness and prosperity of the people.¹²³

3. *Subsequent Developments.*—The BAWI legislation and the *Albritton* case established general patterns which were followed in subsequent industrial development legislation. One such pattern evident in most programs is the interposition of legalistic devices to avoid the application of constitutional limitations. In *Albritton*, the court relied heavily on BAWI's authorization of municipal operation of industrial facilities in finding that the plan conformed to the constitutional credit limitation,¹²⁴ even though it was never anticipated that municipalities would actually engage directly in manufacturing operations. The utilization of local development corporations in the Pennsylvania,¹²⁵ New England, and Oklahoma plans is an example of the interposition of a legal device which insulates public agencies from direct lending to private interests. Another development from BAWI is an expansion of the public purpose doctrine to accommodate economic stimulation. The *Albritton* interpretation of the public purpose doctrine was necessarily broad, allowing the legislature to find a public purpose whenever

120. *Albritton v. City of Winona*, 181 Miss. 75, 98, 178 So. 799, 804 (1938).

121. *Id.* at 99, 178 So. at 805.

122. *Id.* at 97, 178 So. at 804.

123. *Id.* at 99, 178 So. at 804, quoting Cooley, J., in *People v. Township Bd. of Salem*, 20 Mich. 452, 4 Am. Rep. 400 (1870).

124. *Albritton v. City of Winona*, 181 Miss. 75, 98-99, 178 So. 799, 804 (1938).

125. The Pennsylvania plan is financed out of current revenues and, thus, does not come within the credit limitations. PA. STAT. ANN. tit. 73, § 308 (1960). See also Pinsky, *supra* note 115 at 301.

economic or social conditions suggested a need for change.¹²⁶ Other courts have adopted this approach on the theory that when the net public benefit gained through private use of public credit promotes the general welfare, a public purpose is promoted.¹²⁷ Courts deferring to legislative wisdom concerning the definition of public purpose examine industrial development financing plans only to determine if the means employed will reasonably accomplish the stated purposes.¹²⁸ Where courts have thus expanded the public purpose criterion, few, if any, effective restrictions remain on industrial development financing plans that do not come directly under the ambit of constitutional credit limitations.¹²⁹

From the foregoing discussion it is apparent that those courts purporting to adhere to the public purpose doctrine must find some public justification for industrial development programs. Generally such courts have based their decisions on the premise that financial assistance to industry promotes the economic welfare of the community.¹³⁰ Some of these courts have failed to inquire whether the plans were intended to promote the basic industries or the service industries which might have some effect on a public purpose determination.¹³¹ Moreover, these courts have not recognized generally the non-economic effects of economic stimulation through industrial promotion.¹³² A more pragmatic approach is taken by those courts which leave the question of public

126. *Albritton v. City of Winona*, 181 Miss. 75, 99-100, 178 So. 799, 804-05 (1938).

127. *E.g.*, *Wayland v. Snapp*, 232 Ark. 57, 334 S.W.2d 633 (1960) (the main benefits accrue to the public, although industry is incidentally benefited).

128. *E.g.*, *Holly v. City of Elizabethton*, 193 Tenn. 46, 241 S.W.2d 1001 (1951). The court there held that the statute in question must clearly contravene constitutional provisions before it would be declared invalid. The court also found "incidental public benefit" from the promotion of industry.

129. Revenue bonds, for example, are self-liquidating, have no claim on tax or general revenues, and are not subject to debt limitations. Some courts have held that they do not constitute a lending of the public credit, *E.g.*, *Green v. City of Mt. Pleasant*, 256 Iowa 1184, 131 N.W.2d 5 (1964) (a debt of the state must be created before constitutional provisions are contravened); *Village of Deming v. Hosdreg Co.*, 62 N.M. 18, 303 P.2d 920 (1956) (no municipal debt created by issuance of revenue bonds, hence no charge upon municipal credit is incurred).

130. *E.g.*, *Dyche v. City of London*, 288 S.W.2d 648 (Ky. 1956) (relief of unemployment); *Newberry v. City of Andalusia*, 257 Ala. 49, 57 So. 2d 629 (1952) (providing a local sales outlet for local products); *Albritton v. City of Winona*, 181 Miss. 75, 178 So. 799 (1938) (relief of unemployment). *Cf.* *Polansky v. Town of Eagle Point*, 30 Wis. 2d 507, 141 N.W.2d 281 (1966) (public purpose is a matter of law, not fact). *Contra*, *State v. Town of North Miami*, 59 So. 2d 779 (Fla. 1952) (merits of plan not relevant).

131. *E.g.*, *Miller v. Police Jury*, 226 La. 8, 74 So. 2d 394 (1954) (milk processing); *Newberry v. City of Andalusia*, 257 Ala. 49, 57 So. 2d 629 (1952) (pine stump processing to cultivate local markets).

132. The court in *Village of Deming v. Hosdreg Co.*, 62 N.M. 18, 303 P.2d 920 (1956), seemed to consider other than economic factors in applying a net gain test where advantages must significantly outweigh disadvantages.

purpose to the legislative drafters of industrial financing plans, upholding them where the mechanisms devised reasonably relate to the purposes and objectives stated therein.¹³³ One commentator has observed that:

the only valid criterion would seem to be whether the expenditures are sufficiently beneficial to the community as a whole to justify governmental involvement; but such a judgment is more appropriate for legislative than judicial action. The judiciary should invalidate expenditures only where reasonable men could not differ as to their lack of social utility.¹³⁴

III. FINANCING PLANS AND THE MODERN INDUSTRIAL STATE

A. Regional Considerations

The net effect on a community or a region of economic stimulation through the promotion of industrial development is difficult to determine, since long-range interrelated economic, political, and social effects are involved.¹³⁵ Predictions concerning these effects will likely influence the type of financing plans adopted by state legislatures and the kind of industries selected for participation in industrial development programs. It seems mandatory, then, that certain economic, political, and social factors be carefully considered before any community or region undertakes to accomplish economic stimulation through comprehensive industrial development programs.

