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MUNICIPAL INDUCEMENTS TO PRIVATE INDUSTRY

INTRODUCTION

In recent years many state and local governments have inaugurated extensive programs aimed at attracting private industry to their areas. The primary reason for this encouragement is the belief that the establishment of private industry in most communities will result in increased prosperity and a higher standard of living through the creation of more jobs, greater spending power, and higher income. In carrying out these programs, the three most frequently used methods of municipal or state inducement have been (1) advertising of the area's advantages, (2) municipal financial aid, such as the construction of plants to be leased to industry, and (3) the granting of special tax concessions. Although the legality of the inducements used by municipalities has frequently been questioned, the legal problems seem to remain obscure. The emphasis in this Note will therefore be placed on the legal restrictions upon municipal inducements; however, the social and economic implications will not be ignored.

ADVERTISING AS A PUBLIC PURPOSE

Nearly one-half of the states and many municipalities now appropriate public funds for the purpose of advertising the general business conditions peculiar to their area. The area's accessibility to markets, raw materials, service facilities, and labor supply are apt to be among the conditions mentioned in the brochures, folders, and magazine advertisements that are circulated throughout the country. There exists an expectation that the information in these publications will exert an influence on the industrial leaders who are considering the ramifications of relocation.

The legality of this municipal advertising expenditure rests upon a finding, first, that the expenditure has been authorized by the legislature since a municipality can exercise only those powers expressly or impliedly conferred upon it by the legislature, and, second, that the expenditure is for a valid "public purpose." The "public purpose" restriction is either expressly provided for in the state constitutions, or is inherent in the nature of government since

2. See Floyd, Effects of Taxation on Industrial Location 3 (1952).
5. See 9 Duke B. A. J. 15, 16-17 (1941).
it is said that the activities of a government and its subdivisions must be confined to the business of the government for which purpose these bodies were created.\textsuperscript{8} Taxing or spending of public funds for a private purpose has long been held invalid as a taking of property without due process of law,\textsuperscript{9} but the problem still remains as to what constitutes a "public purpose."

Although the concept of "public purpose" is not susceptible of one definition, the courts generally construe it to mean an expenditure which serves as a benefit to the inhabitants of the community as a body and which is, at the same time, directly related to the functions of the local government.\textsuperscript{10} This broad general definition is helpful only as a guide for the court in deciding by the facts of each case what constitutes a public purpose. Such expenditures as those for the development of public parks, construction of airports, payment of bus fare for school children, and establishment of housing projects have been held to be for a public purpose, while, on the other hand, expenditures for construction of an opera house, operation of child care centers, tourist camps, and golf courses have been held not to be for a public purpose.\textsuperscript{11} Since it is virtually impossible to draw from such decisions a meaningful principle which would serve as a useful guide, it is clear that the problem of public purpose must be particularized and dealt with on a very concrete level.

In the past, advertising was not always considered to be for a public purpose, but now the great majority of the courts in the United States hold that an expenditure of public funds for advertising the advantages of a municipality to attract industry is for a public purpose when authorized by the legislature.\textsuperscript{12} These decisions are based on the theory that advertising of this type is a promotion of the trade and commerce of the community.\textsuperscript{13} One study has revealed that much of this advertising has been of dubious effect,\textsuperscript{14} but, if there is a benefit, it is one that, unlike direct financial supports to an industry, does not aid primarily one private organization but rather inures to the entire community. Consequently, the expenditure does not appear to be an unwarranted public appropriation insofar as the public purpose doctrine is concerned.

\begin{footnotes}
\item[10] See 16 McQuillin, Municipal Corporations § 44.35 (3d ed. 1950).
\item[14] See 67 American City, April, 1952, p. 117.
\end{footnotes}
The problem should diminish in magnitude with the recent entrance of private enterprises into the field of such advertising. Banks, power companies and railroad companies, among other private interests, have set aside sums of money for advertising the area's wares, sometimes in cooperation with government units. These companies seem to derive substantial gains from the growth and expansion of the community because of their advantageous position in the area's economic structure. Thus they will probably continue to advertise so long as they believe it leads to area growth.

