

## Growth and Muni Bonds

**A** LONG with other financial markets, the market for state-local government bonds (municipal bonds) felt the pressure of restrictive monetary policy in 1966. Yet, despite a sharp drop in muni-bond sales during the summer period's tight-money peak, total state-local sales reached \$11.05 billion for the year as a whole. This was exceeded only by the previous year's record sales of \$11.14 billion.

Over the 1962-66 period, municipal-bond sales exhibited a 6-percent average annual rate of growth. This upsurge in borrowing accompanied a sharp rise in state-local government spending, which over the postwar period has increased far more steeply than federal spending. By late 1964, in fact, state-local expenditures on goods and services actually exceeded those of the Federal government, and continued to do so through the middle of last year, when sharply increased expenditures for Vietnam reversed the balance once again.

Interest rates on municipal bonds have

fluctuated with overall monetary conditions. In the last several years, little variation in spread has developed between muni-bond yields, on the one hand, and corporate and Treasury bond yields, on the other. In 1962, the average yield on Aaa municipal bonds was 3.03 percent; by 1965, it was 3.16 percent; and for 1966 it was 3.90 percent with a peak of 4.18 percent being reached in September. Lower-rated bonds followed a roughly similar path, but there was one new development: the spread between Aaa and Baa bonds tended to narrow somewhat over time. In 1962 the spread varied between 57 and 80 basis points, while in 1966 the spread was from 39 to 60 basis points.

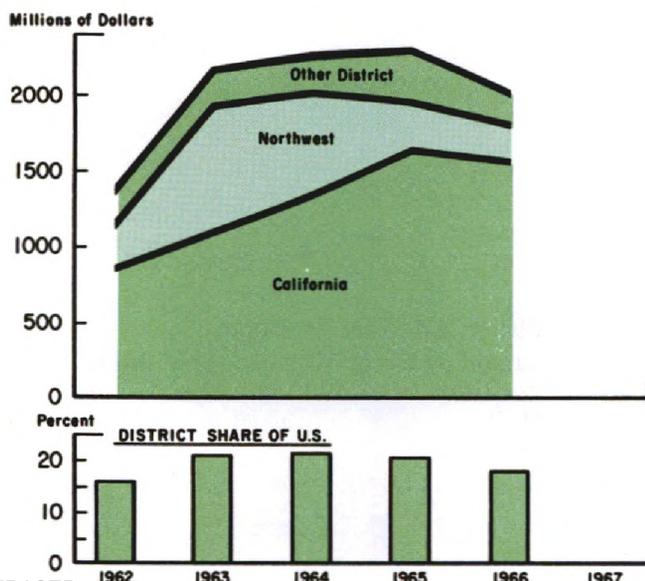
### West outpaces nation

Governmental units in Twelfth District states increased their borrowing as well as their spending at a faster-than-national pace during the 1962-66 period. Total new issues rose from \$1.38 billion in 1962 to \$2.30 billion in 1965, before declining to \$2.02 billion in 1966. Thus, the West's share of total bond sales rose from 16 to 18 percent over the period, and actually exceeded 20 percent in 1964 and 1965.

The average volume of borrowing has tended to vary directly with the various states' population and income. While there are, of course, other forces influencing decisions to borrow, the high degree of correlation of these two factors with bond sales is quite clear, and the relationship undoubtedly is mutual. Income and population growth, in other words, have been major factors inducing and supporting the growth of Western state-local borrowing over this timespan, and the consequent rise in state-local spending has added to income and attracted potential migrants.

California governmental units naturally

### Muni-bond sales slacken during tight-money period



were the largest borrowers over this period; their issues were never less than half the District total of funds raised, and in 1966 California issues (\$1,642 million) made up almost four-fifths of the regional total. Furthermore, in every year since 1962, they accounted for the largest dollar volume of issues of any state in the union. The totals were bolstered during the past three years by five State of California issues of \$100 million or more.

Washington came next in regional importance, being second to California in every year of this period except 1966. Washington's peak was reached in 1963, when its \$722 million in new flotations—mostly associated with the financing of the Columbia River power project—gave it fourth place in national rankings. That state also floated a \$314-million offering in 1964—the fifth largest single issue sold in the nation up to that time.

### Physical and human resources

A breakdown of last year's total flotations permits an analysis of the purposes for which Western governmental units borrow so heavily. The largest category last year, making up one-third of the District total (as against one-sixth nationally) was public utilities and conservation. California's program dominated both District and national borrowing in the category of water-resource and recreation development. Six issues, ranging from \$20 million to \$160 million in size, helped push the state-wide total to \$638 million.

Next in importance was education, which took more than one-quarter of total funds raised in the District last year. Higher education in District states accounted for almost 6 percent of total borrowing, as opposed to a 3-percent share nationally. The District also outpaced the nation in borrowing for elementary and secondary education. Over the 1962-66 period as a whole, California governmental units led all others in borrowing for this purpose, as the state in some years devoted almost 30 percent of its bond receipts to elementary and secondary schools.

