Study of the Availability of Funds to Finance Industrial Development in South Dakota

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STUDY OF THE AVAILABILITY OF FUNDS TO FINANCE
INDUSTRIAL DEVELOPMENT IN SOUTH DAKOTA

BY
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A thesis submitted
in partial fulfillment of the requirements for the
degree Master of Science, Major in
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STUDY OF THE AVAILABILITY OF FUNDS TO FINANCE

INDUSTRIAL DEVELOPMENT IN SOUTH DAKOTA

This thesis is approved as a creditable and independent investigation by a candidate for the degree, Master of Science, and is acceptable for meeting the thesis requirements for this degree. Acceptance of this thesis does not imply that the conclusions reached by the candidate are necessarily the conclusions of the major department.

Thesis Advisor

Major Advisor

Head, Economics Department

Date
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CHAPTER I

INTRODUCTION

The state government of South Dakota, along with many communities, has taken the position that industrial development must be encouraged if South Dakota is expected to correct such problems as low income levels and outmigration of young working people. Recent evidence of the interest in industrial development is shown by the introduction in the South Dakota legislature of bills designed to make state funds available to help finance industrial development.¹ The interest of various communities is seen by the organization of numerous community and/or industrial development groups. At present there are 126 development groups in South Dakota.²

This interest in industrial development indicates that local groups are aware that one avenue to increased income levels and employment, and decreased outmigration from South Dakota is diversification of South Dakota's economy through increased industrialization.

¹During the past two legislative sessions, five bills designed to provide state loans or loan guarantees were introduced in the state legislature but none gained approval. These bills were Senate Bills 205 and 220 introduced in 1974, and Senate Bills 245, 220, and 281 introduced in the 1975 legislative session.

²According to a spokesman of the Industrial Division, Economic and Tourism Development, formerly the Industrial Development and Expansion Agency, as of July, 1975, 25 of these development groups were considered quite active in the sense of being able to offer financial help, land, buildings, and utility service to prospective firms. Forty were active in the sense of holding meetings but not able to attract industry without assistance. The remaining 61 groups were development groups in name only.
The State Planning Bureau's 1974 policy plan for economic development stresses that South Dakota's economy must be diversified if an attractive economic environment is to be developed.

The move to diversify can be illuminated by examining South Dakota's income and employment structure. In 1970, as in past years, the largest industry in South Dakota, in terms of employment and total income generated, was agriculture. Following agriculture in order of magnitude were government, wholesale and retail trade, service industries, and manufacturing. Problems of this type of economy, where agriculture is the main export sector with the other export sectors lagging far behind, include slow growth, a tendency of the economy to fluctuate with agricultural cycles, and a decline in employment opportunities.

An example of the problem created by relying primarily on agriculture is given by the employment statistics of South Dakota. Between 1960 and 1970 South Dakota's agricultural employment dropped from 80,000 to 59,000, a decrease of 26 percent. It was projected to drop by another 25 percent by 1980. Fortunately other sectors of the economy have been able to absorb most of the excess labor.

While agricultural employment decreased by 21,000 from 1960 to 1970, employment in urban non-manufacturing industries increased by 32,700.


primarily in the services and government sectors. Manufacturing employment increased by only 2,700.\textsuperscript{5} It is unlikely that government and service industries will continue to grow at a sufficient rate to absorb agricultural outmigrants unless South Dakota's total population shows signs of growth. Other sectors of the state's economy will have to absorb those people no longer needed in agriculture. Increasing employment opportunities in the manufacturing sector through industrial development is seen to be a possible answer to the problem.

Up to now South Dakota has experienced slow industrial growth. In 1970, South Dakota had new capital expenditures in manufacturing amounting to 18.5 dollars per person compared to 61 dollars per person in Montana, 14 dollars per person in Wyoming, 16 dollars per person in North Dakota, and 108 dollars per person as the national average.\textsuperscript{6} The same year only 7.4 percent of South Dakota's civilian labor force was employed in manufacturing. The national average was 25.9 percent.\textsuperscript{7}

A widely held hypothesis to explain the slow industrialization in South Dakota is that a shortage of financial capital for industrial

\textsuperscript{5}Ibid., p. 27.


development is restricting efforts to expand the manufacturing sector in the state. The argument is made that there is insufficient capital for industrial development because either South Dakota does not generate sufficient capital internally, or that sufficient capital is being generated but is flowing to more attractive investment out of the state. Depending upon which case is true, if either, different approaches must be undertaken to alleviate the capital shortage problem. Without a fuller understanding of the supply and demand of financial capital for industrial development, successful efforts to improve the economic well-being of all South Dakotans will be hampered.

