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Many of the problems in municipal debt relate to these facts and conditions:

(1) Borrowing for most cities and for other municipal corporations is a necessity resulting from the functions which they perform.

(2) Public credit is often employed when taxation would be more legitimate.

(3) Borrowing, although usually indulged in too extensively when not carefully regulated, when used with discretion becomes a ready and legitimate means of securing immediate use of funds.

(4) To borrow successfully implies constant recourse to money markets, and familiarity with the market conditions as well as a keen sense of the rights and interests of the borrowing public. Connected with these general considerations are most of the problems with which we have occasion to deal here.

Many minor political units and practically all cities have important functions of an administrative character as well as of a business nature which include receipt and expenditure of large amounts of public money. An adequate performance of these functions involves in most cases the use of borrowed funds. These are, ordinarily, supplied by the investing public acting through the medium of banks and trust companies. Local units, therefore, through their elected officers, bid with private firms and corporations for the command of available capital. One problem in public debt, therefore, is the equalization of the bargaining power between local officials, representing taxpayers, and financial interests; and also of guarding against any betrayal of the public and still protecting the interests of the creditor.

The methods of protecting these interests are dissimilar. Municipalities are interested in selling bonds or other evidences of indebtedness at the lowest possible interest rates, in making terms of the longest duration allowable in order to defer taxation, and in borrowing as much as possible to keep down the tax rate. Creditors are interested in paying the lowest possible price for

bonds, in securing high interest rates, in the legality of the issues, in the forms which the instruments take, in the time they are to run, in the security offered, and in their general negotiability, etc. The safeguarding of interests of both parties to these financial transactions involves both political and economic considerations. The political side is concerned in that the public is acting through elected officials, who, in most instances, hold office for limited tenure only and on condition that they act in sympathy with the demands of a political constituency. The rights of the public must be in a measure guaranteed through such officials. On the other hand the problems of debt contraction, debt manipulation and debt payment involve not only political but also important economic considerations. Both sides of these questions require attention.

It is often impossible for local officials to be efficient and at the same time to retain their offices. Unfortunately efficiency is too frequently sacrificed. We must recognize that incompetency at least is too often the rule among public officials, and particularly so among those whose duties are of a really constructive and sometimes of a technical nature. The every day routine, for instance, of tax matters, may be mastered in every detail, and yet the ability and the desire to successfully and economically float a series of bonds and to make proper provision for paying the same may be wholly lacking on the part of the official. The use of a sinking fund to pay current expenses sometimes proves too great a temptation to be withstood. An official, or an administration which has squandered public money and raised a tax rate inordinately, may often be displaced, but cases are almost unknown where officials have lost public confidence, or administrations have been changed because of excessive borrowing. Opposition is contrary to the interests of the taxpayer because the day of payment is generally so far in future that chances remain of his not having to pay, or at least of his being better able to pay. Spasmodic objection to borrowing may make itself felt here and there, but the majority of taxpayers are usually willing to allow borrowing to continue. Small popular votes on questions of debt approval or rejection are the rule. The discount of the future acts as a potent force in determining action. Human nature and the political control of municipalities seem to be in league with the abuse of credit—the former because of discount of the

future, the latter because of necessity to please a constituency. Some regulation of the power to borrow money and to dispose of the same is absolutely necessary, and the question turns upon the nature of proper control.

Constitutional debt control amounts, on the one hand, to a prohibition against subsidizing private capital, and on the other hand to a limitation of debt to a certain percentage of the assessed value of property. There can be no percentage of debt to the assessed value of property, which is *a priori* correct. In some political jurisdictions a 5% limit operates as no restriction,* and yet the abuse of public credit is proportionately as great as for the units borrowing much more. In other cases a 5% limit operates as an obstacle to legitimate enterprise. † There can be no single percentage limit that applies with equal legitimacy to all political units or even to those similarly situated. The variations in the limits in the United States, which range from 2½ to 18 and in Canada ‡ approach 20%, are conclusive evidence of this truth. Besides, to merely indicate a maximum to which all units may borrow is not to regulate the use of public credit.

It may be that there is a percentage of debt to assessed value of property which for cities and towns of a specified district tends to assume a certain level, but that this percentage should apply to all units alike is indefensible. The average ratio of debt to assessed value of property for the cities and town of Rhode Island, in 1907, was 5.16%, and for 1908, 5.38%. But the maximum percentage for 38 civil divisions in 1907 was 23.26%, for a city with a population of 1,274; while the minimum percentage for the same divisions in the same year was 0.12% for a city of approximately the same size. Like variations are found as to 1908.§ A comparison of the same nature for Massachusetts shows a maximum percentage ratio of 7.45% for a city with a population of 97,434; and a minimum percentage ratio of 2.47% for a city with a population of 69,272. Eighteen cities,

* For the period 1903-1909 inclusive there was no county in Wisconsin which had an outstanding debt equal to 50% of the legal limit—5%—for counties. More than 71% of the average indebtedness of the 61 indebted counties of the state for this period was less than 15% of the legal limit, *i. e.* less than 15% of the 5% of the assessed value. These facts are taken from study of county indebtedness in Wisconsin which the author made for the Wisconsin Tax commission.