**Restrictions on Municipal Financing of Plants for Private Industry**

Another inducement frequently used by municipalities is that of financing the construction of plants, which are then leased to private industry. Since 1936, when Mississippi enacted a statute authorizing this practice, six states have followed with similar legislation devised to reduce unemployment and balance agriculture with industry. The major difference in these laws is that Mississippi and Louisiana legislation authorize the issuance of "general obligation" bonds payable from the taxes and general funds of the municipality, while statutes in the other five states allow only the issue of self-liquidating revenue bonds which are payable solely from the rental income of the project financed. Thus, the municipality in the latter states can in no way incur an obligation to pay the debt from its general funds upon default of rental payments by the lessee. The Mississippi statute also creates an industrial commission to effectuate the purposes specified. That commission is empowered to determine whether the public convenience and necessity require a plant in an area and whether the municipality may sell, lease or operate the plant. Some municipalities have issued revenue bonds for this purpose without express statutory authorization.

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15. Discussion with Mr. Eugene A. Kraut, Assistant Industrial Director, Saint Paul Chamber of Commerce.
22. See, e.g., State v. Town of North Miami, 59 So. 2d 779 (Fla. 1952).
Under the most common method, the municipality issues tax-exempt self-liquidating revenue bonds, proceeds of which are to be used for the acquisition of a new plant. These plants are later leased to the companies for an extensive period at an annual rental charge that will ultimately discharge the bond debt at its maturity. Further rental charges by the municipality are customarily nominal, therefore, the cumulative rental payments over a long period will not greatly exceed the purchase price of the plant.

Of all the inducements, plant financing seemingly provides the most beneficial aid to an industry, since it allows the enterprise to retain its working capital unimpaired and available for business rather than to tie up a large sum of money in the investment of the building itself. In addition, the company is generally not burdened with the usual ad valorem property taxes incidental to doing business, as the city owns the building even though it is usually built to company specifications. The concern is also allowed to deduct the annual rental payments from net income for purposes of computing income taxes. It is interesting to note, however, that the latter privilege was jeopardized recently by a bill proposed in Congress which attempted to disallow this deduction on the grounds that benefits of the federal tax exemption of municipal bonds were being diverted to private industries. The provision was not adopted and industrial development revenue bonds have specifically been declared tax-exempt, but the committee report seems to indicate a growing dissatisfaction with the misuse of the bond exemption and the result may be similar legislation in the future.

Municipal financing of industrial development has encountered several legal obstacles which have threatened its validity and the constitutionality of statutes which authorize it. One successful prohibition has been a provision in many state constitutions which forbids a state or its subdivisions from donating to or lending its credit to or in aid of any private enterprise. This provision was

25. Ibid.
27. See ibid., supra note 24 at 115.
28. Newberry v. City of Andalusia, 257 Ala. 49, 64, 57 So. 2d 629, 641 (1952) (dissenting opinion).
32. See 47 Yale L. J. 1412 (1938).
33. See 1 Jones, Bonds and Bond Securities § 148 (4th ed. 1935).
originally enacted to preserve the financial stability of the municipality following a period when municipalities had speculated in the investment of stock of railroad companies with proceeds obtained by municipal bond issues. The practice was carried to such an extent that discharge of the debts became impossible, resulting in an impoverishment of the municipality and a pecuniary loss to the taxpayer.

The most significant application of this constitutional prohibition in found in a recent New Mexico case where a declaratory judgment action was brought to test the constitutionality of a state statute authorizing the municipal financing of industrial buildings through the proceeds of municipal revenue bonds. The court ruled that the state statute was unconstitutional since the object of the legislature was clearly contrary to the constitutional provision forbidding a municipality from lending credit in aid of private enterprise.

Although such a constitutional provision has been the legal basis for invalidating a similar plan by a Florida municipality acting without statutory authority, and, in the past, has even invalidated a state statute which authorized municipal plans of this type financed by the issue of general obligation bonds, the significance of the New Mexico decision lies in the fact that this is the first statute struck down which authorized the issuance of revenue bonds payable only from plant income. Since 1936 when the recent surge of state legislation began, three of the four other statutes requiring revenue bond financing have survived the test, the court holding in each case that the activity was not a lending of credit in aid of a private industry. In these cases the courts stressed the point that the municipality could incur no liability on the revenue bonds other than an obligation to pay the amount of the rental payments received from the lessee industry. The fourth statute has remained unchallenged. The Mississippi statute, allowing general obligation financing, satisfactorily met the challenge in 1938 when the court dis-

