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Industrial Development Bond Material

(Treasury Statement for Insertion in the Record of the Secretary's Testimony Before the Senate Finance Committee, September 4-5)

History of the Issue

For some years, state and local governments have issued industrial development bonds using the proceeds to build industrial plants for business concerns locating within their areas. Such bonds have been secured by rentals or installment sales payments obtained from these concerns. The arrangements have permitted business firms to secure financing through lower tax-exempt interest rates in place of the higher rates that would obtain on their own taxable obligations.

In the initial stage of state and local industrial development bond financing, the Internal Revenue Service issued private rulings which permitted this use of the tax-exemption feature, and, in 1954, a public ruling was issued. At that time, only a few states had authorized industrial bond issues and the total annual amount of debt issued, the amounts of individual issues, and the size of business concerns benefited were relatively small.

The situation changed dramatically, however, in the mid-nineteen sixties. As interest rates on corporate bonds and other corporate borrowing increased, an upsurge occurred in industrial development bond flotations. In state after state enabling legislation was passed and the major industrial concerns began to turn to these bonds as a method of financing their fixed-capital requirements. As the large corporations began to utilize this technique, individual bond issues of the size of $50 million and even $100 million became commonplace. This, in turn, had a marked impact on the annual volume of new issues. Thus, in comparison with a total volume of new issues of less than $100 million in 1962, the reported volume of new issues had reached $500 million by 1966 and in 1968 rose to a level of $1.56 billion.

Once the expansion in these bonds was underway, the very real dangers in this device became apparent. It became clear to municipal and county officials that the expansion in these bonds was forcing interest rates on regular municipal bonds to higher levels. The expansion was also having an increasingly greater effect upon Treasury revenues. It was estimated that if the prevailing rate of growth of new issues had continued, the annual revenue loss would have amounted to $1.5 billion by 1975.

Recent Legislation

As you know, under the Conference Report on the Revenue and Expenditure Control Act of 1968, action was taken to curb the use of tax-exempt bonds or private industrial and commercial pursuits. Under this legislation, tax exemption was confined to issues below $1 million. A subsequent amendment raised the ceiling to $5 million in conjunction with a provision under which capital expenditures made by the same company, or related company, in the same municipality or county within three years preceding or three years following the date of the tax-exempt issue would be treated as outstanding bond issues for the purpose of calculating the $5 million limitation.

Recent data on the volume of tax-exempt industrial development bond financing indicate that this legislation has well served the intent of the Congress to limit this use of tax exemption. In 1968, 165 tax-exempt bond issues, amounting to more than $1.5 billion, were floated to finance manufacturing and commercial facilities as defined by the legislation. In comparison, in the first half of 1969, only 28 issues, amounting to $14 million, were issued. The amount of debt issued in the first two quarters of the year subsequent to the enactment of the legislation contrasts with the first two quarters of the year which preceded enactment when 65 issues totaling more than $600 million were floated.