Social-welfare activities, such as public housing, veterans, and recreation, amounted to 14 percent of District borrowing last year. Almost one-third of the total was concentrated in a single State of California issue, which divided \$100 million equally between recreation and veterans programs. Oregon also raised \$30 million in two issues for veterans.

Transportation issues took under 9 percent of District borrowing, concentrated mostly in two large bond issues—\$50 million for the San Francisco Bay Area Rapid Transit District and \$48 million for the California Toll Bridge Authority. Transportation issues, by the way, have been declining in importance over the past decade, since the Federal highway program has relieved much of the financial burden on states and local governments.

The District failed to participate in the upsurge of industrial-aid financing, which

**PURPOSES OF BORROWING, BY STATE, 1966**  
(\$ millions)

	Elem.-Secondary Education	Higher Education	Transportation	Utilities, Conservation	Social Welfare	Other	Total
Alaska	—	—	—	5	—	6	11
Arizona	14	28	5	16	7	23	93
California	346	60	131	638	219	190	1,584
Hawaii	—	—	1	—	3	20	24
Idaho	5	1	1	—	3	1	11
Nevada	10	—	19	13	3	6	51
Oregon	33	17	11	18	49	13	141
Utah	8	1	—	3	1	2	15
Washington	21	7	8	27	6	16	85
<b>Total</b>	<b>437</b>	<b>114</b>	<b>176</b>	<b>720</b>	<b>291</b>	<b>277</b>	<b>2,015</b>

## FEDERAL RESERVE BANK OF SAN FRANCISCO

on the national scene was perhaps the most noticeable development in the field of state-local finance last year. This type of financing, which uses the tax-free feature of municipal bonds to provide facilities at a lower cost than private corporations can obtain, is designed to attract new industry to develop particular areas. Nationally, industrial-aid issues doubled in 1966, to \$504 million, or roughly 5 percent of total state-local borrowing, but none of these bonds were issued by Twelfth District states. Actually, only four District states permit the issuance of such bonds, which have come to be widely criticized as a doubtful fiscal practice.

### States expand their borrowing

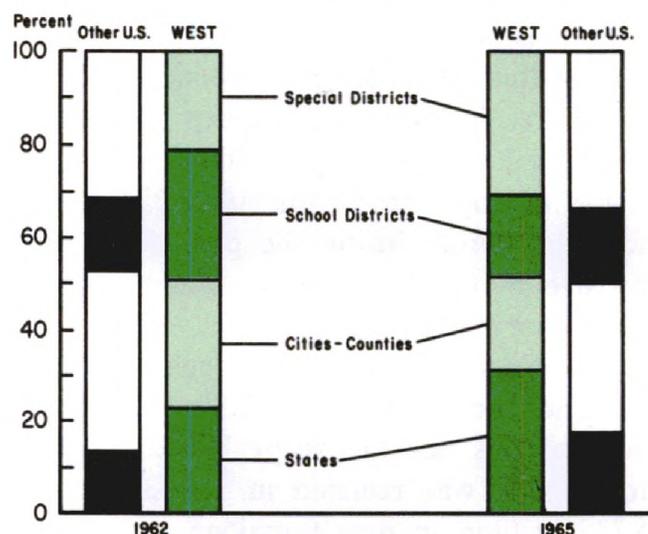
In the West as in the rest of the nation, borrowing by state governments has increased relative to that by cities and counties. Borrowing by special districts and similar public bodies meanwhile has risen substantially, because of the capabilities of such organizations for accomplishing area-wide projects or because of the desire to avoid limitations on borrowing imposed by state constitutions.

School-district financing has tended to lag, but since educational expenditures have remained high, this simply represents a shift to state-government borrowing. The State of California, to cite the most obvious case, borrowed over \$600 million between 1962 and 1966 to provide credits for local school-construction programs.

The dollar volume of bonds raised by special districts more than doubled in the 1962-65 period alone, thereby financing such heterogeneous activities as toll bridges, electric companies, water works, and irrigation projects. These public bodies have been set up to handle projects not easily operated by ordinary government organizations or to undertake joint functions for several governments.

In the West, where public power and

### State-government borrowing more important here than elsewhere



water projects have been historically important, the special district has continued to play a major role. The Columbia River project was largely financed by public-utility districts in Washington, while California's water-development program has stimulated local water and irrigation districts to increase their activities. California meanwhile has witnessed the development of a new form of public agency—a special authority which constructs some project, usually a civic building or stadium, and then leases it back to the city or county concerned. Recent issues under this kind of arrangement include the \$27-million San Diego Stadium and the \$26-million Oakland-Alameda Stadium.

Like public bodies everywhere, District governmental units have expanded their borrowing in order to finance their growing expenditures. A temporary setback occurred during 1966's period of monetary restraint, but the basic uptrend has now reasserted itself; in the first half of 1967, muni-bond sales in the nation as a whole were about 30 percent higher than in the like period of a year ago. Indeed, the strong growth trend in municipal borrowing seems certain to continue in line with the upward trend in state-local expenditures.

—Robert Johnston