34. See 1 Jones, op. cit. supra note 33, § 148.
35. Ibid.
37. Ibid.
38. State v. Town of North Miami, 59 So. 2d 779 (Fla. 1952).
41. Newberry v. City of Andalusia, 257 Ala. 49, 57 So. 2d 629 (1952); Holly v. City of Elizabethton, 193 Tenn. 46, 241 S. W. 2d 1001 (1951); Faulconer v. City of Danville, 313 Ky. 468, 232 S. W. 2d 80 (1950).
42. Ibid.
tistinguished the statute from a similar Mississippi statute declared unconstitutional four years previously as a municipal lending of credit. The court reasoned that the municipality in this plan, unlike the one in the previous plan, retained power through its commission to ensure the use of the property for the purposes intended to be accomplished by the law. The soundness of the distinction has been questioned. The Louisiana provision permitting the issue of general obligation bonds, although challenged, was not attacked as an unconstitutional lending of credit, since it is itself a constitutional amendment.

The soundness of the legal support behind the New Mexico decision is at least doubtful in view of the fact that the purpose of this constitutional provision was to protect the fiscal structure of the municipality. No danger arises under the New Mexico statute where revenue bonds are the mode of financing since the general credit on taxing power of the municipality is not pledged.

The use of revenue bonds, however, has been condemned by some financial experts as an undesirable method of financing and a rather risky investment. Although these obligations are represented as municipal bonds, some critics claim that the bonds are not true municipal obligations, since they are not secured by the taxing power of the municipality. Rather, the sole backing is the revenue from the project financed. Actually these revenue bonds more closely resemble the obligations of a corporation. Since the average investor is not aware of these facts, default of payment by the industry might weaken the municipal name and credit.

Another impediment to the successful operation of a municipal industrial development program is the "public purpose" doctrine which prohibits spending public funds or taxing for a private purpose. For many years the doctrine has been invoked to invalidate statutes authorizing municipalities to finance the erection of plants through the proceeds of general obligation bonds. It has in the past

44. Id. at 105-106, 178 So. at 807.
47. See Garwood, Are Municipal Subsidies for Industrial Location Sound? 68 American City, May, 1953, pp. 110, 111.
49. Ibid.
50. Ibid.
51. See Garwood, supra note 47 at 111.
52. See 47 Yale L. J. 1412 (1938).
been held that the encouragement or promotion of a private industrial enterprise is not a public purpose for which taxes may be imposed or public funds appropriated. The strongly advocated position that the addition of a new industry in many communities is for a public purpose because it alleviates unemployment and "its twin offspring, hunger and crime" has been rejected. Instead, the reasoning has been advanced that the primary benefits are received by a private industry which is in no way controlled by the municipality while the community only obtains incidental gains from the expenditure. Furthermore, courts have claimed that the addition to a community of any business which employs capital and labor benefits the area to some extent, but the appropriation of public funds to each additional builder, innkeeper, or merchant in the area, for example, would not be an appropriate public expenditure although these enterprises would seem to be equally deserving of the aid.

Yet, a strong argument can be made for the proposition that this type of program is for a public purpose, especially when used in the deep South. A glance at the statistics will reveal the amazing recent increase in per capita income in the South, and it is not unreasonable to suppose that this is due to the migration of industries to that area. Since the South has always been plagued with poverty and unemployment, it is difficult to perceive of a more beneficial aid to a community than relief from these deplorable conditions. Thus, as a purpose, inducement to industry should qualify as "public" within the meaning of the state constitution.

The Mississippi statute which authorizes the issue of general obligation bonds has been successful in escaping the destructive force of the public purpose doctrine. When the statute was challenged on these grounds, the Mississippi court acknowledged the fact that similar projects have been held not to be for a public purpose, but