† The experience of Chicago is a case in point. *Vide*, the interpretation of the Mueller Law (Chap. xxiv, Hurd's *Revised Statutes*, 1905), May 18, 1903, in "Lobdell v. City of Chicago," 81 N. E., 354, 227 Ill., 218.

‡ Perry, J. Roy, "Public Debts in Canada," University of Toronto Studies, Vol. I, pp. 79-80.

§ "Report of Taxation Laws," Providence, R. I., 1910, pp. 149, 155.

or 55% of all in the state, showed a percentage of net debt to assessed value under 5%; while 15 cities, or 45% of all, showed a percentage of net debt to assessed value of over 5%. Even a larger variation exists for the towns—11.04% to 0.00%.*

Both as a measure of the amount of debt which a city is financially able to bear, as well as a barometer of the needs for borrowed funds constitutional, limitations are objectionable. As a code of regulations in which the interests of both creditor and debtor are guaranteed they amount to nothing. The amount of funds which a city should borrow is a portion of the total contribution which the taxpayers are willing to make governed in each case by the uses to which such funds are applied. If a community is new large expenditures are necessary to effect improvements indispensable to city development. If the city in question is large, and growing rapidly, the tax rate cannot be adjusted so as to provide for large capital expenditure and resort must be had to borrowing. On the other hand, in older communities, and often in school districts, normal expenditures can and should be adjusted to the machinery of taxation. The necessity of borrowing depends in each case upon the activity of the community together with the position to which it has arrived in satisfying cardinal needs and the policy of extension which it has adopted. How much a municipality borrows is largely inconsequential provided there is need for borrowed funds, and in case the payment of debt within a reasonable time is assured.

Borrowing is a financial device, useful when employed with discretion, and it is seldom liable to great abuse when a rigid policy of liquidation is followed. It is not borrowing that is bad in itself; it is the disposition to escape tax burden by borrowing which is objectionable. The chief difficulty, and the one to be corrected, is the weakness in the system of local government whereby officials are permitted and encouraged to borrow for purposes which should be supported by taxation, to borrow too much for legitimate purposes and to defer debt payment too far into the future. Rigid constitutional restrictions on the amount of debt will not correct these abuses. The only certain guarantee against their continuance is the adoption of a system of administrative control in which a competent state board or commission, whose sanction must be had for the use of borrowing,

* "Statistics of Municipal Finances," Boston, 1907, pp. 66, 192.

for the duration and amount of money to be borrowed, plays the controlling part. Control of municipal debt is a necessary part of the control of local finance, and in many respects the most urgent part. The problems associated with it call for further consideration.

The chief problem in debt payment so far as the debtors are concerned is the equalization of tax burdens between the present and the future. Most commonly provision is made for debt payment by the accumulation of a sinking fund, *i. e.*, "a fund to which a fixed proportion of the loan can be carried * * * and either applied at once in the reduction of the debt or invested at interest until it can be so applied." * Many state constitutions provide for the accumulation of such funds † by requiring that there be levied direct annual taxes at the times the loans are made and periodically thereafter. The sinking fund *per se* in public finance and public conscience so little developed that bond- was so low and public conscience so little developed, that bond- holders had to be given some assurance that the principal of their loans would be paid when due, but as a method of debt payment and as a temptation to unprincipled and ignorant city officials, not only does a sinking fund clog and complicate the finances of a municipality but it has absolutely no redeeming features. Originally required as a guarantee to the creditor, and later as complete protection to the debtor, it has now in far too many instances neither one of these functions because the "fund" degenerates into an "account." Taxes may be levied in good faith, but that the proceeds are kept intact and invested properly, that they are not used to pay current expenses, for instance, is never certain so long as accounts are inaccurately and unintelligently kept and no public reports are made of them. The inviolability of this fund is the taxpayers' only protection against double taxation.

The taxpaying personnel may not be the same at the time the fund is misspent as it is when resort to further taxation is

* Murray, Alexander. "Municipal Finance," etc., *The Accountant*, March 26, 1910, p. 445.

† Payment of debt by the sinking fund method is being replaced to some degree by the serial method. This movement is praiseworthy for it takes out of the hands of local officials the control of large sums of money with which complicated questions arise concerning investments and which furnish temptations for illegitimate usage. Of the 158 cities of the United States with population of over 30,000 in 1907, 135 reported some serial loans. "Statistics of Cities with Populations over 30,000" 1907, Washington, p. 73.