The Problem

As South Dakota continues its efforts to encourage industrial expansion, the apparent lack of funds for industrial development will continue to be a major area of concern. An important component of this concern is lack of knowledge. There have been only limited attempts to estimate the supply and demand for financial capital for industrial development in South Dakota. No attempt has been made to inventory and appraise the capacity of all sources of investment capital which are available to meet the present needs of industrial expansion.

Loren Tauer and Barbara Preston have each done a study on supply and demand of investment capital in South Dakota. Their findings are summarized in the review of literature.
Objectives

The overall objective of this study is to investigate whether or not a shortage of financial capital for non-agricultural industry exists in South Dakota and if so to examine the causes and magnitudes of the shortage.

The specific objectives are:

1. To list and describe institutions which control funds that are potentially available for investment in new plants or for expansion of established industry in South Dakota.

2. To estimate the current and potential availability of funds for industrial development use from each source listed.

3. To determine by sub-state region the supply and demand of industrial development funds in South Dakota.

4. To analyze the current and potential supply-demand balance for industrial development funds.

5. To identify financing methods which could be adopted by South Dakota to provide additional financial capital if the need is evident.

Review of Literature

Although little research has been done as to the magnitude of the supply and demand for industrial development capital in South Dakota, a considerable amount of research has been done on the many available methods of financing industrial development. Several of these studies are reviewed below.

Several methods that state and local governments have available to them to encourage and finance industrial development have
been outlined in a study by Bridges. The methods outlined are:
(1) state loan guarantee funds, (2) state direct loan programs, (3) local industrial bond financing, (4) tax concessions, (5) statewide development credit corporations, and (6) local development corporations. The use of these methods varies considerably from state to state.

Methods of finance which are primarily available to local governments are local subsidies and industrial revenue bonds. The issue of local subsidies has been examined by Laird and Rhinehart and Cumberland and VanBeek, while the use of industrial revenue bonds was studied by Johnson, Rudel, and Rose.

Laird and Rhinehart examined the use of local subsidies to industry to overcome the problems of surplus labor and low incomes caused by market imperfections. They support the use of local subsidies to accelerate market adjustments and to buy time for areas suffering high unemployment and low incomes. Cumberland and VanBeek criticize the use of local subsidies on the grounds that subsidies


11 John H. Cumberland and Frits VanBeek, "Regional Economic Objectives and Subsidization of Local Industry," Ibid., 253-263.

would only work if technology permits ready substitution of labor for capital, and if industries could be induced to move their operations to the area offering the subsidy. They think subsidies may only perpetuate the problems of low incomes and unemployment, and suggest education and retraining of labor rather than local subsidization to raise productivity in areas of high unemployment and low incomes.

One of the fastest growing sources of supply for financing industrial development has been revenue bond financing. Johnson, Rudel, and Rose examined the history of industrial revenue bonds in the United States and in South Dakota. At the time of their publication (1972), five municipalities in South Dakota had issued industrial revenue bonds with a total value of over six million dollars. Approximately 650 new jobs were realized through the use of these bonds. The benefits of using this type of financing include increased employment directly resulting in increased income, a multiplier effect on income, inducement of other firms to settle in the area resulting from attracting the first firm, and a broader base for property taxes. Costs to the area may include a need for additional public facilities, adverse environmental effects, effects on interest costs of other municipal bond issues, and the risk of failure. The authors stated that industrial revenue bonds may not be right for all communities, but may be useful in letting a community determine its own development.

The role of the federal government in industrial development over the past few years has been expanding. The primary source of
federal funds which may be used for industrial development, the Small Business Administration (SBA), is examined by Einar Johnson.\textsuperscript{13} Rosine\textsuperscript{14} and Woods\textsuperscript{15} each studied various other programs provided by the federal government. The publication by Johnson provided a summary of the many SBA programs which may be utilized for industrial development purposes. Among the services offered through SBA programs are loans to state development corporations, provision of loans and counseling to local development groups, lease guarantees for small businesses which cannot obtain prime commercial space because of low credit ratings, direct business loans, and business loan guarantees.