Since a net benefit to the community is the primary goal of industrial development financing, the initial inquiry should be "whether the proposed project will augment the community's total value position."¹³⁶ Thus, at this stage a minimum inquiry would include the economic needs of the community and its regional employment multiplier,¹³⁷ the likelihood of the success of the proposed project, the probable effects on presently existing local industries, local labor conditions, and the impact on the existing facilities of the community.¹³⁸

133. See note 128 *supra*.

134. Note, *Incentives to Industrial Relocation: The Municipal Industrial Bond Plans*, 66 HARV. L. REV. 898, 903 (1953).

135. The values of the community and its long-range goals may be influenced by the types of workers employed by the industry and immigrating to the community. The receptiveness of the community to the particular types of basic industry should be evaluated to avoid potential psychological tensions. See Cumberland & Van Beek, *supra* note 28, at 261. See also E. WIHTMAN & W. SCHMIDT, *PLANT RELOCATION: A CASE HISTORY OF A MOVE* 47 (1966).

136. Note, *The "Public Purpose" of Municipal Financing for Industrial Development*, 70 YALE L.J. 789, 796 (1961).

137. The regional employment multiplier would suggest the number of basic industry workers required to raise total employment to the desired level. See note 26, *supra*.

138. Note, *supra* note 136, at 796.

Additionally, the incoming industry should be carefully selected on the basis of comprehensive criteria. Factors to be considered are the nature of the industry's products,¹³⁹ the technical sophistication of the industry,¹⁴⁰ financial stability, employee wage rate levels,¹⁴¹ potential utilization of local raw materials and products, corporate structure,¹⁴² and the potential ability of the industry to exert political and economic pressure on the community.¹⁴³

B. Industrial Considerations

From the standpoint of industries considering the use of industrial development financing, the business investment decisions involved require exhaustive studies to determine the interrelation and relative importance of many factors. The availability of governmental financial inducements is only one factor, albeit an important one, which must be considered before a final decision is reached on the location of new or expanded industrial operations.

Generally speaking, industrial location decisions are influenced by the variable cost elements in the price of the industrial product. Regional factors which reduce certain variable cost elements are likely to carry considerable weight when the relative advantages of one region over another are evaluated. Basically the industrial manufacturing process can be considered as involving four stages, each of which has a direct relation to the cost elements: (1) obtaining the plant site, the plant, and the machinery necessary for production; (2) obtaining raw materials, electric power, and fuel; (3) selecting a labor force and establishing the

139. The products produced by the industry would determine their marketability outside of the region.

140. A process of inductive retardation could occur where rapid technological changes are occurring in some industries but not in others. The technologically stagnant industries can check the growth of those achieving technological sophistication, thus retarding the overall economic growth. A. GOURVITCH, *A SURVEY OF ECONOMIC THEORY ON TECHNOLOGICAL CHANGE & EMPLOYMENT* 231 (1966). *See generally*, J.K. GALBRAITH, *THE NEW INDUSTRIAL STATE* 11-21 (1967).

141. Psychological tensions could increase if there is a substantial difference between the average wage rate of the industry's employees and the median income of the community. *See* Cumberland & Van Beek, *supra* note 28, at 261.

142. The industry may attempt to "insulate" itself from breach of contract or lease liability by incorporating the new facility separate from other holdings." Note, *supra* note 136, at 801.

143. *Id.* Once a community has grown up around a particular basic industry, the economy of the community may become largely dependent upon the industry. Such dependence makes the community subject to pressure through industry threats to pull out or reduce operations. If the industry has other plants capable of absorbing the capacity of the local plant, the industry may be tempted to use its superior position to control community affairs, especially those affairs relating to the industry.

manufacturing process; and (4) shipping the finished products to markets.¹⁴⁴ Each of these stages of production has cost elements which may be fixed or variable with respect to the regional location of the plant. Absent any governmental financial inducements, variable cost elements occur in stages (2), (3), and (4), while the cost elements in stage (1) are relatively constant regardless of geographic location.¹⁴⁵ Consequently, in a model situation where there are no governmental financial inducements and social factors are not considered, the primary factors influencing industrial location are: (1) the availability of desired raw materials, electric power, fuel and water; (2) the potential labor force; and (3) the accessibility to markets through convenient transportation facilities.¹⁴⁶ When financial inducements in the form of industrial development financing plans are made available, the cost elements associated with obtaining plant facilities become variable in direct relation to the type of inducements offered. Thus, a fourth variable is introduced into the decisional process.

In addition to evaluating the economic importance of the plant cost variable in light of possible financial inducements, industries should undertake exhaustive studies of the basic purposes underlying the inducements, since industrial development financing may be the result of an effort to compensate for serious regional environmental shortcomings.¹⁴⁷ Such deficiencies may be of minor importance to a particular industrial enterprise, but their existence should be known and their effects investigated. If a regional area seeks to develop its potential through industrial development financing, it may be advantageous for industry to participate; on the other hand, if the region is attempting to offset serious permanent deficiencies by such financing, it may be prudent for a particular industry to seek capital through other means or in other areas.

The variable elements of cost in the price of an industrial product will likely determine the tentative selection of a region as an area of

144. "In each of these steps a certain expenditure of natural resources and labor is invested. Each of these expenditures precipitates itself into the price which is secured for the product on the market." ALFRED WEBER'S THEORY OF THE LOCATION OF INDUSTRIES 25 (C. Friedrich ed. 1929).

145. *Id.* at 30-34.

146. Note, *Legal Limitations on Public Inducements to Industrial Location*, 59 COLUM. L. REV. 618 (1959). Cost elements included in these factors are: utility costs, wage rates, unemployment insurance costs, and transportation rates. See E. WHITMAN & W. SCHMIDT, *supra* note 135, at 41. See generally J. THOMPSON, *METHODS OF PLANT SITE SELECTION AVAILABLE TO SMALL MANUFACTURING FIRMS*, RESEARCH REPORT TO THE SMALL BUSINESS ADMINISTRATION (1961).