Of the growing use of the serial method of debt payment in Massachusetts, see "Third Annual Report of the Statistics of Municipal Finances," 1908-9, p. xxvi. Boston, 1911.

made necessary, but this does not change the effect of the misappropriation. The moneys have been set aside for a particular purpose, and their use for purposes not intended cannot fail to cloud not only the perspective of the public relative to the total tax levy also to open the way for an illegitimate use of public funds. Occasions may arise when certain savings would result from the application of sinking funds to new borrowing powers, especially when desirable investments are not at hand, when bonds outstanding are not due and cannot be readily purchased, etc. Most of these difficulties, however, may be avoided by the adoption of serial payment. At best such a procedure is questionable and is possessed of many of the objections as in the prevalent practice of some American cities that invest their bond issues in their own sinking funds, thereby creating a forced market for their securities.* "For a municipality to sell its bonds to the sinking fund is the same as borrowing from the sinking fund." † The local government board in England, in its "Provisional Orders," specifically inserts the following clause when dealing with securities in which public sinking funds may be invested: "But exclusive in every case of the securities of the corporation." ‡ The conservation of these funds and their use for the purposes intended require honesty among city officials, scientific and accurate accounts, and a certain amount of publicity or outside control of a disinterested and adequate sort. Absolute honesty in every official is not to be expected, and accounts are far from being satisfactorily kept. To provide for these deficiencies, Ontario, Canada, for instance, has enacted that persons who are responsible for diverting money from sinking funds are not only liable for the amounts diverted but are disqualified from holding municipal office for two years. § Moreover, failure to levy the amount required to be raised for sinking fund purposes in any one year brings disqualification for office for two years upon the members of the

* "Sixty-five cities reported city securities alone as constituting the assets, other than cash balances, in their sinking fund; eight cities reported other investments, but no city securities; 38 reported both city securities and other investments; and 43 cities reported cash as the only asset." "Financial Statistics of Cities having a Population of over 30,000," 1910. Bureau of the Census, Washington, 1913.

† Chamberlain, Lawrence. "Principles of Bond Investment," 1911, p. 214. *Vide*, also Chandler, Alfred D. "The Metropolitan Debts of Boston and Vicinity, Brookline, Mass.," 1905.

‡ Quoted in Biddell, Geo. "Local Loans in England," p. 334. Biddell in commenting upon this and other clauses remarks that they "are the best extant with regard to sinking funds." *Ibid*, p. 41.

§ "Consolidated Municipal Act," 1903, Sec. 418. 3 Ed. VII, Ch. 193.

council so neglecting it.* The same province has adopted a further provision in order to guarantee the continued existence of such a fund after it has been raised. Section 8 of The Ontario Municipal Securities act † allows the deposit of such funds with the treasurer of the province, while section 11 ‡ requires that a return shall be made to the treasurer of Ontario showing whether the sinking fund for the year was raised, how it was applied or dealt with, and the conditions of the investments in which the funds were made. The present movement in the United States looking toward uniform accounts for municipalities and systematic reporting to a central administrative body is also a distinct step in the direction of guarding adequately the interests of the taxpayers.

The creditor, on the other hand, has little more than passing interest in the strict maintenance of these funds. The taxing power is most generally adequate security for the liquidation of his claim. Government solvency "depends wholly upon the efficiency of the taxing power of the government and the wealth of the private citizens." § Generally speaking municipalities have but one way of meeting their debts. Creditors rely almost wholly upon the power of taxation and upon the probable continued existence of taxable values.

Another difficult problem in connection with public debt is the determination of the proper time in which debt payments should be made. Theoretically there is no relation between a sinking fund and the life of an asset. The purpose of a sinking fund is the payment of debt; the purpose of a depreciation fund is to secure the maintenance of the efficiency of property. The latter is calculated almost wholly according to its "use" or "life." But a public debt must be paid, and the chief consideration in determining the proper time for payment in respect to depreciating property is its life. Not all properties, however, depreciate with the same rapidity; indeed, some do not depreciate at all, but on the other hand constantly appreciate in value. There can be no one period, therefore, for debt redemption that will suit all municipal properties. Twenty years duration for bonds issued to macadamize a street is too long, because on two or three

* *Ibid.* Sec. 418 (5).
† 8 Ed. VII, Chap. 51 (1908).
‡ 8 Ed. VII, Chap. 51, as amended by 9 Ed. VII, Chap. 76, (1909).
§ "Statistics of Cities with Population over 30,000," 1907, p. 18.

occasions during this period the necessity will arise for repeating the improvement. On the contrary, twenty years is too short a time for bonds issued to purchase land for a city wharf or park, because these properties will almost surely appreciate in value. And yet in Wisconsin, for example, cities are borrowing for all city purposes on twenty-year bonds. This is wasteful, because of the enormous loss through interest payments, and unscientific because of the violation of the canon of taxation—realizable equality.