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55. Ibid.
57. Loan Association v. Topeka, 87 U. S. (20 Wall.) 655, 665 (1875) (dictum); State v. Town of North Miami, 59 So. 2d 779, 784-85 (Fla. 1952) (dictum).
58. See McLaughlin and Robock, Why Industry Moves South 12 (1949). The chart indicates the percentage increase in per capita income in southern states from 1940 to 1947. The percentage increases ranged from 136% in Virginia to 226% in Mississippi as compared to a 130% increase in the continental United States.
distinguished the challenged statute on the basis that the legislature
in enacting the statute specified a public policy predicated on the
abnormal social and economic conditions of the time which justified
the enactment of the statute. The Louisiana constitutional amend-
ment was passed at a time when a group of dairy farmers, compris-
ing the major portion of the area's inhabitants, were unable to sell
their milk because it could not be processed, so the municipality, act-
ing under the amendment, purchased and leased a plant to a milk
processor. Because the provision is a constitutional amendment, it
could only be attacked effectively on a federal ground, and there
does not seem to be such a federal ground since the United States
Supreme Court had dismissed for lack of a substantial federal ques-
tion the appeal from a decision on a similar Mississippi statute. In
upholding the plan and the amendment, the court reasoned that the
primary purpose was to relieve the area of a serious economic con-
dition and that the leasing of the property was only incidental to the
desired results. The reasoning in both the Mississippi and Louisi-
a decision appears to be contrary to the prevailing law and does
not seem to provide satisfactory criteria for distinguishing the cases
from prior law. The mere inclusion in a statute of its express pur-
pose should not be a decisive factor in distinguishing the Mississippi
case nor should the arbitrary distinction between primary and inci-
dental purposes be adequate in the Louisiana case. Actually, these
courts appear to be establishing that municipal financing of plants
now qualifies as within the definition of public purposes. In effect,
this is a modification of the law but is made to look as if there
were no change.

Through the authorization of the financing of this program by
self-liquidating revenue bonds, other industrial development statutes
have been able to avoid running afoul of the public purpose doctrine,
since that method does not involve the pledging of the general credit
or taxing power.

The most recent innovation in the field of business development
has been the formulation of industrial development foundations. These organization are corporation set up by private citizens to pro-
vide financial services to industries in an effort to create an incentive

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60. Albritton v. City of Winona, 181 Miss. 75, 109, 178 So. 799, 809,
appeal dismissed, 303 U. S. 627 (1938).
61. Ibid.
So. 2d 394, 398 (1954).
63. For similar reasoning see Note, 66 Harv. L. Rev. 898, 903 (1953).
64. See note 41, supra.
65. See Business Week, April 9, 1949, p. 30.
for relocation or expansion in their area. Funds, obtained by subscriptions of stock and donations, are used primarily for three main purposes: (1) buying, developing, and selling industrial sites, (2) buying, building, leasing, and selling plants and (3) loans to new industries and sometimes even to establish industries for expansion purposes. In an extremely rare case one industrial commission has gone so far as to offer $10,000 cash to any industry which would locate at their city and employ more than 100 people. Usually, however, these commissions do not even advocate selling or leasing plants or sites below their costs.

In 1943 Albert Lea, Minnesota, was selected by the United States Chamber of Commerce as an area to experiment with these foundations. Since that area's "Jobs Incorporated" was so successful in attracting industry, the United States Chamber of Commerce used the Albert Lea System as an example of a way to encourage the location of industry. In recent years, many of these foundations, a great part of them non-profit, have sprung up throughout the country and have been regarded as successful. This step seems to be a most effective stride in the right direction by communities who pursue a satisfactory industrial development program. The device is equally available to groups of individuals in all areas of the United States; furthermore, the method appears to be a desirable means of achieving the goal since it avoids the abuse of bond tax-exemption. Municipal bonds are not used and the funds of the public and the taxpayer are not involved, so there is no danger of injury to the taxpayer or municipality; consequently, this practice will probably not be barred by legal sanction.

Subsidies in the Form of Tax Exemption

As an incentive to location in their areas, many state and local governments have offered exemption of municipal taxes to private industries. The granting of these indirect subsidies is not a recent

66. Id. at 32.
67. Id. at 31.
68. See 65 American City, Nov., 1950, p. 87.
71. Correspondence with Mr. William H. Sykes, Executive Secretary of Albert Lea's "Jobs Incorporated" indicates that the United States Chamber of Commerce used the Albert Lea plan as an example in 1953.
72. See Business Week, April 9, 1949, pp. 30, 36.
73. See 65 American City, Nov., 1950, p. 87.
75. See 16 McQuillin, Municipal Corporations § 44.75 (3d ed. 1950).
development in the United States but has been practiced since the early colonial days.\textsuperscript{76} Tax concessions have grown in importance since the last depression when extensive legislation of that type was adopted\textsuperscript{77} until, by 1949, tax concessions to industry were offered in seventeen states,\textsuperscript{78} primarily in the regions of New England and the South.\textsuperscript{79}