147. Prior to the widespread use of industrial development financing, the mere fact that a community offered this inducement suggested that such shortcomings existed. See Note, *supra* note 146, at 619.

potential location. Once this tentative selection has been made, however, other factors are often considered in an effort to obtain a better understanding of communities within the area and their industrial potentials. Inquiries are often made to determine the availability of social overhead capital¹⁴⁸ and the attitudes of communities toward industrialization.¹⁴⁹ Communities utilizing industrial development financing plans in which a significant degree of discretion is vested in the community planners can be expected to be receptive to industrial location. Such communities, however, may have a scarcity of skilled labor and inadequate social overhead capital with little potential for developing either.¹⁵⁰

C. Problem Areas

In addition to the economic and social considerations faced by both the regions utilizing industrial development financing and potential participating industries, there are a number of legal, financial, and governmental problems which go beyond the public purpose and public credit limitations discussed earlier. These problems are most apparent with respect to the bond programs, but they also exist with the related types of financing.

1. *Legal Problems.*—Perhaps the chief legal problems arising with industrial development bond financing are those created in the event of a default on a particular bond issue. Although a bond issue is likely to be secured by a mortgage on the industrial property,¹⁵¹ it may be possible for bondholders to hold the issuing municipality liable for any deficiencies over the proceeds realized from the mortgage. Since general obligation bonds are backed by the full faith and credit of the issuer, the bondholders hold debt obligations of the municipality, and tax or other

148. Social overhead capital includes transportation, educational, recreational, and other municipal facilities. See W. ROSTOW, *THE STAGES OF ECONOMIC GROWTH* 19 (1960).

149. The attitude of the local citizens has an important bearing on the assimilation of the industry into the area. An industry contemplating a move will likely inquire as to the desire of employable persons to work in the plant, the status of labor and race relations, the feelings of older residents toward industrialization, the effect of new industry on existing wage rates, and the availability of skilled labor. E. WHITMAN & W. SCHMIDT, *supra* note 135, at 47-48. See generally U.S. NEWS & WORLD REPORT, Oct. 26, 1956, at 109.

150. Even with economic stimulation, very small communities are not likely to develop adequate social overhead capital. For example, the town of Lewisport, Kentucky, (population - 600) undertook a \$50 million industrial development project financed by revenue bonds. The facilities were to be leased to a major aluminum company which expected to produce approximately 60,000 tons of finished aluminum yearly from the plant. Such an operation would likely entail the utilization of social overhead capital and skilled labor beyond the capacity of such a small community to produce. See BUSINESS WEEK, Dec. 14, 1963, at 45-49.

151. E.g., ALA. CODE tit. 37, § 824 (1940); MISS. CODE ANN. § 8936-960 (Supp. 1966).

general revenues can be reached to discharge these obligations.¹⁵² Revenue bonds, on the other hand, are not charged against the general credit of the community and, in theory, the bondholders are restricted by the bond contract to claims against the revenues obtained from the lease between the industrial concern and the municipality.¹⁵³ The municipality could, however, become directly liable to revenue bond holders under the theories of: (1) misrepresentation, (2) negligence in issuance, (3) breach of implied covenant, warranty or good faith, or (4) breach of trust.¹⁵⁴ Since these theories imply a gross misuse of the power to issue revenue bonds, a strong case against the municipality would be necessary before recovery would be allowed. Nevertheless, such theories are available, and bondholder plaintiffs, with the benefit of hindsight, may be able to persuade some courts to assess liability against the municipality in accordance with one or more of these theories.¹⁵⁵

A problem which exists for all of the plans where either the municipality or a local development corporation is required to hold legal title to the industrial property is the securing of a suitable industrial site. The availability of such sites is not likely to pose a significant problem in most small communities where underdeveloped areas are located in quantity nearby. However, if the owner of a particularly desirable industrial site refuses to sell or the legal title is fractionalized among multiple owners, it may be necessary or desirable to employ eminent domain to acquire the site.¹⁵⁶ The extent to which eminent domain may be used depends, in part, on the "public use" requirement. There are two views as to the requirements constituting "public use." The restrictive view characterizes "use" as utilization or control, which has been interpreted to mean that the public must "actually have some right to use

152. Armstrong, "Municipal Inducements"—*The New Mexico Commercial and Industrial Project Revenue Bond Act*, 48 CALIF. L. REV. 58, 62 n.19 (1960). It might not be necessary to reach the tax and general revenues of the municipality, since, in case of default, the municipality would have a cause of action against the breaching company and the damages assessed could be sufficient to discharge the bonds. If the company were insolvent, however, the municipal revenues would be reached.

153. *Id.*

154. *Id.* See also Fordham, *Revenue Bond Sanctions*, 42 COLUM. L. REV. 395 (1942); Note, *supra* note 136, at 793.

155. Armstrong, *supra* note 152, at 62. Due to the increasing use of municipal industrial bond financing by established, blue chip corporations, defaults have become infrequent. As of 1963, no issue involving a major corporation has defaulted, either as to principal or interest. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, INDUSTRIAL DEVELOPMENT BOND FINANCING, Report A-18, at 51 (June 1963); BUSINESS WEEK, Dec. 14, 1963, at 46. However, it may be too early to say with assurance that major corporations will not default, since most industrial development bond plans are less than ten years old.

156. Note, *supra* note 146, at 640.

and enjoy the appropriated property, to command the services of the occupiers, or to have a voice in the control and management of the property."¹⁵⁷ Clearly, under this view use of eminent domain to acquire industrial sites is not authorized. A more liberal view interprets public use as requiring only a public benefit.¹⁵⁸ Under this view, eminent domain would seem to be available for the acquisition of industrial sites on the theory of public benefit through economic stimulation. However, eminent domain under this view has been used sparingly—only where there has been a special benefit associated with the condemnation.¹⁵⁹ Some states have avoided potential problems in this area either by expressly authorizing or prohibiting the use of eminent domain in the industrial development legislation.¹⁶⁰

2. *Tax Problems.*—State and local tax problems center around the potential erosion of local tax bases caused either by the absorption of industrial property into public ownership or the granting of tax exemptions to normally taxable sectors.¹⁶¹ It is at least arguable that economic stimulation occasioned by industrial utilization of tax exempt facilities more than offsets the loss of tax revenue as a consequence of increased tax collections from improved property in the service industry sector. Such effects are subject to speculation, however, and consequently require careful evaluation by the economic planners of the community. Tax and fiscal discrepancies may arise among various regions within a state if the tax exemptions granted by one region have significant effects in another. Thus, when a community contemplates public ownership of industrial facilities or the offering of property tax inducements, an effort should be made to insure that most of the benefits are secured by that region.¹⁶²

157. *Id.* at 641. Under this view, use by the entire public is not essential. A common use is required, however, if the locality is restricted. *Sublett v. City of Tulsa*, 405 P.2d 185 (Okla. 1965) (eminent domain sought for an integrated port development and industrial park program). *See also* I J. LEWIS, *EMINENT DOMAIN* § 258 (3d ed. 1909).

