The use of tax-exempt securities to finance the cost of pollution control.

Joseph L. Amort

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THE USE OF TAX-EXEMPT SECURITIES TO FINANCE THE COST OF POLLUTION CONTROL

BY JOSEPH L. AMORT

A thesis submitted to the Department of Economics in Partial Fulfillment of the Requirements for the Degree of Master of Arts at the University of Windsor

Windsor, Ontario 1975
Pollution is an economic externality resulting from competitive firms undervaluing the resources of air and water as factor inputs. Unfortunately, pollution will continue to be generated as long as cost-minimizing firms are allowed to shift the costs of environmental cleanup to society. As well, since firms are undervaluing their factor inputs the prices they set are not a true reflection of the total costs of doing business and, therefore, a misallocation of resources will result.

It is incumbent upon the government to coerce firms to internalize their costs by removing the zero price tag associated with the resources of air and water.

One method by which the government may do this would be through a policy of subsidization. The profit maximizing firm will view a subsidy as an opportunity cost in terms of foregone revenue and the more efficient it is in reducing pollution, the greater the opportunity for profit.

The use of tax-exempt securities to finance the cost of pollution control is one such subsidy and it appears to be an effective method to persuade firms to internalize the external costs they have been passing on to society.
ACKNOWLEDGEMENTS

This thesis would never have been written without the patient guidance of Professor R.P. Mendels. It was his encouragement and assistance that enabled me to present this thesis in its present form. I would like to thank Professor J. Strick for his many helpful comments throughout the several drafts and especially for his help in securing the necessary time to enable me to complete this thesis. I would also like to thank Professor T. Price of the Faculty of Political Science for giving of his time as a member of the thesis committee. Finally, I would also like to thank my wife for her patience, understanding, and encouragement through the years it has taken me to achieve this goal.
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INTRODUCTION

While some form of environmental disruption has accompanied mankind's activities over the centuries, a combination of recent developments has caused what once was considered an annoyance to become a crisis. Increases in population, unparalleled affluence and technological progress in the United States (and other highly industrialized nations) has resulted in widespread pollution.

The world population doubled between 1650 and 1850. It doubled again by 1930 and this doubling now only takes thirty-five years. It follows that this population is clustered in more compact areas. It is estimated that 40 percent of the world's population live in urban areas and 50 percent of urban dwellers live in cities of 100,000 or more. Naturally, the more people there are, the more wastes there are to recycle. The concentration of people and their accompanying wastes makes the task of recycling and disposal all the more difficult.

There has also been a great increase in per capita wealth and, as a result, production has risen to satisfy growing demands. This production increases consumption of resources for industrial purposes.

which in turn generates greater waste from the process of extraction
and manufacturing.

In the April 1971 issue of *Environment*, Barry Commoner, Michael
Corr., and Paul J. Stamler argue that the rapid increase in environmental
disruption is due primarily to changes in technology. This technology
has brought about a reliance on synthetic chemicals, the private automobile,
cement, and domestic electrical appliances, and much greater power
consumption. They argue that environmental conditions have deteriorated
much more rapidly due to technological change than by increases in
either population or affluence.

To determine the extent of environmental disruption, namely water
pollution, the Environmental Protection Agency (EPA) ran a study of
the major drainage basins in the United States. The details of this study
appear in Table 1 of Appendix A. The explanation (in Appendix A)
of the results of the survey leads one to conclude that the overall picture
of water quality in the United States is appalling.

The extent of air quality deterioration in the United States is summarized
in Table 2 of Appendix A. An estimated 263.9 million tons of discharges
from motor vehicles, industrial plants, large and small power and generating
plants, refuse disposals, individual heating systems, and from miscellaneous
combustion and production activities entered the atmosphere in that
year, again an appalling figure.

The net economic consequences of air and water pollution are extensive.
The effect on human health results in a net decrease in productivity through
lost man-hours worked and increases the costs of health care; poor air quality results in damage to agricultural crops and livestock while poor water quality endangers the global food chain; air and water pollution can result in substantial property damage and thereby have a negative impact on residential property values; finally, there is a social cost associated with the foregone use of pollutant-damaged recreational facilities.

It was estimated that it would cost $42.6 billion to update and operate acceptable waste treatment facilities for American domestic and municipal water from 1971 to 1980. The President's Council on Environmental Quality estimated that it would cost $23.7 billion to meet established air quality standards between 1970 and 1975.

The preceding discussion raises two basic questions. First, recognizing that continued pollution of our environment must stop, who should take the initiative to stop further pollution from occurring? Second, who should pay the enormous cost of an environmental clean-up and the continued abatement of pollution?

The purpose of this thesis is to analyse the issues involved and to advance a partial answer to both of these questions.

Chapter 1 analyzes pollution as an economic externality and lays the foundation for governmental intervention to coerce firms to internalize


these external costs. Chapter II outlines the various methods that the government can use to accomplish this purpose and provides an economic analysis of these methods. Chapter III assesses the effectiveness of the government's efforts in pollution abatement. Chapter IV examines a relatively new method to finance the cost of pollution control viz. the use of tax-exempt securities. Finally, Chapter V provides the summary and conclusion.

The scope of this thesis is limited to air and water pollution as the greatest environmental disruption has taken place in these media. As well, this thesis is limited to the United States as the use of tax-exempt securities has never been adopted in Canada.
CHAPTER 1

The Economics of Pollution

A. Introduction

Traditionally, we depend upon the price mechanism to allocate scarce resources among their alternative uses. The price system can not be expected to function properly, however, if factor inputs are priced improperly, or not priced at all. Abuse of water and air resources comes about largely because air and water are undervalued. In fact, they are regarded as free goods. Therefore, as the pricing system does not reflect all the costs of scarce resources, there will be a continued misallocation of resources in the economy.

As competitive firms do not view the use of the resources of air and water as a factor input, the competitive market system produces undesirable "spillover" effects on the environment. A typical example would be the injection of waste products into our air and water resources, waste products that results from the production process of firms. Taking a closer look at the cost structure of a firm in a purely competitive market enables us to examine why pollution is commonly referred to as an externality.

B. Pollution as an Externality

The marginal cost schedule of a firm represents the additional costs incurred to produce a given unit of output. The implicit assumption is that all costs are borne by the firm and thus become private costs. Given this assumption, then in figure 1-1, the full incremental costs of production could be shown as the marginal private cost schedule (MPC). ⁵

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The firm will maximize profit at an output of OE. The MPC schedule includes the incremental costs to the firm of labour, materials, and capital. However, emphasizing the word private in the firm's marginal cost schedule, indicates that other costs of production may exist. External costs are defined as any costs that are additional to the costs resulting from the production outlays of the firm. Total social costs are defined as the sum of the private costs of the firm and any external costs.

Thus, it is possible to conceive of another marginal cost schedule that includes both private and external costs. This is called the marginal social cost schedule (MSC). As drawn in figure 1-1, it lies above the MPC schedule at every level of output. The vertical difference between the MPC and the MSC schedules at any given quantity measures the external costs per extra unit of output. Assuming a perfectly competitive market, and assuming that the firm takes account only of private costs, the firm maximizes profits by producing an output of OE units where $P_t = MPC$.