Today the redemption periods concentrate on twenty and thirty-year periods. This would not be true if there existed for each state a competent authority, disinterested in unduly extending the period, whose duty it was to make the duration of loans roughly equal to the lie of the property acquired by borrowed money. Questions of depreciation, involving as they do wear and tear, obsolescence, the effect of invention, changing methods in the solution of problems, etc., are so complicated that a close approximation to the life or the utility of properties can be made only by experts. To leave this problem for local officials to solve is equivalent to leaving it unsolved and to furnishing the opportunity for the abuse of credit and waste of public money.

England has set an example in this respect after which it would be well to pattern. Each general statute which confers borrowing power upon local authorities, specifies a maximum number of years for the repayment of local loans made under it. These periods vary from 10 to 60 years, and each act covers a number of purposes.* The determination for the actual period of each loan is left to the government departments—most generally to the local government board. This board is equipped with a "staff of engineers * * * amongst whose duties is that of holding local inquiries * * * into the circumstances under which it is sought to spread the expense of any work over a number of years by raising a loan for such work. Such an inquiry is in most cases obligatory under statute, if the new loan

* Borrowing is made to some extent under local acts, but the 60-year maximum is closely adhered to. It has been exceeded but four times. By standing Orders 173-A (1882), the rule was laid down that no committee should in any case allow 60 years to be exceeded or grant any period "disproportionate to the duration of the work to be executed, or to the object of the loan." "Report of the Select Committee on Repayment of Loans by Local Authorities, 1902," pp. iv-v.

The Public Works Loan Commissioners by section ii of the Public Works Loan Act of 1875 are directed to have regard to the durability of the work when fixing the periods for which loans may run.

will cause the indebtedness of the district to exceed one year's assessed value. At these inquiries the question of the probable durability and continuing utility of the work is gone into by the inspector, and it is his duty and that of the chief engineering inspector to advise the board as to the period for which the loans should be sanctioned." * Estimates of the utility, etc., of works are made item by item, or by groups of items, and an appropriate term for the repayment of the loan fixed. In order to avoid the multiplication of separate loans for items of different duration, the custom is to "grant an equated period for the whole loan which is arrived at by considering the sums required for each group of items and the term assigned to that group; but equation is not practised when the sums included in each group are large, and the local authorities express a preference for separate loans." † The following are a few of the purposes for which the Local Government board sanctions loans and the periods usually allowed for repayments: Baths, 20 to 30 years; boats, 10 to 15 years; buildings, 5 to 40 years; carts and vans, 10 years; clocks, 10 years; culverting watercourses, 30 years; electric lighting, first instalment, 25 years; gas fixtures, 2 to 30 years; markets, 20 to 60 years; land, 60 years; library books, 5 years; machinery, 10 to 20 years; street improvements, 10 to 30 years; water supply, 5 to 30 years, etc. ‡

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* "Report of the Select Committee on Repayment of Local Loans by Local Authorities," 1902, p. iv. The committee thinks it "impossible to suggest any more thorough method of arriving at the necessary calculations in the first place than the local inspections and inquiries now held by the local government board * * * ." *Ibid,* p. xii.

† *Op. cit.* p. iv. The following is an example of an equated period for a loan for gas works purposes according to the method followed by the local government board, *ibid.* Append., I, p. 261.

Description of work	*Estimated cost*		*Usual term*			
Buildings	£2,500	times	30	years	equals	£ 75,000
Mains	1,245	"	30	"	"	37,350
Gasometer	1,500	"	30	"	"	45,000
Condensers	530	"	30	"	"	15,900
Purifiers	1,000	"	20	"	"	20,000
Benches	1,200	"	15	"	"	18,000
Meters	530	"	10	"	"	5,300
Retorts	600	"	2	"	"	1,200
Total	£9,105					£ 217,750

NOTE—217,750 divided by £9,105 equals 23.9. The period accordingly allowed is 24 years.

‡ *Op. cit.* Appendix I, pp. 259-61. The following is a rough estimate of the proportion which various periods hold in the loans of the leading English local authorities:

Duration	*Proportion*	*Duration*	*Proportion*
5 years	0.1 per cent	30 years	12.0 per cent
10 "	0.2	35 "	1.0
15 "	0.6	40 "	22.8
20 "	2.1	45 "	4.1
25 "	9.0	50 "	44.0
		60 "	4.0

The Accountant, London, Vol. 37, p. 162.