158. Note, *supra* note 146, at 641.

159. Such projects would include land reclamation, development of natural resources, and slum clearance. *See id.* at 641-42; N.Y. Times, Jan. 7, 1959, at 1, col. 7.

160. Since eminent domain is a sovereign right, it may be exercised only by authority of the state. I NICHOLS, *EMINENT DOMAIN* §§ 1.14, 3.22 (3d ed. 1950). Some states authorize the use of eminent domain to acquire industrial sites. *E.g.*, KY. REV. STAT. § 58.140 (Baldwin 1963); MISS CODE ANN. § 8936-09 (Supp. 1966). Others restrict such acquisitions to purchase, lease and gift. *E.g.*, ALA. CODE tit. 37, § 511(22) (Supp. 1967); ILL. ANN. STAT. ch. 24, § 11-74-4 (Smith-Hurd 1962).

161. *See Westmeyer, Industrial Bond Controversy Boils*, NATIONAL CIVIC REVIEW, June 1964, at 329-30.

162. Walker, *Fiscal Considerations Involved in Patterns of Industrial Development*, 31 TAX POLICY 3, 4-6 (March 1964).

Of primary concern to the federal government is the misuse of the federal tax exemption under section 103 of the Internal Revenue Code through issuance of municipal industrial development bonds. Since section 103 exempts interest earned on the obligations of a state or its subdivisions, a typical abuse of this feature would involve the purchase of a substantial portion of the bond issue by the company invited to lease the industrial facilities. Under this scheme the company would enjoy a double tax advantage, since it would be receiving tax exempt income in the form of interest on its municipal bond holdings while taking expense deductions for rentals paid to the municipality for the purpose of amortizing the bond issue. Section 162(a)(3) of the Code curbs this possible abuse to the extent that expense deductions for rentals are not allowed if the company takes title to or acquires an equity in the premises.¹⁶³

In addition to potential misuse of the federal tax exemption, a further problem arises because, in effect, federal funds are being used, through the tax exemption, to finance industrial development, while the control of these funds rests entirely with the respective local governments.¹⁶⁴ Moreover, the diversion of normally taxable funds into tax-exempt municipal bonds used to finance private industry causes an erosion of the federal tax base directly proportional to the dollar volume of bonds issued.¹⁶⁵

An interesting inconsistency becomes apparent when revenue bonds are used for industrial development. To come within the tax immunity provisions of section 103, it must be shown that the bonds are the obligations of a state or its subdivisions. Yet, to escape state statutory debt limitations such bonds are not viewed as obligations of these governmental units.¹⁶⁶ Thus, for federal tax purposes industrial

163. *But see* *Gem, Inc. v. United States*, 192 F. Supp. 841 (N.D. Miss. 1961), where the rental deduction was allowed even though the lease provided for successive renewals at nominal rentals. This suggests a method of avoiding the full effect of § 162(a)(3).

164. Note, *Local Industrial Development Bond Financing*, 7 B.C. IND. & COM. L. REV. 696, 700 (1965-66).

165. *Id.* Although it may appear that increased economic activity induced by the industry would cause a broadening of the federal tax base which would more than offset the tax base erosion due to the issuance of tax exempt bonds, this would be true only where an industry is induced to establish new or expanded operations which would be postponed if bond financing were not available. Otherwise, where industry is merely relocating, a net federal tax base erosion is likely, since the economic stimulation in the new area would be compensated by an economic decline in the old area of operations.

166. See Ratchford, *Revenue Bonds and Tax Immunity*, 7 NAT'L TAX J. 40, 42 (1954). Furthermore, as Ratchford suggests, "the primary purpose of tax immunity is to protect the existence and the essential functions of states. . . . [I]f a given function is not sufficiently important to justify a state in assuming financial responsibility for it, the state is in a weak position to ask the

development revenue bonds are viewed as debt obligations while for state purposes they are not. As a result, revenue bonds are more vulnerable to attack in the area of federal tax reform, the main thrust of which has been toward removing or curtailing the tax exemption.¹⁶⁷

3. *Economic and Financial Problems.*—Whenever economic stimulation is attempted through public industrial development inducements, economic and financial problems can be anticipated. One of the main financial problems is created by competitive advantage held by industries participating in public financing programs over industries which do not utilize or cannot obtain such financing.¹⁶⁸ By not having to use their own capital or credit to modernize, relocate, or expand their operations, participating industries enjoy an advantage over competitors and can obtain the benefit of capital at a lower cost than industries issuing their own securities.¹⁶⁹ The increased use of industrial development financing by major corporations financially able to obtain their own capital¹⁷⁰ indicates that such advantages are of more than incidental interest to industry.

Overextension of credit is a major problem faced by relatively small communities which undertake large industrial projects. The problem is most acute where the industrial development bond method of financing is employed. When general obligation bonds are involved, default of the bond issue could seriously impair the financial stability of the municipality. Even when revenue bonds are utilized the credit of the community would be adversely affected by any defaulting issues, since any future attempts to borrow funds for other purposes would be viewed

federal government to subsidize that function by exempting from taxation the interest on the bonds issued to finance it." *Id.* at 43.

167. Treasury Secretary Fowler has indicated his disapproval of the tax exempt feature of industrial development bonds. *The Wall Street Journal*, June 17, 1966, at 22, col. 3. Bills have been introduced in Congress to this effect, but without much success. *E.g.*, H.R. 517, 88th Cong., 1st Sess. (1963); H.R. 11645, 90th Cong., 1st Sess. (1967). The Treasury Department has indicated that it would support such measures in the second session of the 90th Congress, *The Wall Street Journal*, Jan. 25, 1968, at 18, col. 3, and a bill rider which would remove the tax exemption from industrial development bonds effective January 1, 1969, has passed the Senate during this session. *The Wall Street Journal*, March 29, 1968, at 14, col. 1. The bill, as H.R. 18529, 90th Cong. 2d Sess. (1968), is presently in the House Ways and Means Committee.