However, if we are going to take into account all costs – private and external – then the price-marginal cost equality should occur at the output level where $P_t = MSC$ or $ON$ in figure 1-1. This means that the excess of any units between the private optimal level of production OE and social optimum level ON represents over-production of goods. Society would be better off with ON units of this good rather than with OE units because the resources used to produce the last NE units have greater productive value in other employments. The same reasoning implies that some other good or goods in the economy are being underproduced,
or not produced at all. Thus, the first result of not taking into account external costs shows that an external diseconomy in an otherwise competitive market system distorts the optimum allocation of resources; the quantities produced of some goods are too great and the quantities produced of other goods are too small.

We can now extend the analysis one step further by assuming that all firms cause exactly the same social costs in their operations. Thus, we can shift our analysis from the firm to the industry level, and we can consequently represent the cost conditions of all firms in the industry by the MPC and MSC schedules in figure 1-1. The aggregate of all firms with similar marginal cost conditions can be summarized in the industry supply schedule. The MPC schedule of each firm is its supply schedule at all price levels that exceed average variable costs. Figure 1-2 shows the industry private supply schedule (PSS). The summation of the MSC schedules of all firms is labelled SSS or the Social Supply Schedule. The SSS curve lies above the PSS curve, reflecting the difference between marginal private and social costs for all firms in the industry. The vertical distance between these two industry schedules is the aggregate of the external costs imposed on society for any given level of output by the industry.

The PSS and the SSS schedules together with the industry demand schedule (D) in figure 1-2 can be used to analyze the full effects of the external diseconomies of production on relative prices and resource allocation. The demand schedule intersects the private supply schedule
in figure 1-2 at a price of $Pt$ and a total quantity of $OM$. The equilibrium industry price $Pt$ is the going market price that faces each firm in the industry, as shown in figure 1-1. Total industry output of $OM$ is just equal to the sum of all the individual firms' outputs of $OE$ in figure 1-1.

![Figure 1-2](image)

According to previous assumptions, the SSS schedule, not the PSS schedule, reflects the social marginal costs of output. If SSS were the industry supply schedule as shown in figure 1-2, the level of industry output would be $OK$ units and the market price would be $Pk$. Comparing this result with the actual industry price and output in equilibrium, we can conclude that the private market for a good leads to too high a production.
of that good. (by \( KM = OM - OK \)) units and too low a price (Pt instead of \( Pk \)). Society, as a whole, would be better off if firms behaved as if SSS, not PSS, were the industry supply schedule.

C. Externalities, Monopolies, and Imperfect Competition

The discussion of the externalities problem so far has assumed perfect competition in all markets. The analysis can be extended to include monopolies and markets characterised by imperfect competition. The net effect of externalities on the allocation of resources will depend on the extent of monopoly power exercised by the firm(s). A firm exercising monopoly power will set its profit-maximising price above its marginal cost. This results in a lower output relative to a perfectly competitive industry and distorts the allocation of resources by producing too little output compared to the level of output in competitive industries. Therefore, the resource allocation distortions caused by monopoly power and externalities may actually improve the overall allocation of resources in an economy. However, if external costs are found mainly in competitive industries, then both the competitive and externality effects reinforce each other in distorting the allocation of resources.
D. A Market Solution for the Externalities Problem

If we recognize pollution to be an externality, it may be possible to use the profit motive to lead to a solution to this problem by giving the firm an incentive to internalize the external cost it was previously imposing on other firms and households. Such a solution can be imposed by having the government extend its traditional role in a market economy by "assigning and enforcing property rights to environmental resources", and is discussed in the following chapter.

\[^{6}\text{Ibid, p. 77.}\]
CHAPTER II

The Role of Government in Controlling Pollution

There are three possible means by which the government can intervene to coerce firms to internalize their costs: 1. direct regulation and prohibition; 2. fiscal disincentives or taxation; and, 3. fiscal incentives or subsidies.

A. Direct Regulation or Prohibition – Federal Legislation on Air Pollution

The Clean Air Act of 1970 (known as the "Muskie Clean Air Bill") is the central legislation upon which the American federal government's effort to improve air quality is based. It relies entirely on regulation to control air pollution and is directed at both mobile and stationary sources of air pollution. 7

The law requires that carbon monoxide and hydrocarbon emissions be reduced by 90 percent from the uncontrolled levels of 1970. This limitation on discharges must be met by 1976. 8 In addition, the law requires that


8 Due to economic conditions, these standards have now been relaxed and their implementation deferred.
automobile manufacturers give customers a 50,000 mile or five year
warranty that the vehicle will continue to meet the standards.

The 1970 law also applies to concentrations of various pollutants
existing in the atmosphere. This feature empowers the Administrator
of the Environmental Protection Agency (EPA) to establish maximum
allowable rates of discharges for different classes of sources, for example,
pulp mills and electric power generators, and to enforce them through
the federal courts.

National emission standards have also been set for sulfur oxides,
hydrocarbons, carbon monoxide, nitrogen oxide, oxidants and other
particulate matter. Each standard has two levels – primary standards
are to be achieved by 1975 and "reflect pollution levels that will result
in no detrimental human health effects". Secondary standards, much
more severe, are an additional safety margin for preventing damage
to vegetation and property. These standards are to be met in a reasonable
time period after 1975.

B. Direct Regulation or Prohibition - Federal Legislation
on Water Pollution

The Water Quality Act of 1965 represents the pivotal legislation
asserting federal government leadership in anti-pollution efforts. The

9Joseph J. Seneca, Michael K. Taussig. Environmental Economics,
The most important feature of this Act is that:

It requires states to establish water quality standards for their waters and to develop a program for attaining them. This program is to be regarded as a benchmark for judging the progress of a state in attaining its water quality standards and for assisting federal officials in determining the maximum amount of discharges consistent with the water quality standards. Then they issue licenses limiting discharges in aggregate to this maximum, usually following some rule of thumb such as uniform percentage removal. In enforcing these license provisions, states must undertake surveillance of dischargers and must initiate judicial or quasi-judicial proceedings when violations occur.\textsuperscript{10}

The Water Quality Act of 1965 was amended by the Clean Water Restoration Act of 1966. The purpose of this law was to raise the quality of interstate waters; however, the law did not provide for the establishment of a single set of national standards. Instead, Congress provided for an elaborate procedure to insure that the establishment of standards would be primarily a state responsibility, subject to federal approval. Under the 1967 (sic) Act, each state was given until June 30, 1967 to adopt water quality standards applicable to interstate waters within its borders. If a state failed to meet this deadline, or if the standards submitted to the Department of the Interior were rejected, the department itself was authorized to establish water quality standards for interstate waters within the state.\textsuperscript{11}

The efforts of the federal government in both air and water pollution rely on "nationally protected quality standards to be achieved by more


\textsuperscript{11}Grad (et al), op. cit., p. 62.
specific state regulations to control emissions and effluents. In both instances there is an attempt to utilize federal regulatory power, relying on state origination of standards in the first instance.  

C. An Economic Analysis of the Use of Prohibition/Regulation as a Means of Controlling Pollution

In figure 2-1, the marginal social benefit (MSB) and marginal social cost (MSC) schedules are drawn in reference to the units of pollution abatement for some hypothetical pollutant.