Among the various types of exemptions, the most common is that of exempting industries from local property taxes on plants and equipment for a limited period, usually five to fifteen years.\textsuperscript{80} The obvious advantage to industry lies in the relief of a regular business expense.\textsuperscript{81}

Since the legislature has the power to classify the property that shall be taxed, it, rather than the local government, has the power to determine the property which will be exempt from taxation.\textsuperscript{82} The power, however, may be delegated to a municipality.\textsuperscript{83} The legislative power to exempt may be limited by certain state constitutional provisions.\textsuperscript{84} The exemption can not be an arbitrary one that results in no benefit to the public, but must be for a "public purpose."\textsuperscript{85}

Oddly enough, a direct subsidy to private industry would be invalid or not for a "public purpose," but an indirect subsidy in the form of a tax exemption has generally been upheld.\textsuperscript{86} The public purpose requirement is not as strictly construed when applied to tax exemptions which involve no direct appropriation of funds as it is when a direct expenditure is involved.\textsuperscript{87} Although the courts uphold exemptions under the "public purpose" doctrine, a tax exemption, nevertheless, would seem to be an absolute gift to the industry. Since the industry is discharged from the annual obligation of paying a debt while, concurrently, the municipal treasury is deprived of a source of revenue, a court would seem to be justified in declaring a tax exemption to industry illegal in states that forbid the granting of

\textsuperscript{76} See Baker and Curry, \textit{Taxpayer's Paradise in the Caribbean}, 1 Vand. L. Rev. 194, 216 (1948).
\textsuperscript{78} See 64 American City, Nov., 1949, p. 121.
\textsuperscript{79} See Newcomer, \textit{supra} note 77 at 120.
\textsuperscript{81} Id. at 383.
\textsuperscript{82} See Baker, \textit{Tax Exemption Statutes}, 7 Texas L. Rev. 50, 60 (1928).
\textsuperscript{83} 16 McQuillin, Municipal Corporations § 44.65 (3d ed. 1950).
\textsuperscript{84} See Baker, \textit{supra} note 82 at 50.
\textsuperscript{86} See \textit{e.g.}, Crow v. General Cable Corp., 223 Ala. 611, 137 So. 657 (1931); Duke Power Co. v. Bell, 156 S. C. 299, 152 S. E. 865 (1930).
\textsuperscript{87} See Baker, \textit{supra} note 82 at 61.
donations or things of value to a private association. However, it has been held that the expected public benefit derived from the operation of a new factory was adequate consideration for the exemption. This reasoning seems to be inconsistent with the attitude of the courts concerning the location of an industry as a public benefit when a direct payment is involved.

Another ground for attacking the validity of industrial tax exemptions laws in the past was a provision in many state constitutions requiring equal and uniform taxation. The provision was construed as not demanding absolute equality since this is impractical, even in tax assessment of similar property in the same classification. Classifications, which may be made according to the character or use of the property, had to be reasonable and not arbitrary. The provision, now is not on effective limitation because many states have abolished the law and the remaining provisions are now very liberally construed.

Attacks on the basis of due process or equal protection have not been successful due to the failure of the courts to extend them into the field of tax exemption. Although a few states prohibit tax exemptions by express provisions in their constitutions, industrial tax exemptions have generally been upheld.

Although there have been vigorous complaints in industrial states protesting that burdensome tax structures are driving out private industry, taxes are usually not a major factor in determining the location of a business, and studies indicate that tax exemptions have had little success as a method of enticing industries to move to their areas. After the exemption expires, tax rates tend to rise appreciably as the additional community services such as