168. *See* CHEMICAL WEEK, Aug. 17, 1963, at 88.

169. *See id.*

170. The largest issue ever sold for a single industry is Mississippi's \$130 million industrial development bond issue for the construction of shipbuilding facilities at Pascagoula, Mississippi. The facilities are to be leased to Ingalls Shipbuilding Corporation, a subsidiary of Litton Industries. *The Wall Street Journal*, Nov. 15, 1967, at 21, col. 1. Other recent large issues include an \$82.5 million issue by Middletown, Ohio, to finance the building of a mill for Armco Steel Corporation, and a \$75 million issue by Crossett, Arkansas, to expand facilities for Georgia-Pacific Corporation. *The Wall Street Journal*, Dec. 4, 1967, at 26, col. 1, 2.

with extreme caution by lenders and investors.¹⁷¹ The overextension of credit problem is faced to a lesser degree by regions employing either the New England or Oklahoma plans.¹⁷² The Pennsylvania plan avoids the problem by making industrial loans out of current revenues.

From the standpoint of the investor contemplating the purchase of industrial development revenue bonds, the financial structure of the participating industry is an important consideration, since, in effect, the investor is asked by the issuing municipality to provide risk capital for the industrial enterprise. The success of the industry in the community largely determines whether bondholder investors will realize a return on their investments. Since municipal liability in case of default must be based on tenuous theories,¹⁷³ there is little to protect investors from the consequences of ill-advised revenue bond industrial development projects. The Securities and Exchange Commission has approached this problem by requiring full disclosure of the company's lease obligations and its obligation to pay off the bonds, since the investor "is in reality purchasing an interest in the lease obligation of the private company."¹⁷⁴ In proposing rules to make such disclosures mandatory on the participating industries, the Securities Exchange Commission is seeking to "enable investors to make informed investment judgments"¹⁷⁵ with respect to these bonds.

The growing popularity of industrial development financing plans suggests that a competitive aspect may be influencing regions to increase the attractiveness of their plans as a defensive measure. From a financial standpoint, this increasing attractiveness of industrial development financing directed toward major manufacturing enterprises could tend to squeeze out smaller industrial concerns having a greater financial need of such assistance. For example, the success of a municipal bond issue may depend upon the financial position of the participating industry, since it may be difficult, if not impossible, to sell bond issues where the participating industries are not of blue chip stature.¹⁷⁶ The proposed Securities and Exchange Commission regulations would tend to aggra-

171. See Ratchford, *supra* note 166, at 46.

172. Both the New England plan and the Oklahoma plan involve the state's credit. The New England plan involves a pledge of the state's credit to insure payments on mortgage loans, while the Oklahoma plan involves the use of general obligation bonds by local development corporations. See text accompanying notes 60-73, *supra*.

173. See text accompanying note 154, *supra*.

174. The Wall Street Journal, Feb. 1, 1968, at 9, col. 2.

175. *Id.*

176. See generally BUSINESS WEEK, Dec. 14, 1963, at 45.

vate this potential situation by emphasizing financial position rather than the economic needs of both the industry and the community.¹⁷⁷

4. *Governmental Problems.*—One of the major problems in the area of industrial development financing is the degree of participation by governmental units in private industrial undertakings. With the exponential growth of industrial development financing more industrial facilities are coming into governmental ownership, raising the fear that industry will be taken over by state and local governments.¹⁷⁸ Such ownership, it is contended, violates traditional principles of free enterprise and endangers the economic system by causing economic dislocations through the introduction of artificial criteria in the location of industrial and economic activity.¹⁷⁹ These problems are at least partially allayed when governmental ownership is viewed as a temporary measure and the governmental activities are seen as administrative functions designed only to insure proper functioning of the financing programs. Problems persist, however, due to governmental excesses and abuses. The competitive nature of industrial development financing has led to charges of “industrial piracy” by non-participating regions which have seen some of their industry migrate to other areas.¹⁸⁰ That retaliatory measures have been adopted by these regions is indicated by the phenomenal growth in popularity of financing plans. Such regional competition could intensify and, thus, destroy the purposes for which the financing plans were created. The possible expansion of industrial facilities beyond the long-range economic needs of the area and the utilization of such plans to finance facilities that are not industrial in nature suggest other problem areas.¹⁸¹

D. *Opposition*

Industrial development financing has been opposed by various financial, economic, labor, legal, and governmental spokesmen¹⁸²

177. The basic policy behind the Securities Act of 1933 is to insure adequate disclosures are made to investors so that informed investment decisions can be made. *See, e.g.*, *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953).

178. For a general listing of arguments both for and against the use of industrial aid financing, see Reilly, *Industrial Aid Financing: Pro and Con Arguments*, *The Commercial and Financial Chronicle*, Apr. 29, 1965, at 34, col. 2.

179. Westmeyer, *supra* note 161, at 330.

180. Note, *supra* note 164.

181. *Id.* *See Brandes v. City of Deerfield Beach*, 186 So. 2d 6 (Fla. 1966), for a case where approval was sought for a bond issue, secured by pledges of certain tax revenues, for the construction of facilities to be leased to the corporate owner of the Pittsburgh Pirates baseball team. Approval was denied.