Thus in England a conscious attempt is made to adjust the period to the life and the utility of properties acquired thus to equalize tax burdens between the present and the future taxpayer. There are no valid reasons why the same could not be done with us, and there is every reason why it should be done. Borrowing then becomes an alternative to taxation and not a device to escape taxing.

Our general conclusions respecting the time of debt payment may be summarized as follows:

(1) Debts should be paid within such periods as experience and prudence dictate, with the aim in view to deal fairly with the present and the future.

(2) When properties acquired are of a kind which depreciate and will need to be renewed at frequent intervals the loans should be paid within their life or utility.

(3) Where properties are of a more permanent character the periods which they are allowed to run should be proportionately longer, approaching a pereptual debt for such things as land for parks, etc.

(4) A reasonable scale could with little difficulty be decided upon by an expert board, and if enforced would go far toward putting municipal debt payment on a scientific basis.

(5) All things considered, serial payment is preferable to sinking fund payment for public debt.

Another question arises in connection with the payment of public debt which is not covered by constitutional provision, and one that most individual localities do not solve. It is the determination of the relation of sinking funds for productive and for unproductive properties, and of sinking funds to depreciation funds. Sinking funds are to pay off debt, but debt for unproductive and for productive property raises different questions and calls for different treatment. Sinking funds, to be built up from the general tax levy, are required for most loans irrespective of the uses to which the proceeds are put. There is nothing in our state constitutions or our laws generally which provides for separate treatment of productive or unproductive loans in this regard. Should sinking funds for productive properties be collected from the taxpayers *per se?* Such procedure is manifestly unjust unless they and consumers are identical in personnel. This is seldom the case. If debt for certain prop-

erties is not to be counted as debt, in the constitutional sense, because the properties are revenue bearing, not only should the bonds sold to procure such properties be secured by their earning power or the properties themselves, and not by the tax rate, but the prices of the commidities or services furnished to the consumer should not only cover the cost of maintenance but sinking fund charges as well. This fund, although built up for the most part from the earnings of the properties, might be supplemented by the difference between the rate of interest at which the city is able to borrow for this purpose and the rate of interest that would have to be allowed on the bonded debt of a private company.

Ordinarily the accumulation of sinking funds begins at the time moneys are borrowed, but in the case of productive properties it could be well deferred until these become producing agents. This would be true, however, only on the supposition that the fund comes out of the revenues of the properties. Moreover, the complicated questions of depreciation funds and their relations to sinking funds in the cases of productive properties call for some attention. Should both charges be required? Private corporations, with which publicly-owned utilities have to compete, do not ordinarily carry sinking funds as such for the retirement of their bonds, but at their maturity they either fund them, or pay them with the proceeds of new issues. But this practice is not allowable as respects public debts, and justly so. Is it just to the present generation to hand over to the future fully-equipped operating utilities absolutely free from debt? These problems, important to the taxpayer, and involved in the subject of payment of public debt, are not solved by the present constitutional provisions nor are they being solved by the bulk of municipalities undertaking productive enterprises. No solution can be found for them, it is maintained, outside of an especially drawn statute administered by a board or boards with powers sufficiently broad to cover not only the authorization of borrowing, the determination of the kind of credit instruments used, and the periods which they are to run, but also the power to evaluate public properties, to accept or reject the plans of proposed undertakings, and to guarantee the legality of bonds or other instruments issued.

Powers similar to these conferred upon administrative bodies

are not uncommon. Outside of the United States regulations similar to these are the rule. In England the local government board not only authorizes municipalities to borrow under general statutes but in a general way works out the details of proposed undertakings by a competent corps of engineers and fixes the periods which the bonds sold to procure the funds are to run. In much the same way these functions are performed by administrative authorities in France. In Ontario, Canada, the Ontario Railway and Municipal Board * is authorized to supervise local municipal accounts and to study the rates charged for municipal services in order to determine whether the utilities are operated in such a way as to pay the debt, together with the cost of maintenance and operation, or whether the rates are too high or too low. † The board is also empowered to guarantee the bonds issued by municipalities, so that their validity is not open to question in any court on any grounds whatsoever. ‡

To confer similar powers upon administrative boards in the United States would be a distinct step in the right direction. In some of the states the nucleus for such control exists. In other states the machinery exists in all but perfected form. In Wiscousin, for instance, the tax commission and the railroad commission act in coöperation in evaluating public utilities. The tax commission uses the value for tax purposes while the railroad commission considers the value in fixing reasonable rates. The tax commission supervises municipal accounts and has the power to install accounts, while the railroad commission requires public utility corporations, both municipal and private, to keep their accounts on forms provided by it and to report regularly to that body. In that state, therefore, the foundation for an almost perfect control and direction of municipal finance has been laid. What is necessary further is the removal of the constitutional limitations on municipal debt, the passage of a general statute covering cities when fully classified, and the conferring on the tax commission and the railroad commission, acting together, such other powers added to those which they now have, acting separately, essential to a complete regulation of municipal debt. Such control should cover the total amount of debt obligations allowed, both temporary and funded,

* Organized in 1906, 6 Ed. VII, Chap. 31.
† 7 Ed. VII, Chap. 38, amending 6 Ed. VII, Chap. 31, sec. 57.
‡ 8 Ed. VII, Chap. 51.

the amount for each property or use, control of accounts both as to form and publication, marketing securities, and their certification as to legality, etc.