![Graph showing optimal pollution level and complete prohibition level.](image)

Figure 2-1

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12Ibid., pp. 64-65

13Seneca, op. cit., p. 207.
The schedules represent the marginal social benefits and marginal social costs respectively, associated with each level of pollution abatement and the corresponding level of environmental quality. The optimal level of output of pollution abatement within the framework of benefit-cost analysis is at point OA. Rigidly enforced prohibitions may move society along the horizontal axis as far as OB; that is, to absolute purity, which people do not value and may not even be able to perceive. The marginal social cost of achieving perfect purity may be extremely large, as it could involve the complete shutdown of some industrial firms or public utilities. "The economist's benefit-cost analysis provides a strong argument against prohibition as a general environmental policy instrument." 14

D. Fiscal Disincentives or Taxation

One of the problems with the present control system and standards for air pollution (in the Clean Air Act of 1970) for automobiles is "how to get the car owner to tune and maintain his engine periodically?" Economists at Rand Corporation proposed the answer - a Smog Tax. 15 In one version of this tax, cars would periodically be tested and

14Ibid., p. 208.

assigned a smog rating. The rating could be indicated by a seal or coded
device attached to the car. Then, when the driver purchases gasoline,
he would pay a tax over and above the present gasoline taxes, and the
amount of the tax would depend on his smog rating. Under the smog
tax system, an individual can reduce his smog tax bill in several ways:
first, tuning up or overhauling his engine to reduce emissions and obtain
better gas mileage; second, he can buy a car with a better smog rating.

The smog tax is relevant for it answers the question of who should
be responsible for the continued attainment of emission standards.
It seems to be a practical means by which to reduce automobile emissions
by placing the responsibility on owners and backing it up with appropriate
economic incentives.

In 1972, The Nixon administration submitted the Pure Air Tax
proposal to Congress.¹⁶ This proposal was added to ensure that the
standards of the Clean Air Act of 1970 would be met. The tax would be
levied on electric power plants that burn coal and oil to generate electricity,
refineries, smelters and perhaps other industrial processess. Among
the primary pollutants, sulfur oxides are one of the most damaging to
human health:

The Clean Air Act of 1970 requires air regions (as specified in
the Act) to meet primary air quality standards by 1975. In regions not
meeting these primary standards, the tax would be set at fifteen cents
per pound of sulfur discharged from all sources within the

¹⁶Seneca, loc.cit., p. 235.
region. If the region meets the primary standard but not the more restrictive secondary standard, the tax would be ten cents per pound. If there is compliance with both standards, no tax would be levied.

The Pure Air Tax represents the first seriously considered national emission charge. The immediate effects of the sulfur tax would be to encourage firms to install antipollutant technology and, at the same time, to move towards lower sulfur content fuels.

E. An Economic Analysis of the Use of Taxation as a Means of Controlling Pollution

In the category of tax weapons, "effluent charges are the particular form of taxation having the most direct application to the problems of environmental quality". 17 A per unit tax on effluent discharges removes the zero price tag associated with the use of air and water resources for waste disposal purposes, and thereby narrows the unrestricted property rights implicit in the free use of the environmental media. Firms and individuals are thereby forced to consider effluent charges as another cost of doing business.

In figure 2-2 with an effluent charge of OF dollars per unit of waste discharged, the firm takes action to not discharge its first OX waste units, saving AFB dollars relative to paying the effluent charge for discharging this amount of wastes. To the right of point B,

17 Ibid., p. 220.
Figure 2-2

Reduced
Waste Units

Reduced
Unit of Waste
Effluent Charge

Wastes Reduced
Subsidy per Unit of
Reduction

MSC or Waste
MSC of Waste

MSB or Waste

OX units, eliciting to pay the OF per unit effluent charge on the remainder.

from A to B (that is, the first OX waste units) and if the waste load exceeds a heavily shaded line ABC, taking internal actions to avoid waste discharges.

Thus, the firm acts along the higher costs of not discharging. Thus, the firm will pay the effluent charge and discharge wastes rather than

19
G. Fiscal Incentives or Subsidies

The Water Pollution Control Act of 1956 established the first federal subsidy for treatment plant construction. This subsidy takes the form of federal grants to municipalities covering up to 55 percent of the cost of plant construction. In addition, some states augment the grants to the point where cities are responsible for only 15 percent of total construction costs. Since 1956 this program has grown so rapidly that by 1973 nearly $1 billion per year was being spent by the federal government to subsidize public waste treatment. To be eligible for these grants, a state must have adopted a plan for achieving water quality standards which are acceptable to the EPA. Present regulations stipulate that such plants must require a minimum secondary treatment of 85 percent removal of organic wastes or its equivalent.

This program encourages cities to provide at least secondary treatment of the wastes of all discharges connected to municipal sewer systems. While these discharges include the bulk of the nation's households and commercial enterprises, the majority of the nation's industrial wastes are discharged directly to rivers and streams.

To encourage waste treatment activities by these dischargers, the Tax Reform Act of 1969 allows accelerated depreciation, for tax purposes.

18Freeman, loc.cit., p. 116.
of waste treatment plant investments. The objective of this $120 million annual "tax expenditure" is to stimulate more spending on pollution control by reducing the aftertax cost of such investments.

In general, Federal government subsidies take the form of loans, guarantees and grants. The federal government makes available a variety of low interest loans for the purchase of pollution equipment. In some cases outright grants are made. Such grants may constitute up to 80 percent of the cost of new treatment facilities in economically depressed areas. Clearly, the government's objective is to provide jobs and economic security as well as to eliminate pollution. The federal government is also experimenting with what are called "Demonstration Projects." Washington will grant up to 50 percent of the cost of a water cleanup project if the program is related to a basin wide effort. If there is no coordinated program the federal government will provide only 30 percent of the cost and then only on the condition that the state matches the contribution. Congress authorized an increase in federal grants from $150 million for fiscal 1967 to $1.25 billion for fiscal 1972.

H. An Economic Analysis of the Use of Subsidies as a Means to Control Pollution

The effects of a subsidy are equivalent to those of an effluent charge. The government could offer a subsidy of 0.5 dollars (in figure 2-2)

19Ibid.

per unit of waste not discharged. This policy would be symetrical to the effluent charge policy in terms of waste reduction. The firm would reduce wastes up to OX units because it is profitable to do so, earning a net profit of AFB dollars on the OX units of wastes treated. \(^{21}\) However, a fundamental difference in economic incentives exists between the subsidy and the effluent charge methods.

G. A Comparison of Taxation and Subsidization

In the case of an effluent charge, the firm reacts to the potential economic penalty of a tax per unit of waste discharged into the environment. The firm takes action to minimize the net revenue effect of this tax by avoiding waste discharges if it can do so for less than the OF dollars per unit and paying the tax for all other waste units. An ultimate effect of the effluent charge is to increase the overall cost of operation and thereby reduce the quantity of final output offered at each price. If the effluent charge is applied throughout the industry, the final result is to increase the market price of its product and to reduce the quantity sold. Thus, the improvement in environmental quality is paid for by the consumer of the product via higher prices and by society, in general, through a decrease in output.

On the other hand, a government offer of a subsidy of OF dollars acts as a bribe not to discharge wastes. The subsidy is an opportunity.

\(^{21}\) Seneca, loc.cit., p. 222.
cost in terms of foregone revenue and also has the effect of internalizing the social costs of waste discharges. ... "Normal profit incentives will operate as in any other market, and the more efficient the firm is in its waste reduction, the greater the profit opportunities." 22

22 Ibid., pp. 222-223.
CHAPTER III
Assessing the Effectiveness of Existing Pollution Control Programs

A. Direct Regulation and Enforcement

One of the conclusions of the previous chapter established that the cost-benefit analysis strongly argued against the use of prohibition as a general environmental policy instrument. Some recent findings support this conclusion.