182. *E.g.*, the Investment Bankers Association, the AFL-CIO, the Municipal Division of the

generally on the grounds that the legal, financial, and governmental problems associated with such financing outweigh the benefits to be gained therefrom. Perhaps the most militant opposition has come from the Investment Bankers Association. Since 1951 it has continuously opposed municipal industrial aid financing. In that year the IBA adopted a resolution calling for its members to exercise extreme caution in underwriting and otherwise dealing with municipal industrial development bonds and to inform various legislators and other interested parties about the inherent dangers of such financing.¹⁸³ The specific grounds given as justification for the resolution were an acute concern for the injurious effects on public credit and the possible threats to the American system of free enterprise and federal system of government.¹⁸⁴ A recent letter to American business from the IBA¹⁸⁵ broadly stated the grounds for its opposition as violations of "principle and good government."¹⁸⁶ In April, 1966, the IBA wrote to all United States Senators and Representatives urging that they support legislation which would make municipal industrial development bond financing unlawful.¹⁸⁷ Notwithstanding the opposition of the IBA as a group, prominent IBA members have continued to participate in the sale of municipal industrial development bonds.¹⁸⁸

The adverse position of organized labor can be traced to a pattern of industrial migration from highly unionized regions to other areas, largely in the South, where conditions were less favorable to organized labor. Labor has long suspected that industrial enterprises deliberately attempt to locate in low wage areas or in states having "right to work" laws.¹⁸⁹ At least one company has openly admitted that its decision to locate a new plant in the South was influenced, in part, by the recipient state's favorable labor laws.¹⁹⁰ Consequently, industrial financing plans and tax exemptions, when coupled with "right to work" laws, could make certain areas substantially more attractive to industrial concerns

American Bar Association, the Association of Municipal Finance Officers, the United States Chamber of Commerce, and various individual economists and industry leaders. Cumberland & Van Beek, *supra* note 135, at 254; BUSINESS WEEK, Dec. 14, 1963, at 45.

183. Reilly, *supra* note 178, at 16, col. 1.

184. *Id.*

185. The letter was sent to 500 of the largest industrial concerns in the United States. 47 PUBLIC MANAGEMENT, Jan. 1965, at 16.

186. *Id.*

187. The Commercial and Financial Chronicle, Aug. 11, 1966, at 12, col. 1.

188. *E.g.*, the Chase Manhattan Bank, which purchased Mississippi's \$130 million bond issue for the Ingalls Shipbuilding facilities. The Wall Street Journal, Dec. 4, 1967, at 26, col. 2.

189. Note, *supra* note 146, at 618 n.6.

190. U.S. NEWS & WORLD REPORT, Oct. 26, 1956, at 108.

seeking new regions in which to locate. Since southern states often offer such a combination, labor views financial inducements to industry as an ultimate threat to union power.¹⁹¹

Individual economists and industrialists have voiced some criticism of industrial development financing on both philosophical and pragmatic grounds. The main thrust of their criticism has been directed toward the bond type of financing, since it entails the maximum degree of governmental involvement in private industrial financing. From a philosophical standpoint such spokesmen are "opposed to government being in any enterprise in which private business can handle itself adequately."¹⁹² The tight credit situation has furnished a more practical ground for opposition. Tight credit indicates that commercial lending institutions are less willing to loan money to finance industrial improvements, with the result that industrial enterprises are likely to turn to the public sector for financing. This stimulus to municipal industrial development bonds is likely to "place serious pressures on the municipal bond market itself," which could result in higher municipal bond rates generally.¹⁹³

Mounting criticism has developed in the federal government concerning state and local tax exemptions to industry. The Advisory Commission on Intergovernmental Relations voiced this criticism in a recent report studying the influence of state and local tax policies in industrial location.¹⁹⁴ The crux of the commission's criticism is that tax exemptions and concessions to industry "can have baneful effects on our Federal system by setting in motion a self-defeating cycle of competitive tax undercuttings and irrational discriminations among business firms."¹⁹⁵ These effects, the commission concluded, occur primarily at the local level, since the influence of tax exemptions on industrial location increases "as the location process narrows down to a particular jurisdiction within a region."¹⁹⁶ Thus, it appears that this criticism is

191. Cumberland & Van Beek, *Regional Economic Development Objectives and Subsidization of Local Industry*, 43 LAND ECON. 253, 254 (1967).

192. The Wall Street Journal, Dec. 4, 1967, at 26, col. 3.

193. *Id.* at col. 2.

194. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, STATE-LOCAL TAXATION AND INDUSTRIAL LOCATION, Report A-30 (April 1967) (hereinafter cited as ADVISORY TAX REPORT). See also The Wall Street Journal, Oct. 10, 1967, at 9, col. 2.

195. ADVISORY TAX REPORT 83 (Recommendation No. 4). The Commission pointed to the Louisiana Council on New Industry as an illustration of its recommendation. The Council is authorized to "negotiate contracts with manufacturers which in effect will allow Louisiana to meet the best (lowest) tax offer of any other state in which a manufacturer contemplates locating." *Id.* at 84.

196. ADVISORY TAX REPORT 78 (Finding No. 4). Similar conclusions have been reached by

primarily levied at those states authorizing municipal discretion in granting tax exemptions and concessions.

E. Relative Advantages and Disadvantages of Industrial Development Financing Plans

The main advantage and primary purpose of all types of industrial development financing is the economic stimulation of underdeveloped areas. In theory, at least, the economic growth generated by new or expanded industrial activity will be distributed and shared by the various secondary growth sectors of the community through increased aggregate personal income, retail sales, bank deposits, and tax revenues.¹⁹⁷ Thus, while the overall economic activity of the community will increase in intensity and diversity, basic industrial enterprises obtain the benefit of low-cost capital while participating in the development of the community.

The financing plan best suited to the realization of these objectives while minimizing potential problem areas depends upon the needs and the capabilities of both the community and the industry. Each of the financing programs has advantages which make it especially attractive under certain conditions. As was suggested earlier, the bond plans are particularly adaptable to large scale industrial financing involving major corporations. Tax exemptions may also attract major corporations to underdeveloped areas, but the financial benefits derived therefrom are not immediately available to industries for plant construction purposes. From an administrative standpoint, however, tax exemptions are easy to confer and can be utilized to assist several local industries simultaneously.

The mortgage insurance and development corporation loan plans have the advantage of integrated participation by private lending institutions. Governmental involvement is not as direct nor as massive as in the bond or tax exemption programs. A high degree of coordination and cooperation between governmental, financial, and industrial interests is essential. Thus, under these plans financing is made available to those small and medium sized enterprises which are potentially overlooked by the other types of financing.

other commentators. "Industrial development inducements are a more important factor in the choice of location within the region than in the choice of location of region." Bridges, *State and Local Inducements for Industry (Part II)*, 18 NAT'L TAX J. 175, 183 (1965).