With the establishment of a system of control such as is here referred to for one state, and the inauguration of a scientific and economic use of public money, many of the problems of municipal dishonesty, with their source in incompetency and graft, as well as those other problems associated with the prevalent tendency to borrow too much and to postpone payment too long, would gradually be solved. Cities will continue to grow, and the demands upon the public treasury will increase. If these are to become business units then business principles must be adopted and administrative devices multiplied and perfected. Until these problems are solved public moneys will be wasted through debt contracted and unscientifically handled, and borrowing power will be abused and the taxpayers pay the cost. Until some such change is made the fixed percentage of debt to assessed value will serve to handicap some municipalities, while leaving to others too extended borrowing powers, debt will be used where taxation alone is legitimate, sinking funds if provided will be used to pay current expenses, money will be wasted by borrowing when market conditions do not justify loans being made and by undertaking enterprises which are uneconomic both as to the types undertaken and the services rendered. The data and experience which a board or commission of the type indicated would accumulate would in a short time be of inestimable value, not only in directing municipalities as between private and public ownership and operation, but it would also serve as scientific information upon which to build standards of efficiency in public endeavor.

In marketing municipal bonds local authorities, through their representatives, enter the money market and bid with private corporations and others for command of the available capital. * Practically no municipal bonds find their way to the stock ex-

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* *The Commercial and Financial Chronicle*, Vols. 88, 90, pp. 113, 121 respectively reports the following municipal bonds sold from 1892-1909 inclusive; thousands omitted:

1892	$ 83,823	1898	$103,084	1904	$250,754
1893	77,421	1899	118,113	1905	183,080
1894	117,176	1900	145,733	1906	201,743
1895	114,021	1901	149,498	1907	227,643
1896	106,496	1902	152,846	1908	313,797
1897	137,984	1903	152,281	1909	332,476

changes, * but are sold direct to banks,† trust companies and saving institutions only to be resold to the public to serve as investments for their savings, or to be used in National banks as security against government deposits. No difficulties are experienced in selling municipal bonds providing there is a market for securities at all, because the form of the bond is desirable and the security is almost perfect. William A. Prendergast ,when comptroller of the city of New York, speaking of the bonds of that city said, "There is no better security in the world. Nothing less than a cataclysm so general in its effect as to be nation-wide can seriously affect it." ‡ What is true of New York city is in large measure true of the great bulk of growing cities in the United States. It is especially true of the large cities whose bonds are constantly before the people and whose continued growth is assured, whose properties are valuable, and whose machinery of taxation is well developed.

If bonds are issued according to law, if they are within the debt limit, and all legal requirements have been properly complied with, the security is nearly perfect, for the holder can compel payment by resort to the courts. Taxes are a lien prior to all other claims and their levy is mandatory. But the fact that bonds are within the legal limit of debt, and issued according to law, although certified to by appropriate officials at the time bids are made, must be verified by the buyer, and their validity is often not easy of proof. "Municipalities are not held to a strict accounting of debts and obligations incurred, unless the same are legally incurred, and it has too frequently happened that municipalities have sought (and in cases succeeded) to avoid their just obligations upon purely technical grounds." § "Opinions on the subject vary, but anywhere from 20 to 50 per cent. of the aggregate municipal bonds are defective in the procedure of their issue. That is to say, flaws are detected by

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* Of the gross amount of negotiable securities of $25,314,429,058 admitted to the New York Stock exchange as of June 6, 1910, state bonds constituted but $85,403,943; New York City bonds $422,614,600, and other city securities $19,455,000.

† Of the $60,000,000 of 4¼% bonds sold at 100.94 by New York city in the spring of 1911, and which were oversubscribed five times, $48,000,000, or 80% went to investment banking houses; $11,500,000 or 19.25% to insurance companies, and only $500,000, or 0.75% went to private investors. "The Recent New York City Bond Sale"; Escher, Franklin, in *Harper's Weekly*, Feb. 11, 1911, p. 22.

‡ *Collier's Weekly*, May 6, 1911, p. 34.