88. See Evers Woolen Co. v. Town of Gilsum, 84 N. H. 1, 26-27, 146 Atl. 511, 524 (1929), where similar reasoning was used but the exemption was only to a single manufacturer and was held void principally on other grounds.
90. See Baker and Curry, Taxpayer's Paradise in the Caribbean, 1 Vand. L. Rev. 194, 201 (1948).
94. See Newcomer, supra note 77 at 116-117.
95. See Baker and Curry, supra note 90 at 203.
97. See 16 MacQuillin, Municipal Corporations § 44.75 (3d ed. 1950).
98. See Cordner, State Tax Burdens as an Influence in the Location of Industry, 19 Taxes 537, 544 (1941).
100. See Newcomer, supra note 77 at 121.
schools and roads are installed to meet the sudden growth of the area.\textsuperscript{101} Also, exemption laws and tax rates are flexible and sometimes cannot be relied upon because they are so readily subject to change.\textsuperscript{102}

Although tax exemption has been defended as a needed aid to infant industries and a generator of additional tax revenues which will reduce the burden of the remaining taxpayers,\textsuperscript{103} it has been subjected to considerable criticism by writers.\textsuperscript{104} The primary objections are first, that it stimulates keen competition between the states which weakens the economic framework;\textsuperscript{105} and second, that tax exemptions encourage the location of unstable industry through the artificial basis of temporary lower costs. These industries may then fail when the exemption period is over;\textsuperscript{106} also, location influenced by the tax exemption does not occur in the area of the most economic utilization of capital and labor resources. On a nationwide level, this would appear to be undesirable since the waste attributable to improper allocation would be shifted to the nation’s consumers in the form of higher prices. In addition, the exemption has been attacked as psychologically disturbing to those who must continue to pay taxes,\textsuperscript{107} especially if the exempt industry is a competitor of the taxpayer. Since an industry may depart or fail after the expiration of the exemption period and often locates in an area regardless of the concessions,\textsuperscript{108} the detriment suffered through the loss of tax revenue appears to exceed any long term benefits from the exemption.

**CONCLUSION**

Contrary to popular belief, artificial inducements rarely play a significant role in determining a responsible industry's location.\textsuperscript{109} Rather, studies indicate that the main factors governing management's decisions have been: (1) the area's proximity to markets; (2) its proximity to raw materials; (3) availability and cost of labor.\textsuperscript{110} Although the southern states have perhaps extended the greatest aid to industry and coincidentally have made the greatest

\textsuperscript{101} See Baker and Curry, supra note 90 at 224.
\textsuperscript{102} See Garwood, supra note 99 at 366.
\textsuperscript{103} See 9 Duke B. A. J. 15, 16 (1941).
\textsuperscript{104} See Snell, supra note 80 at 383-84.
\textsuperscript{105} See Baker and Curry, supra note 90 at 223.
\textsuperscript{106} Ibid.
\textsuperscript{107} See Snell, supra note 80 at 384.
\textsuperscript{108} See Garwood, Are Municipal Subsidies for Industrial Location Sound?, 68 American City, May, 1953, pp. 110, 111.
\textsuperscript{109} See Business Week, Sept. 17, 1949, pp. 70, 72.
\textsuperscript{110} See Garwood, supra note 99 at 365.
advancement in industrial development, the growth was not necessarily caused by the subsidy programs, but rather, by the natural economic advantages of the South, such as the growing markets and increased supplies of raw materials and labor.^{111} It is, therefore, probable that inducements of this type are only effective when the economic advantages of two areas are similar.

In addition to the legality and practicality of these inducements, there is the more important consideration of their social and economic desirability. Although defended by segments of industry,^{112} these inducements on a municipal level have been broadly condemned by prominent finance associations^{113} and labor unions,^{114} among others. On a nationwide basis, municipal inducements could stimulate competition and incite retaliatory measures to the point that all advantages obtainable by any area would be nullified.^{115} Furthermore, although in many instances an industry brings to a new area complete economic rehabilitation, little thought is given to the stream of idle equipment, resources, and manpower left in the wake of that company's departure.

Because industry is now recognized as such an important cog in maintaining a smooth running economy, it is doubtful that the intense struggle for industry between the areas will subside. But since inducements like advertising, tax exemptions, and financing plants on the municipal level have been of limited value, alternative methods like the use of industrial development foundations or chambers of commerce which do not use public funds, and seldom advocate "give-away" programs, appear to be a more desirable form of encouragement.

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111. National Planning Association, Committee of the South Reports, New Industry Comes to the South 2 (1949).
113. Ibid.
114. See Reader's Digest, March, 1956, p. 27.
115. See Garwood, supra note 108 at 111.