197. Note, *The "Public Purpose" of Municipal Financing for Industrial Development*, 70 YALE L.J. 789, 800-01 (1961). For a numerical study of the potential effects of new industry on a community, see CHAMBER OF COMMERCE OF THE UNITED STATES, *WHAT NEW INDUSTRIAL JOBS MEAN TO A COMMUNITY* (1960).

Each of the programs also has disadvantages and weaknesses. While the bond plans are capable of raising large sums of capital, the mechanisms involved are necessarily cumbersome. Voter approval, certificates of convenience and necessity, and agency investigations may all be required prior to the issuance of municipal bonds.¹⁹⁸ Consequently, bond plans are unsuited to the simultaneous assistance of small, local industries. Additionally, where adequate supervision of bond plans is not a requirement, overextensions of credit and other abuses are potential dangers. None of the direct assistance programs is completely compatible with a free enterprise system, as is evidenced by the variety of legalistic devices used to circumvent constitutional and judicial limitations on state economic activity. None of these programs minimizes the regional competition aspect of industrial development financing. Tax exemptions are the most compatible with a free enterprise economy, as is indicated by a long historical background; however, they are open to abuse and to intense regional competition, especially when controlled by municipal interests.

F. Prognosis

The past decade has witnessed a dramatic increase in the utilization of industrial development financing. New plans have been devised which offer integrated programs of industrial financing ranging in scope from mortgage insurance to complete bond financing.¹⁹⁹ The dramatic nature of this growth may prove to be the undoing of these programs if regional competition is allowed to obscure their original objectives. In addition to an intensification of regional competition, the indiscriminate use of industrial development financing could occasion a return to the status quo existing prior to the advent of the BAWI program through stabilization of the plant construction cost variable to the point where it no longer influences the choice of geographic plant location. This, in turn, could precipitate the development of more ingenious and pervasive financing programs to attract industry with the result that the free enterprise system would be seriously imperiled. Before this point is reached, however, corresponding pressures are likely to influence Congress to outlaw industrial development financing completely or, at least, to curtail the tax exempt feature of industrial development bonds.²⁰⁰ Consequently, foresight, planning, and cooperation are essen-

198. *E.g.*, MISS. CODE ANN. §§ 8936-52 to -58 (Supp. 1966).

199. *E.g.*, Rhode Island. For a general description of the Rhode Island integrated plan, see RHODE ISLAND INDUSTRIAL BUILDING AUTHORITY, RHODE ISLAND FINANCING PLANS (undated).

200. *See Note, supra* note 164, at 701; Henderson, *Financing of Industrial Development*

tial at all levels of government and by all interests concerned if economic stimulation is to assist in achieving economic maturity in all sectors.

IV. SOME RECOMMENDATIONS

A. *Planning and Supervision*

There is much that can be done at the state level to insure that any industrial financing plan will, in fact, promote the objective of economic stimulation while reducing risks, minimizing problems, and safeguarding against abuses. It should be the duty of the state, through statutory standards strictly observed and enforced by state agencies, to effectuate the declared public policy of the state and to exercise overall supervision of industrial financing consonant with the economic interests of the communities, the state, and the nation. To obtain the necessary background information for the intelligent administration of industrial development financing, state agencies should undertake comprehensive studies, through the use of professional analysts, to determine the long-range economic objectives of the state and its regions and the best possible means of accomplishing these objectives. Mississippi, for example, requires its Agricultural and Industry Board to undertake, with competent professional assistance, a thorough study of markets, products, and the industrial base necessary to supply the available markets with the desired products.²⁰¹ Detailed cost estimates involving facilities, labor, and operating costs are also prepared.²⁰² In this manner the Agricultural and Industry Board is kept continuously informed of the various economic conditions and needs of the state and its capacity to support industry.

Community planners can also be of assistance in developing standards and criteria for the administration of industrial development projects. The degree of assistance needed from the community planners will vary with the type of inducement offered, but close cooperation at local and state levels is necessary to assure the efficient functioning of any financial program. Before submitting a bond plan to a state agency for approval, or before recommending that other inducements be offered to encourage industrial activity, community planners should focus their attention on the size and type of industry desired in the community. The basic considerations discussed earlier could serve as a basis for an

by *State and Local Governments*, 63 BAYLOR BUS. STUDIES 18, 27-28 (1965).

201. MISS. CODE ANN. § 8939-01 (Supp. 1966).

202. MISS. CODE ANN. §§ 8939-01(4) to (6) (Supp. 1966).

evaluative study. Similar studies should be (and generally are) undertaken by industrial concerns contemplating a move into a new area.

Background investigations, evaluative studies, and close cooperation are of little value if adequate statutory safeguards are not incorporated into industrial financing legislation. These safeguards should provide means of remedying each of the potential state and local problems anticipated. For example, the problems of municipal liability, eminent domain, and tax abuse should be specifically covered in bond legislation. The risk of municipal liability could be reduced by requiring state approval of bond plans,²⁰³ by specifically authorizing or curtailing eminent domain, and by minimizing tax abuse by prohibiting the sale of industrial development bonds to participating industries.²⁰⁴ Similarly, tax exemptions should be controlled at the state level to insure uniformity and coordination throughout the state. In essence, statutory safeguards for each of the programs are necessary to insure the proper allocation of funds according to pre-established criteria.

B. Tax Reform

1. *State and Local.*—At the state level tax reform should center on two main themes: (1) an evaluation and revision of local tax structures with a view toward taxing those sectors directly related to the program of economic stimulation; and (2) an integration of the state program of tax exemption to achieve an orderly scheme of taxation commensurate with economic objectives. Where intelligent tax planning is pursued, part of the money used to accomplish economic stimulation can be recovered through tax revenues and made available for needed social overhead capital. A program of general sales taxation, for example, would tax the increased economic activity itself. As a result, the funds made available would bear some relationship to the demands on the public sector caused by economic growth. On the other hand, tax

203. If a reviewing agency is required to approve bond plans, the risk of a municipality undertaking an ill-advised project is correspondingly reduced. Some states have established agencies empowered to investigate and required to approve any municipal industrial development bond plan before the community may proceed with the project. *E.g.*, MISS. CODE ANN. §§ 8936-12, 8936-52 (Supp. 1966). Other states require agency approval only if general obligation bonds are to be issued. *E.g.*, TENN. CODE ANN. § 6-2905 (Supp. 1968). In some instances the agency undertakes only a limited investigation to ascertain if the proposed bond issue conforms to the provisions of the enabling act, to determine if revenues derived will actually amortize the bond issue, and to determine if the bond issue is sufficient or excessive for the scope of the proposed project. *E.g.*, MICH. STAT. ANN. § 5.3533(33) (Supp. 1968).