§ Squire, A. "Essential Recitals in Various Kinds of Bonds," *Annals of the American Academy*, etc., Vol. 30, p. 254.

attorneys in their examination." * Of course municipalities may be made the basis of civil procedure in the case of bad faith, and this helps to compensate for the disadvantages which creditors experience through changing administrations, new policies, etc., and the fact that they must scrutinize the legality of the issues. The present debt limits, which at best provide against bankruptcy, and the presence of the taxing power make an investment in municipal securities almost second to none. Yet they are not what they might be to the creditor and far from equally advantageous to the debtor.

The one supreme fact in which the creditor is interested is the right to enforce the use of the taxing power. Indeed, it may be said, one of the main purposes of the debt limit is to insure the existence of such a proportion between the amount of indebtedness and taxable wealth, that the debts contracted will in all cases be paid. This is another safeguard extended to the bondholder. True it prohibits in most instances a too flagrant use of the borrowing power, but at the same time it woefully lacks all marks of an intelligent administrative policy. Not content with making the bonds in all cases a lien on taxable property an added precaution is taken to prohibit this mortgage from tempting the taxpayers to repudiation. But what of the protection to the taxpayers? Whether the asset acquired from the use of borrowed funds is properly used, whether it is wasted or ruthlessly destroyed, the creditor cares little. His security is certain so long as taxable private wealth endures. Even in these comparatively few cases where bonds are seemingly based upon the earning power of municipal utilities—since they are counted outside the constitutional debt limit, if they pay the interest on the bonded debt, and contribute to the sinking fund a sufficient amount to pay the bonds at maturity—the creditor is safeguarded by the pledge of the faith of the issuing corporation in case the properties do not make such contributions. In any case, the existence of taxable value upon which the city may be legally compelled to levy taxes is the source of the security and not the fund accumulated for its payment.

Negotiability is always an important factor in the value of

* Lownhaupt, Frederick, "Municipal Bonds; Facts Regarding their Issue and their Security," Booklet No. 4, *Moody's Mag.*, 1911.

any credit instrument.* The security of two issues may be identical, and yet the bonds of well-known places or places near financial markets have a greater negotiability and hence greater value than those from places not so well known or so advantageously located. The market for municipals is narrow, and the adoption of any measure which will widen it cannot but react upon the demand and through it upon their value. There is no necessary reason why the bonds of a small village whose population is enterprising, whose affairs are well managed and whose growth is certain, ought not to command as low an interest rate as those of large cities, providing they are issued with as great a discrimination as respects purpose, form and amount and possess equal negotiability. Yet such is strikingly not the case. A distinct step toward giving municipals these characteristics would follow the certification of their *necessity* and their legal validity by some recognized competent centralized authority. The fact that such securities existed would be advertised broadcast by financial houses and would react both to the advantage of the creditor in a wider market and to the debtor in a reduced interest rate.

Such has been the experience in those countries where certification has been put on an efficient basis. The Ontario Railway and Municipal board say of their experience in this matter: "A great many applications were made to the board, although there were no irregularities in by-laws or the debentures, in order to secure the certificate of the board, and thus enable the municipalities to obtain the highest market price for their securities, and to facilitate their sale, and make their transfer more convenient and inexpensive. Not only have the municipalities received a better price for their securities, but a great saving of expense has been effected by the act. It is estimated that the enhanced price and the saving of expense to the municipalities will amount to thousands of dollars each year."* But the power to certify the legality alone is not sufficient. Its necessary complement is the power to certify the *economic necessity* of debt contraction, as well as to prescribe the amount and form of debt which is allowed. In these respects the judicial review provided for and the powers given to the supreme court

* *Vide*, "The Better Protection of Municipal Securities," *Bankers Law Journal*, 1907, Vol. 24, p. 785. This is the report of the Committee on Municipal Securities to the executive council of the American Bankers association.

* "Ontario Railway and Municipal Board, Third Annual Report," 1908, p. 12.

in the state of Georgia to validate municipal bonds, as well as the law of Colorado which requires that refunding bonds be registered by the state auditor, are defective.* The same may be said of the Texas law, which gives to the attorney general the power to validate municipal bonds, as well as of those parts of the constitutions of North Dakota † and Oklahoma,‡ which provide for bond validation.