In 1969, the General Accounting Office released the results of a detailed study of several rivers. The report concluded that even though $5.4 billion had been spent at all levels of government for waste treatment plant construction during the previous twelve years, the nation's rivers were in worse shape than before.\textsuperscript{23} The Environmental Protection Agency (EPA) has also surveyed the extent of water quality deterioration in the United States. In 1970, "the EPA reported that 27 percent of the nation's water's were polluted. In 1971, the relevant figure was 29 percent".\textsuperscript{24}


While the existing laws seem adequate, the record shows that their enforcement is often quite lax, that in some cases enforcement has been hampered by intentional efforts to subvert the law, and that technology and industrial expansion simply moved too fast for control authorities to keep up with the latest developments.

For example, to ensure that the standards for auto emissions, as prescribed by the Clean Air Act of 1970, are met, cars are tested before they are sold. The shortcoming of this law is that there is no follow-up to assure that cars continue to meet the standards set for them after as little as 10,000 to 15,000 miles of use. While the 1970 law requires manufacturers to guarantee that the cars will meet standards for 50,000 miles or five years, good maintenance and tuning by the owner are important factors in limiting emissions. At present there is no means to force an owner to tune and maintain his engine periodically.

In the area of water pollution, the Water Quality Act of 1965 authorizes federal enforcement actions whenever it is found that state-established water quality standards are being violated. Alternatively, a governor or state agency can request the EPA to initiate enforcement efforts to deal with an interstate pollution problem. The EPA can initiate court actions 180 days after notifying violators. This provision of federal law was not used at all until August 1969, and as of the end of 1971, the EPA had issued only twenty-seven notices.


26 Ibid., p. 117.
Recent evidence in the attempts to make the 1899 Refuse Act work causes one to conclude that there was an intentional effort to subvert the law. This law prohibits the discharge of "any refuse matter of any kind or any description whatever" into any waters unless the discharger has obtained a permit from the U.S. Army Corps of Engineers.

This all but forgotten law came to the forefront in 1969 as charges were brought against several firms as a consequence of individuals' initiatives. Some convictions were obtained, fines levied, and rewards paid to vigilant citizens as the law provides. But in June 1970, as the number of cases began to increase, the Justice Department attorneys were issued guidelines that instructed them not to bring charges against firms holding a permit issued by a state or local government. With this action, the Justice Department, in effect, established a policy of selective non-enforcement of one of the nation's laws. This policy was re-enforced in December 1970, when the Administration announced that, while permits were required of all dischargers, including those "exempted" by the earlier Justice Department policy, no prosecutions would take place as long as an application had been filed by July 1, 1971 and not subsequently rejected by the government.27

Some authorities feel that the net effect of this action "... (repeals) the one potentially effective federal law against pollution".28

B. Tax Incentives or Subsidies

The waste treatment grant program exemplifies how a poor government's grant structure and its administration can result in a great deal of money

27Ibid., p. 138.

28Ibid.
being spent with little being achieved. The subsidy program in this case seems to be a failure. Freeman (et al) give the following reasons for this outcome:

First, states have failed to target federal funds to the municipalities with the most harmful discharges. More than one town situated downstream from major industrial locations has used federal funds to build treatment plants with the result that their treated effluent is of higher quality than the river into which it is discharged. Also, federal funds have been concentrated on smaller, largely suburban communities rather than on the larger cities with the most pollution. For example, nearly 40 percent of the federal grant money has gone to towns with populations of less than 10,000, and these communities contain less than 16 percent of the United States urban population. The largest cities, containing 25 percent of the total urban population, have received only 6 percent of the total federal grant money.

(Second), the construction of treatment facilities does not guarantee their effective operation. In fact, the structure of the recent program creates incentives that work in the opposite direction. A second study by the General Accounting Office has confirmed the widely held belief that municipal plants are often operated inefficiently. Over one-half of the plants surveyed were providing inadequate treatment due to overzealous efforts to reduce plant operating costs, the difficulty and expense of hiring trained personnel to operate the plants, and the failure of cities to repair and maintain equipment. By subsidizing only one part of the costs of effective waste treatment - plant construction costs - the federal government has induced resources into construction activity but has provided no similar inducement for efficient plant operation.

(Third), federal grants for municipal waste treatment plant construction provide an indirect subsidy to industrial and commercial waste dischargers. By subsidizing the capital costs of municipal treatment
facilities, the existing policy tends to reduce the sewer charges imposed on industrial, commercial, and domestic waste dischargers connected to the sewerage system. Because approximately 50 per cent of the wastes handled by municipal treatment plants is from industrial sources, the size of the subsidy to business is substantial. The effect of this subsidy is to weaken the incentives for waste dischargers to seek alternatives to the public treatment of their waste flows. Production process changes, recycling, and materials recovery are all alternatives to sending wastes to the municipal plant for treatment at public expense. These alternatives are numerous and are often less costly. Yet because these alternatives are not eligible for federal subsidies, firms will overlook them in favor of having the federal government pick up the tab. The tax subsidies have a similar distorting effect on the decisions made by firms as to the techniques they choose to reduce their discharges.

Thus, through federal grants for municipal waste treatment facilities as well as through tax subsidies for industrial pollution control equipment, current policy is, in effect, allowing polluters to generate and dispose of large quantities of wastes without bearing the full cost of their discharges and then using the taxpayers' money (at a current annual rate of about $1 billion) to clean up after them.29

To summarize, it appears that the failure of the present regulatory-enforcement and subsidization effort is due to an over-reliance on a centralized administrative procedure. While it is important to have centralized (or national) standards and goals, it is equally important to decentralize decision making to the point of need to ensure that localities, in a coordinated effort, might move closer to achieving national air and water standards.

29Ibid., pp. 118-119.
The following chapter analyses this decentralized decision making process by allowing localities to use tax-exempt securities as a means of inducing firms not only to internalize their costs but also meet national anti-pollution standards.
CHAPTER IV

The Use of Tax-Exempt Securities To Finance the Cost of Pollution Control

A. A Brief History of the Exemption

The Federal Government does not tax the interest on State and local securities through income tax, and State and local governments cannot tax Federal securities. This anomaly rests upon the specific statutory exclusion of such income by the U. S. Congress. The 16th Amendment to the Constitution empowered the Federal Government to levy or tax incomes "from whatever source derived." But when Congress passed the individual income tax of 1913, Congress provided that interest on State and local securities be excluded from income. This statutory exclusion has been retained to the present in spite of continued opposition of Presidents and secretaries of the Treasury and some members of Congress.

Efforts by the Federal Government to abolish the exemption have gone on intermittently since the passing of the 16th Amendment. In 1923, the Green resolution, authorizing reciprocal taxation of Federal and State-local securities, was approved by the House of Representatives.

by a two-thirds vote. However, the effort to repeal the amendment diminished until the depression of the 1930's.

In 1938, President Roosevelt asked Congress to repeal the exemption by legislation rather than by a constitutional amendment, a step that was violently opposed by State and local governments, and Congress refused to accept the recommendation of the President.