204. The mandatory redemption feature now being used under pressure from the Treasury Department could be outlawed by such a provision. *See* note 211, *infra*.

exemptions which do not contribute to economic growth in the primary sector should be abolished in the absence of strong countervailing factors.

2. *Federal.*—Tax reform from the federal point of view is concerned with the possible misuse of the federal income tax exemption in the area of municipal bond financing. Several proposals have been made to remedy the tax problems in this area, but three main proposals have received primary attention:²⁰⁵ (1) amendment of section 103 of the Internal Revenue Code to restrict the allowance of the federal tax exemption in industrial financing situations;²⁰⁶ (2) the issuance of delimiting rulings by the Treasury Department;²⁰⁷ and (3) the enactment of uniform model state legislation.²⁰⁸

The most direct means, short of outright abolition of industrial development bond financing by Congress, is the amendment of section 103. In general, proposed modifications have been of two types—the disallowance of rental expense deductions by participating companies and the taxation of the interest paid by industrial development bonds.²⁰⁹ It is submitted that another type of amendment could include comprehensive criteria by which the tax exemption would be qualified. Bond plans failing to meet such criteria would not receive tax exempt treatment.

Rulings by the Internal Revenue Service and Regulations issued by the Treasury Department serve as another means of alleviating tax problems in this area. Liberal postures with respect to municipal bonds in general have been reflected in past Rulings and Regulations.²¹⁰ Should the Treasury Department desire to close the alleged loopholes presently existing with respect to this type of industrial financing, it should reevaluate its position as reflected through these Rulings and Regulations.²¹¹

205. These proposals are set out in Note, *supra* note 164, at 696.

206. *Id.* at 702.

207. *See id.*; Spiegel, *Financing Private Ventures With Tax Exempt Bonds: A Developing "Truckhole" in the Tax Law*, 17 STAN. L. REV. 224, 227-32 (1965).

208. This proposal was made by the Council of State Governments. Note, *supra* note 164, at 696 n.7.

209. *Id.* at 702. A recent bill to remove the tax exemption from industrial development bonds was introduced in the second session of the 90th Congress. This bill would accomplish a removal of the tax exemption by excluding industrial development bonds from the category of "obligations" described in § 103(a)(1) of the Internal Revenue Code of 1954. H.R. 11645, 90th Cong., 1st Sess. (1967).

210. *See, e.g.*, Treas. Reg. § 1-103-1 (1956), defining "obligation of" as used in § 103 as meaning "obligations issued on behalf of" the political subdivision. *See also* Rev. Rul. 63-20, 1963-1 CUM. BULL. 24; Note, *supra* note 164, at 703.

211. The Treasury Department has recently indicated that it is considering issuing a ruling

The proposal that the individual states enact uniform model enabling legislation is the least likely to improve the existing situation. While such legislation could be drafted containing satisfactory standards and safeguards, it would be difficult to persuade all of the states to adopt it. States already having industrial development bond enabling acts are not likely to "act unilaterally since amending their own programs without a guarantee that the other states will do the same runs too great a risk of incurring a competitive disadvantage."²¹²

V. CONCLUSION

While the economic effects of industrial promotion are reasonably predictable under the economic base theory of growth and development, no clear conclusions have been reached concerning the effectiveness of inducements on the location of industry.²¹³ Thus, once a region concludes that it is essential for it to offer financial inducements to industry in an effort to achieve economic stimulation, it becomes necessary to face the difficult problem of determining the type of inducement which would best effectuate these economic goals. Indicators for allocating funds and establishing priorities among areas within a region can only suggest the areas of greater growth potential.²¹⁴ Consequently, the type of programs inaugurated by states and implemented by communities are apt to be determined by rather vague criteria concerning the effect of inducements on industrial location. If the problem is approached from the standpoint of reducing the plant cost variable, particular types of industry can be attracted to an area with a greater degree of certainty, with the result that long-range planning could be realized.

The increasing popularity of industrial development financing suggests that there are considerable benefits to be gained from the intelligent use of these plans. However, before a community commits itself to a particular industrial development project it should develop a clear concept of the direction in which the community is to move and it

which will eliminate the tax exemption on industrial development bonds. Janssen, *Industrial-Revenue Bonds May Be Attacked By Treasury Ruling in Lieu of Legislation*, *The Wall Street Journal*, March 5, 1968, at 9, col. 2. This has prompted the issuance of bonds carrying a mandatory redemption feature which will allow purchasers to sell their bonds to the participating corporations if the tax exemption is removed. *The Wall Street Journal*, March 4, 1968, at 14, col. 2.

212. Note, *supra* note 164, at 704.

213. Bridges reached the conclusion that inducements can influence the volume and the location of industrial investment. He also reached other general conclusions concerning the importance of particular inducements on industrial location. Bridges, *supra* note 196, at 183-84.

214. See Stewart, *Regional Allocation of Public Funds for Economic Development*, 43 *LAND ECON.* 421, 433 (1967).

should seek to define its long-range economic objectives in the context of its ability to support industrial growth and its economic relation to other regions. The states themselves can, with professional assistance, undertake studies to define regional objectives; but statutory standards implemented by state agencies are necessary to provide a framework within which communities can plan to develop their economic potentials. Legislation should be drafted with care to insure against potential abuses and to prevent industrial development financing from becoming a means of securing artificial competitive advantages which tend to "pirate" industries from other regions. The federal government should consider revision of its tax laws to curtail abuses, while authorizing plans used for the legitimate purpose of intelligent economic stimulation. If the economic effects of industrial development financing are thoroughly evaluated by all interests concerned with a view toward achieving economic maturity in all sectors, then the original objectives of the programs—the promotion of the public welfare—may be realized.

EVERETT H. FALK