What is to be counted as debt within the constitutional limit should not be a subject upon which the court's judgment must constantly be sought. The issues at base are economic and not legal, and while it might be possible for courts to formulate definite legal principles which would settle most of the difficulties arising under the present hodge-podge of legislation, they have not so far done so.§ The provisions governing debt contraction should be so definite and unmistakable as to prevent undue expansion by resort to the courts. Borrowing for legitimate purposes and in legitimate amount as demonstrated by sound policy and needs ought not to be prevented by rigid constitutional provision, nor debt contracted in good faith and after due consideration be invalidated because of some minor errors that may have crept into either through neglect or oversight during the process of issue. As it is today, such errors are sufficient to invalidate the evidences of debt in the hands of innocent holders,‖ and to involve the taxpayers in wasteful and unwarranted expenditure. Too often, no doubt, municipal officials have taken advantage of this fact and either through acts of commission or omission, have been able to sell worthless securities. This fact, together with the enormous amount of borrowing by co-terminous and conflicting jurisdiction for a multitude of purposes has made it necessary for bond houses in effect to validate every issue which they purchase. This is expensive and the costs are paid by

* *Vide.* "Report of the Committee on Municipal Securities to the Executive Council of the American Bankers' association." *Bankers Law Journal,* Vol. 24, p. 788.

† Constitution, 1889, sec. 187.

‡ Constitution, 1907, Art. x, sec. 29.

§ "There is no established rule of construction which the courts have adopted in defining the words [What is debt in the constitutional sense]. The desire on their part to limit the legal indebtedness of municipalities, or to compel the payment of a moral obligation rather than any fixed rule of construction, has at times influenced their decisions." Abbott, Howard S. "A Treatise on the law of Municipal Corporations"; St. Paul, 1906, Vol. i, pp. 334-5.

‖ "It is agreed that where there is no authority for an issue of municipal bonds, that the holder, however full of faith, is not protected and the bonds are void in all hands." Hill, John P. "The Advisability of Registering Negotiable Coupon Bonds." *The Green Bag,* Vol. 16, p. 14 (1904); *Cf.* Simonten, T. C. "A Treatise of the Law of Municipal Bonds" (1896) Sec. 124.

the debtor public. A question essentially economic in all its phases should be solved by resort to economic principles; as it is today, it is primarily a question to be worked over and dissected by the courts.

Municipalities must borrow money. The securities which they issue are possessed of those qualities well suited for investment purposes. Some method should be adopted which will check not only the extravagant use of municipal credit and make it impossible for city officials, either through innocent or wilful misconduct, to flood the market with questionable securities, but which would also determine the procedure of issue and legality of security. A possible controlling agent was suggested above, and in a broad way the powers indicated which are necessary for scientific control. The problem is the adjustment of local debt to the accepted and developed lines of private finance, an adjustment in which the interests of both creditor and debtor are fully conserved and guaranteed. By such a reform, expansive law suits over the legality and validity of contested bonds, far-fetched judicial decisions, counting this and that without or within the debt limit in order to make room for some needed improvement, or to curtail an undue disposition to borrow, would in large measure be displaced by uniformity, precision and certainty.

The problems sought to be emphasized, therefore, are problems of control. Control cannot come through blanket provisions which affect the amount of debt only and ignore the technique of issue. Borrowing is a legitimate method to provide for large capital expenditure; it is nothing more than a simple financial device, commonly employed in our whole industrial system. Adequate and enlightened control must be addressed to the technique of debt creation where the problems of equalizing tax burdens between the present and the future show themselves through the time and method of debt payment, as well as to the technique of borrowing where the relations of debtor and creditor are revealed in the determination of an interest rate.

Public debt is necessary to our local economy. Accurate accounts, publicity and control, so vital as respect current revenue and expenditure, become doubly necessary when debts are incurred for vast undertakings and sinking funds are accumulated

for their payment. Public expenditures are increasing *pari passu* with the function of public powers. Larger and larger amounts of income are being diverted from private into public channels, and borrowing is more and more indulged in. Just as there can be no fixed percentage of public to private income, so there can be no fixed relation between borrowed funds and the total contribution which a people are willing to make. The necessary proportion must vary from time to time and from district to district. Neither can debt be made a certain percentage of the assessed value of property. The criterion for a proper measure of the relation of public to private income is service rendered, whether public income shows itself in taxes paid currently or in indebtedness contracted. Service is the guiding principle, and the measures undertaken to insure this in the form of checks upon the wastefulness of public money, whether by unreliable, incompetent or crooked officials or by meaningless accounts, etc., are likewise applicable to the control of public borrowing.

Our point of view may be summarized in the contention that public borrowing is neither a blessing nor an evil, but a legitimate financial device useful to some political units, indispensible to others, and harmful to still others, which requires for its proper control administrative talent of the highest type. Not only is the present constitutional control theoretically wrong, but as it operates it is open to the most serious objections. As a scheme of regulation it absolutely fails of its purpose. It was designed to prevent abuse of public credit, and it was thought this end could be realized by limiting the amount to be borrowed. In some cases, not only have the abuses but also the uses of credit been prevented; while in others its use has been flagrantly abused in spite of the limitations. These were developed originally of a philosophy which stamped public debt as a public evil, and this philosophy still retains its hold upon us.

The problems in public debt are, however, broader than curtailment of use; they involve regulated use and call for immediate attention.