In early 1942, the Treasury attempted to repeal the amendment by asking Congress to remove the exemption with respect to State and local issues then outstanding, rather than future issues. This proposal was received critically not only by State and local governments, but also by many persons who felt that it would be unfair to existing holders of exempts. Such holders had bought in the reasonable expectation that exemption would continue to be the law. The latter view prevailed and the law remained unamended.

In 1949, in 1951, and in 1954, the exemption issue was raised once more, and again proponents of its abolition made no headway. The 1949 and 1954 Treasury effort was concerned with local public housing authority bonds and industrial development bonds; the 1951 effort concerned the old issue of the general exemption.

Local public housing authorities have long had the right to issue exempt bonds. In addition, the Federal Government makes an annual contribution to authorities equal to the debt service on their borrowings, reduced by the amount by which rents exceed current operating costs. The Federal contribution, however, has a ceiling, since it cannot be more than 2 percent of the then going interest rate on long-term Federal
borrowing. In 1949 the Public Housing Administration and the Treasury recommended that future issues of local authority bonds be made subject to Federal income tax.

Removal of the exemption was opposed principally by the American Municipal Association and the Housing Act of 1949 continued the immunity. In 1953-54 the Treasury again made an effort to have the exemption on local public housing authority bonds removed. It also was concerned about industrial development bonds issued, with exempt status, by localities in a few States.

The Ways and Means Committee first agreed to remove the Federal income tax exemption on interest received from future issues of industrial development bonds. But representatives of the municipalities protested that this was an opening wedge to the termination of the exemption and the Committee did not press the issue.

On October 24, 1968, the American Congress altered the 16th Amendment and as of January 1, 1969, interest income on industrial-aid bonds is still exempt, provided the issue is not above $1 million, or the total of the issue plus capital expenditures of the leasing firm within the issuing municipality does not exceed $5 million for three years before and after the issue. The only exception to this 1968 ruling is that industrial development bonds of any size may have the tax-exempt feature, if they are for such facilities as housing, transportation, sports, industrial parks, or air or water pollution. The significance of this alteration with regards to air and water pollution is discussed in the remainder of this chapter.
B. Forms of Tax-Exempt Bonds

Tax-exempt bonds fall into two broad categories—general obligations and revenue bonds. General obligations are indebtedness secured by the full faith, credit and taxing power of a political subdivision or governmental agency. Revenue bonds are used to identify bonds of a political subdivision or governmental agency which are payable solely from some specified source other than the general taxing power of the issuer. Classified according to the source of payment, revenue bonds fall into the following types:

A. UTILITY

1. Bridge, tunnel or toll highway
2. Electric light and power
3. Gas
4. Public transportation
5. Off-street parking facilities
6. Water
7. Multiple purpose, the more common combinations being electric and water, water and sewer

B. Quasi-Utility

1. Airport
2. Dock and terminal


3. Hospital
4. Public Market
5. Public garage

C. Non-Utility

1. Gasoline tax, cigarette tax, beer tax, utility excise tax, etc.
2. Rentals of public buildings
   a) To another governmental agency
   b) To the public generally
      1) Educational Facilities
      2) Recreational facilities
   c) To private persons or corporations

Revenue bonds have been further divided into industrial development bonds. Industrial development bonds are used by certain municipalities or governmental subdivisions to improve the economic status of their communities by inducing new industry to locate there; for this purpose they have extended their credit to acquire capital for the construction of plants or facilities, which are in turn leased to private industry at attractive prices.

C. The Nature of Pollution Control Bonds

In a fashion similar to the Industrial Revenue Bonds, many municipalities are now issuing environmental and pollution control industrial revenue
bonds to induce firms to reduce pollution. Municipalities have extended their credit to these firms so that they may acquire capital for the construction of facilities to help reduce or eliminate pollution that would otherwise have been generated.

State and local entities will issue tax-exempt securities to purchase property or to construct or equip facilities for lease or use by private enterprises. The private enterprise is obliged to invest in pollution control devices and these bonds are payable only from lease-rental or other payments made by the company involved.

As an illustration of this type of arrangement, Baltimore County, Maryland, offered $28,000,000 in bonds for the Bethlehem Steel Corporation project. The purpose of the offering was to provide,

proceeds for construction of the following pollution control facilities; air pollution facilities for the new Stinter plant, water pollution control plant from coke oven gas coolers, water pollution from blast furnace gas cleaning, water pollution control for sanitary sewage collecting and water pollution of zinc bearing waste paper. 33

In an other example, Flat Rock, Michigan, in an agreement with Ford Motor Company issued a $25,000,000 obligation for, "construction at Ford Motor Company's Michigan casting centre for air and water pollution control facilities to meet State and county standards". 34

Many counties have industrial development boards that were created by state legislature to act as the county authority for local industrial

33 Moody's, Ibid., p. 1543.
34 Ibid., p. 1721.
development. These same boards are now assuming authority to issue pollution control industrial revenue bonds. The Fairfield industrial development board issued $27,500,000 of debt to provide "Funds for construction, installation and equipping of air and water pollution control facilities for the Fairfield works of 'The United States Steel Corporation'." 35

In an even more recent development many counties, under the aegis of the Industrial Development Authority law, are creating Industrial Development Authorities to deal only with the acquisition, construction, installation and equipping of air pollution control facilities. The Allegheny County Industrial Development Authority incorporated December 9, 1969, is such an authority. The Authority entered into a contract with the United States Steel Corporation in 1971 to issue $5,000,000 of obligations, proceed of which were to be used for: "Construction of Air Pollution Control facilities for U.S. Steel's National Duquesne Works located in Duquesne, Pennsylvania." 36

An important feature of this recent attempt at pollution control is that the counties have reciprocal arrangements with those industries that seem to contribute most to pollution: utilities, automobile manufacturing, steel plants, chemical and detergent manufacturing, oil processing, and finally paper manufacturing. 37

Table 1 summarizes the total outstanding amount of municipal and environmental and pollution control industrial revenue bonds.

35Ibid., p. 179.

36Ibid., p. 2925.

37For a complete listing by company, see: Moody's, Ibid., p. A-28.
TABLE 1
STATE & MUNICIPAL
NEW ISSUE ACTIVITY (New Money Only)

LONG TERM ISSUES (MILLIONS)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>TOTAL</th>
<th>GENERAL OBLIGATION(a)</th>
<th>REVENUE ISSUES(a)</th>
<th>MUNICIPAL ENVIRONMENTAL &amp; POLLUTION CONTROL INDUSTRIAL REVENUE BONDS(b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>23,949.900</td>
<td>16,080</td>
<td>7,800</td>
<td>69.900</td>
</tr>
<tr>
<td>1972</td>
<td>20,210.220</td>
<td>12,538</td>
<td>7,228</td>
<td>444.220</td>
</tr>
<tr>
<td>1973</td>
<td>23,176.665</td>
<td>12,806</td>
<td>8,712</td>
<td>1,659.665</td>
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</tbody>
</table>

(b) Calculated from: Ibid., pp. a28-a30.

Table 2 shows that the percentage distribution of recent issues is changing. (Tables 1 and 2, in Appendix B, enable us to put the pollution control bonds into perspective. The percentage distribution between revenue issues and general obligation issues has been relatively stable except for 1954 and 1968 when there was a marked increase in new issue activity on revenue issues.) Table 2 shows a decline in the percentage distribution of general obligations in the years 1971, 1972, and 1973 indicating that a downward trend may be taking place. However, it appears that
pollution control bonds are taking a place of greater prominence; these bonds have increased from an insignificant .3 per cent of total new tax-exempt issues in 1971 to 7.2 per cent in 1973. This marked increase attests to the popularity of this method of financing pollution control.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>TOTAL</th>
<th>GENERAL OBLIGATION</th>
<th>REVENUE ISSUES</th>
<th>MUNICIPAL ENVIRONMENTAL &amp; POLLUTION CONTROL INDUSTRIAL REVENUE BONDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>100</td>
<td>67.1</td>
<td>32.6</td>
<td>.3</td>
</tr>
<tr>
<td>1972</td>
<td>100</td>
<td>62.0</td>
<td>35.7</td>
<td>2.3</td>
</tr>
<tr>
<td>1973</td>
<td>100</td>
<td>55.3</td>
<td>37.5</td>
<td>7.2</td>
</tr>
</tbody>
</table>

Perhaps even more important than the percentage distribution, Table 3 shows that pollution control bonds are steadily becoming a greater proportion of industrial revenue bonds as a whole.

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1972</td>
<td>6.1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td>19.0%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
D. The Nature of the Subsidy to State and Local Governments and the Loss of Federal Government Tax Revenues.

The tax exemption for State and local obligations constitutes a subsidy to the States and their political subdivisions. The subsidy is constituted by "the difference between the interest costs paid by the States and their subdivisions in carrying their indebtedness under the existing tax exemption and the costs which would be incurred if the interest were made taxable." 38 The amount actually involved is very difficult to estimate; and, the task becomes even more difficult due to changing market conditions and other factors. For example, the differential will be affected by changes in the basic interest rates, by current tax rates, by changing estimates as to future tax rates, by the supply of tax-exempt bonds, by the supply of investment funds, and by the quantity of other available securities.

As of any moment in time, the only practical method for estimating what this difference in interest costs may be would be to "compare the current yield (the interest factor) of state and local bonds with the yield of comparable taxable bonds". 39 (See Appendix D, Table 3). The cost of the exemption must be somewhere close to "the differential in yield between high-grade municipals and comparable corporate bonds". 40

38 Kirby, op.cit., p. 686.

39 Ibid.

40 Ibid., p. 687.
Two such series are Moody's yields of Aaa Municipals and of Aaa corporates. At the present time (1971), this differential is in the area of 2.17 percentage points. Assuming that this is the differential favouring state and municipal bonds, the subsidy to the states and local governments amounts to somewhat over $3,446,545,900 a year based upon the present volume (1971) of outstanding state and local bond issues. Yet the estimate of the cost of this subsidy to the Federal Government in terms of income tax revenue loss is around $3,942,378,685 (see Appendix C).

The calculations of Appendix D indicate that the subsidy to the states and local governments for the pollution control bonds rose from $1,737,330 in 1971, to $43,128,487 in 1973, and is currently (1974) valued at $40,554,842. The loss of revenues to the Federal government rose from $1,617,899 to $36,235,279 for the comparable period and is presently valued at $37,388,311.

E. Nature of the Subsidy to State and Local Governments and the Loss of Federal Government Tax Revenues (continued)

The cost of the subsidy to the Federal Government in loss of revenues from the income tax will depend on the following factors: the rate of income tax of individuals and corporations; the distribution of holdings of exempts not only between individuals and corporations but also among corporations.

According to George E. Lent, the distribution of exempt holdings between individuals and taxable corporations depends largely on "the
size of (individual) income above which the corporation and personal income tax rates were equalized.\footnote{41} A relative rise in the Federal corporation income tax rate will cause corporate holdings of exempts to rise, and vice versa. In the postwar period, the levels of the personal-income scale at which the rate for married persons was equal to the corporation income tax rates were as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Personal Income of married persons</th>
<th>Federal Corporation Tax rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946-47</td>
<td>$11,000-13,000</td>
<td>38</td>
</tr>
<tr>
<td>1948-49</td>
<td>25,000</td>
<td>38</td>
</tr>
<tr>
<td>1950</td>
<td>25,000</td>
<td>42</td>
</tr>
<tr>
<td>1952</td>
<td>29,000</td>
<td>52</td>
</tr>
<tr>
<td>1954</td>
<td>45,000</td>
<td>52</td>
</tr>
<tr>
<td>1958</td>
<td>45,000</td>
<td>52</td>
</tr>
<tr>
<td>1969</td>
<td>52,000</td>
<td>52</td>
</tr>
</tbody>
</table>

The level of personal income which is in equilibrium with the rate of corporation income tax has therefore risen because the corporation tax rate has risen relative to individual rates. This would be expected to bring some relative decline in individual holdings and some relative increase in holdings of taxable corporations, and this has happened.

Table 1 of Appendix E shows that, until 1964, individual holdings of State and local debt comprised the largest category, followed by holdings of commercial banks and insurance companies. Table 2 of Appendix E shows that the relative holdings by individuals have fluctuated somewhat, but have steadily declined from 50.4% in 1947 to 36.8% in 1967, while those of insurance companies have grown. However, since 1965, Commercial banks have comprised the largest category in both absolute and relative holdings.

The rise in commercial bank holdings is due to a revision in the Investment Securities Regulation statute:

"The statute contains a general prohibition against a member bank (1) underwriting securities or (2) investing more than 10 per cent of its capital and surplus in the securities of any one obligor. ... The statute also provides, however, that 'The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for (the Banks) own account, investment securities shall not apply to obligations of the United States, or certain other securities. In other words, national banks and member State banks are legally free (1) to underwrite such "exempt securities" and (2) to invest therein without regard to the 10 per cent limitation mentioned above."^{42}

The distribution of holdings between individuals and corporations (and among corporations in different tax brackets) is significant for determining the loss in Federal Government income tax revenues. If individual holdings increase, with the tax structure held constant, the loss in Federal Government revenues will increase and the opposite would be true if individual holdings decreased.

Finally, there will be a differential between the value of the subsidy to the state and local governments and the loss in revenues to the Federal Government caused by the progressive income tax rate. This is because the exemption is worth more to some taxpayers than others. Why this is the case is illustrated by supposing taxable income brackets and rates as follows:

A taxpayer in the top (90 percent) bracket who buys a taxable bond yielding $40 annually, could keep only $4. The exemption is worth thirty-six fortyths of the yield. He would be as well off to purchase at par a tax exempt yielding 0.4 percent as a taxable one yielding 4 percent. A taxpayer in the 80-percent bracket would keep $8 out of $40, and to him exemption is worth thirty-two fortyths of the yield. An equivalent exempt to him must yield 0.8 per cent. A taxpayer in the 60 percent bracket would keep $16, and to him the exemption is worth twenty-four fortyths of the yield. An equivalent exempt must yield him 2.4 percent. A taxpayer in the lowest (20 percent) bracket would keep $32 out of $40 and to him exemption is worth eight fortyths of the yield. An exempt yield of 3.2 percent is equivalent to 4 percent from a taxable bond. 43

If it is assumed that the actual supply of exempts is relatively small, then all of them could profitably be bought by persons in the top bracket, and the yield would be 0.4 percent. But if and as the supply increased, the demand of buyers in the lower brackets has to be tapped, and if buyers in the lowest brackets are brought in—if they are the marginal buyers—the yield will be 3.2 percent. The marginal buyers are those whose income after tax is the same whether they buy exempts or taxables. Since this is an undifferentiated market, all buyers get

43 James A. Maxwell, op. cit., p. 707.
the same yield as the marginal buyers and the high-income buyers secure a sort of surplus or tax saving.

It is this surplus that causes the loss of revenues to the Federal Government to be greater than the value of the subsidy to State and Local governments.

To illustrate how the distribution of holdings and how the progressive tax rate affects the differential between the subsidy and loss of Federal Government revenues, assume that individuals, at a 60% tax bracket, hold all the outstanding debt. Then the loss of Federal tax revenues would be equal to \([(5.52\% \times 150,885,650,000) - \text{from Appendix C} - 4,997,332,600 \times (60\%)]\), a differential of $1,550,736,700. (See line B of page 55). This differential is wholly attributable to the percentage distribution of tax-exempt securities. Assuming the distribution of Appendix C and a 90% tax bracket, the differential attributable to the progressive tax structure is equal to \([(5.52\% \times 55,525,919,000) \times (90\%) - (1,839,018,400) \text{ from line 1, p. 56.}]\) $919,509,200.

What are some of the important factors affecting the differential between the subsidy to State and Local governments and the Federal tax loss? The differential would increase if progression of the Federal Income tax steepened, or if the level of rates increased, or if the level of corporate taxes increased, or if the distribution between individual holdings increased over those of corporate holdings; the differential would decrease if progression lessened, if the level of rates decreased, or if the level of corporate taxes decreased, or if corporate holdings increased over individual holdings.
F. Economic Pros and Cons of the Exemption

One of the basic tax principles is that "equal incomes should bear equal tax liabilities." Taxpayers in similar circumstances should bear similar burdens. One of the arguments levelled against exemption is that:

the exemption for State and local bond interest is a violation of this principle. Any taxpayer who wishes to avoid the tax burden which he would otherwise have to carry may safely and legally pass such burden to others by buying State or municipal bonds. 44

In fact, the exemption grants relief in an inverse ratio to ability to pay. The investor with larger income will get greater relief from the purchase of State and municipal bonds than one in the more modest tax brackets.

Why the exemption is worth more (less) to some buyers was illustrated in section E.

It is not possible to contend with this argument. Looking at the total amount of revenue that is lost due to individual holdings of exempts, Appendix C shows that the loss of tax revenue is $1,839,018,400, twice that of the next highest figure (the loss of tax revenues from commercial banks). However, it should be noted that, as pointed out in Section D that individual holdings of exempts are decreasing and, ceteris paribus, the amount lost in Federal tax revenues from individuals is consequently decreasing too.

44 Kirby, loc. cit., p. 684.
Some authors feel that the tax exemption of State and local bond interest interferes with the free flow of the market in the allocation of resources. \(^45\) This objection, however, is overrated. The State-Local security holdings of top wealthholders (those with gross estates of $60,000 or more) accounted for only 3.5 per cent of their gross estates in 1953, according to Lampman's estimates. \(^46\) At the end of 1960, state-local securities constituted about 3 per cent of the total financial assets of all individuals and nonprofit organizations. \(^47\) Again, in 1966, state-local securities constituted 3 per cent of the total financial assets of all individuals \(^48\) and all corporations.

In connection with the subsidy to the State and local governments in their borrowing functions, the proponents of the tax exemption make their strongest appeal for the status quo. Aside from the upsetting, but temporary, effect of the withdrawal of the exemption from State and local issues, the proponents point out that the additional cost of borrowing to the States and local governments, in the vicinity of some $3,446,545,000 annually when the new issues reach the level of outstanding issues,

\(^{45}\)bid., p. 689.


would have to come from State and local revenues. The revenues are principally derived from regressive taxes, the property and sales taxes. In illustration of that point, it should be noted that more than half of the revenues of the States come from sales taxes, and more than .85 percent of the revenues of the local governments come from property taxes. The conclusion, which can then be drawn, is that the repeal of the exemption would increase the tax burdens of the State and local governments, which burdens can only be discharged through heavier levies under the more regressive taxes. In other words, as the argument goes, "the attempt to improve the fairness of the Federal income tax through the repeal of the exemption would result in a net loss in the overall fairness of the combined Federal, State, and local levies."
CHAPTER V

Summary and Conclusion

Since pollution is an externality, it is incumbent upon the government to exercise its role in the market economy to coerce firms to internalize their external costs. The three methods by which the government may do this were analysed in Chapter II.

The theoretical framework presented in Chapter II argues against the use of prohibition as a policy instrument; this is verified by recent experiences in the United States in trying to control air and water pollution. Subsidies attempting to control water pollution have generally failed as well. While tax proposals have been submitted, those that can have a direct impact on pollution curtailment have not been implemented.

The use of tax-exempt securities is a relatively new method to finance the cost of pollution control. Excluding State and local securities from the income tax has caused considerable polemics in the past and the extension of this tax-exempt feature to finance pollution control is also subject to criticism. The use of tax-exempt securities in general, and to finance pollution control in particular, violates the basic tax principle of horizontal equity and distorts the allocation of resources. Finally, the tax-exemption feature constitutes a subsidy to the States and their political subdivisions.
We are now faced with a choice - to implement a policy of regulatory taxation or a policy of subsidization.

While a subsidy (in the form of tax-exempt securities) may be objectionable in terms of equity, a regulatory tax is also objectionable in terms of horizontal equity. The regulatory use of taxation "involves a social cost in the form of lessened equity of the tax structure; and we must account for this cost when choosing between tax and other types of control." 53

While economic theory shows that the effects of a subsidy and a tax are symmetrical, the incidence of the cost of obtaining the same level of environmental quality is "likely to be more diffuse throughout the economy with the subsidy policy than with..." the tax policy. 54

As a general rule, it would appear that the policy of regulatory taxation would be preferable over a policy of subsidization. However, there is one exception - the case where taxation may force a firm out of business. The resulting unemployment of labour and capital and the loss of tax revenue may be too severe to be socially acceptable. This is even more true in areas where the labour force is immobile and areas that have only one industry or firm.


The use of tax-exempt securities can be used as an "adjustment assistance" subsidy to reverse the adverse effects of pollution control on labour and capital. Adjustment assistance policies are more "likely to be consistent with achieving pollution control at least cost" and "...serves to redistribute the costs of environmental improvement where these costs are borne by few for the benefit of many." 55

The purpose of this thesis was to provide a partial answer to two questions. First, who should take the initiative to stop further pollution from occurring and, second, who should pay the cost of environmental clean-up and the continued abatement of pollution? I hope I have accomplished this purpose and I also hope I have contributed a little knowledge to enable us to make rational choices by assessing the economic consequences of environmental policy.

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</thead>
<tbody>
<tr>
<td>20.9</td>
<td>32.2</td>
<td>41.0</td>
<td>25.7</td>
<td>36.5</td>
<td>45.3</td>
<td>28.9</td>
<td>39.7</td>
<td>50.0</td>
<td>32.8</td>
<td>43.6</td>
<td>53.8</td>
<td>35.9</td>
<td>46.7</td>
<td>57.9</td>
<td>39.1</td>
<td>50.0</td>
<td>61.0</td>
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<tr>
<td>68.2</td>
<td>51.2</td>
<td>35.3</td>
<td>66.9</td>
<td>39.0</td>
<td>20.5</td>
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<td>39.0</td>
<td>20.5</td>
<td>66.9</td>
<td>39.0</td>
<td>20.5</td>
</tr>
</tbody>
</table>

Source: U.S. (less Ohio) by stream miles.
Notes to Table 1 of Appendix A

Table 1 outlines the extent of water quality deterioration in the United States. The first column lists the total stream or shore miles in the basin. The next 6 columns report the number and percent of polluted miles in 1970 and 1971 and the change between the 2 years.

The next to last column in Table 1 provides the EPA's duration-intensity factor which measures the degree of the existing water quality deterioration. The preceding mileage figures simply indicate whether or not the stream was polluted. The duration factor relates the intensity of the pollution to the designated Federal-State water quality standards for the particular water body. This factor increases as the pollution increases within any given stretch of stream mileage. Multiplying the mileage of polluted waters in 1971 by this factor yields the Prevalence-Duration-Intensity Index (PDI) which is a measure of how badly the water is polluted. This PDI is reported in the final column of Table 1.
<table>
<thead>
<tr>
<th>Type</th>
<th>Percent</th>
<th>In Millions of Tons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nitrogen Oxides</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Particulates</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hydrocarbons</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sulfur Oxides</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Carbon Monoxide</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Table 2: Total Air Pollutant Emissions by Type (1970)**

(Appendix A (continued))
APPENDIX B

TABLE 1

STATE & MUNICIPAL NEW ISSUE ACTIVITY (1953-70)

LONG TERM ISSUES (MILLIONS)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>TOTAL</th>
<th>GENERAL OBIGATION ISSUES</th>
<th>REVENUE ISSUES</th>
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APPENDIX B (Continued)

TABLE 2

STATE & MUNICIPAL NEW ISSUE ACTIVITY (1953-70)

LONG TERM ISSUES (MILLIONS)

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<td>100</td>
<td>66.4</td>
<td>33.6</td>
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APPENDIX C

A) Determining the value of the subsidy to State and Local
governments (Data for 1971)

Formula: (Interest Rate Differential) X (Total Outstanding Debt)

Average Yield of Pollution Control Bonds (Aaa Rating): 5.22%a
Average Yield of Corporate Bonds (Aaa Rating) ........... 7.39%b
Yield Differential ........................................ 2.17%
Total Amount of Outstanding Debt .....................$158,827,000,000c
(This amount includes $7,941,350,000 held in government
accounts and is not included in the Total* below.)
Therefore, the value of the subsidy to
State and Local governments is .............. $3,446,545,900

B) Determining the cost of the subsidy to the Federal government
in loss of revenues from the income tax (Data for 1971)

Formula: (Average Rate of Interest of Municipal Bonds x Total
Outstanding Debt) X (Average Tax Bracket of Individuals
and Average Tax Bracket of Corporations)

Estimated Ownership of Outstanding State and
Local Debt: Based on 1967 distribution and
1971 Outstanding debt.

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<th>Percentage Distribution**</th>
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<td>$ 55,525,919,000</td>
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<td>21,576,647,000</td>
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<tr>
<td></td>
<td>$150,885,650,000</td>
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</tbody>
</table>
APPENDIX C (Continued)

Average Rate of Interest of Municipal Bonds: 5.52%
Total Outstanding Debt: $158,827,000,000.
Average Tax Bracket of Individuals: .......... 60%d
Average Tax Bracket of Commercial Banks ...... 27.895%e
Average Tax Bracket of Insurance Companies .. 32.303%f
Average Tax Bracket of Corporations .......... 52%g
Average Tax Bracket of Miscellaneous .......... 52%

1) Cost of the Subsidy to the Federal Government
due to Loss of revenues of Individual Income Tax
(5.52% x $55,525,919,000) X (60%) .................. $1,839,018,400

2) Cost of the Subsidy to the Federal Government
due to Loss of Revenues of Commercial Bank
Income Tax .............................................. 982,774,180

3) Cost of the Subsidy to the Federal Government
due to Loss of Insurance Company Income Tax .... 384,738,710

4) Cost of the Subsidy to the Federal Government
due to Loss of Corporation Income Tax ........... 190,564,930

5) Cost of the Subsidy to the Federal Government
due to Loss of Miscellaneous Income Tax ......... 95,282,465

Total .................................................... $3,492,378,685

From the above figures, the average Income Tax rate is: 41.931%***
Sources for APPENDIX C


b. Moody's Bond Record, 1974, 124.


g. Ibid.

** These percentage distribution figures are from Appendix E, Table 2, for the year of 1967.

*** This agrees with Richard Goode's findings of an overall rate of 41%. See Richard Goode, op.cit., p. 141.
Table 1

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<th>Year</th>
<th>Total Volume by Rating 1971-1974 (000s)</th>
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<tr>
<td>1972</td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td></td>
</tr>
<tr>
<td>1974</td>
<td></td>
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Note: Municiple Environmental and Pollution Control Industrial Revenue Bonds
tax revenues is as follows:

**Loss of Federal Government Tax Revenues**

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<th>1973</th>
<th>1974</th>
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<td>2,424,224</td>
<td>4,136,560</td>
<td>4,494,210</td>
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<tr>
<td>Total</td>
<td>35,521,220</td>
<td>19,766,068</td>
<td>19,221,060</td>
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**Value of the Subsidy to State & Local Governments by Rating**

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<th>1973</th>
<th>1974</th>
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**Interest Rate Differential**

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(Continued)
### APPENDIX E

#### TABLE 1

Estimated ownership of State and Local Interest-Bearing Securities (1947-1967)

(Billions of Dollars)

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<th>Year</th>
<th>Total</th>
<th>Total Public</th>
<th>Total Private</th>
<th>Individuals</th>
<th>Commerce</th>
<th>Insurance</th>
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<th>Misc.</th>
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### APPENDIX E

#### TABLE 2

PERCENTAGE DISTRIBUTION OF STATE AND LOCAL SECURITIES

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<th>INDIVIDUALS</th>
<th>COM MERCIAL</th>
<th>IN INSURANCE</th>
<th>BANKS</th>
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Bibliography

Books


Government Publications


Other Sources


Vita Auctoris

June 3, 1944
Born in Hungary to Anthony and Katherina Amort

July, 1948
Emigrated from Hungary to Alsace, France.

October, 1951
Immigrated to Toronto, Canada, and attended St. David's and Holy Rosary grade schools.

September, 1959 to June, 1965
Attended Oakwood Collegiate Institute and graduated with Senior Matriculation.

September, 1965
Accepted at Waterloo University College and enrolled in the School of Business and Economics.

June 17, 1967
Married to Barbara Lynne (nee Chappell).

August, 1968
Received Bachelor of Arts Degree in Economics at Waterloo University College.

September, 1968 to May, 1969
Attended Waterloo University College for Master of Arts qualifying year.

September, 1969
Accepted and enrolled at the University of Windsor for Master of Arts candidate year.

April, 1970
Completed course work and oral comprehensives at the University of Windsor.

May, 1970
Joined Xerox of Canada Ltd., in Sarnia as an Associate Sales Representative.

May 22, 1972
A son, Joseph Scott, was born.

October, 1973
Joined IBM as a Sales Representative in Windsor.

February 19, 1975
A daughter, Leanne Heather, was born.