The most recent federal program was authorized by the Rural Development Act of 1972 (RDA). Rosine's study outlined various aspects of the RDA. The part of the RDA which is involved with the financing of industrial development was to be implemented by the Farmers Home Administration (FHA). The FHA was authorized to make business and industrial loans to firms which are located in communities of under 50,000 people. The FHA was appropriated $200

\textsuperscript{13}Einar Johnson, "Rural Development Financing by the Small Business Administration," (papers presented at the meeting of the Committee on Agriculture and Rural Development of the Federal Reserve System, Richmond, Virginia, October, 1972), pp. 79-96.

\textsuperscript{14}John Rosine, "Implementing the Rural Development Act," Ninth District Quarterly, Federal Reserve Bank of Minneapolis, February, 1972, pp. 7-12.

million in a revolving fund for the purpose of making these business
and industrial loans.

Additional methods of financing industrial development are the
small business investment corporations (SBIC's) which are privately
owned SBA-licensed companies that supply venture capital and long
term financing to small firms. D. H. Woods has studied the role of
SBIC's in helping finance small businesses. SBIC's are empowered to
borrow from the SBA or from private lending institutions to obtain
funds to loan to small businesses. No SBIC's had been organized in
South Dakota up to October, 1975.

Studies done by Preston and Tauer are the only known
studies which relate directly to the supply and demand for financial
capital used in industrial development in South Dakota. Since this
study is concerned only with South Dakota, the studies by Preston
and Tauer provide useful guidelines.

Preston studied the forces of capital supply and demand in
South Dakota, although due to lack of information only theoretical
analysis was done of the demand for industrial financial capital.
In her analysis of capital supply she first looked at public supply
sources in South Dakota, primarily the SBA. She outlined the SBA's

16Barbara Preston, "Industrial Development in South Dakota: A
Study of the Forces of Capital Demand and Supply," (Student Intern

17Loren Tauer, "The Role of Commercial Banks in Industrial
Department, South Dakota State University, 1975).
organization, functions, goals, and funding. Among her criticisms of the SBA were that the SBA has much red tape, is slow in processing loan requests, is conservative, loans little money and has loan ceilings which are too low. Preston thought that the SBA could be more fully utilized if SBA public relations were improved.

Preston also examined the former Industrial Development and Expansion Agency (IDEA). The IDEA like its successor agency has no funds available for lending, and its main purposes are to provide economic research, field service, and publicity. Although the IDEA has no funds to help finance industrial development, it seeks to help in getting firms to locate in South Dakota.

The private sources studied by Preston are commercial banks and life insurance companies. She observed that many South Dakota bankers are very conservative, and that the banking community is satisfied that the capital demand is being met. Preston's analysis of the insurance industry was limited to life insurance. She estimated that if foreign and South Dakota based life insurance companies would hold assets in South Dakota comparable to the amount of money taken out of the state by life insurance companies, then 577 million dollars worth of assets could be invested in South Dakota. At present 194 million dollars worth of assets are invested in South Dakota by foreign and South Dakota based life insurance companies. Most of

18 Preston, op. cit., p. 15.

these assets are in the form of bonds or real estate with little of that amount being invested in industrial development. Preston concluded that the present supply of funds in banks, insurance companies, and government sources could easily meet any increase in demand for industrial capital. 20

The second study dealing directly with financing industrial development in South Dakota is Tauer's study of the banking industry in South Dakota and its role in industrial development. Tauer's purpose was to determine the demand for industrial capital and to then determine how much of this demand is being met by the banking industry. He projected the demand for funds for industrial expansion to increase from 32.7 million dollars in 1974 to between 46.6 to 74.9 million dollars in 1980, depending upon whether the trend used is for the last 10 years or for the last five years. 21 Tauer found that at present South Dakota's banks have outstanding industrial loans amounting to $125 million. His research revealed that banks are currently supplying 20-30 percent of all industrial investment needs in the state. Tauer noted that large, well established firms are not experiencing problems with obtaining funds, but that small, young firms are being hindered by lack of funds for expansion. Tauer concluded that any increase in demand for industrial capital could be

20 Ibid., p. 50.

21 Tauer, op. cit., p. 90.
easily met by the banking industry without hurting any other sector's capital supply.\textsuperscript{22}

**Procedure**

The supply sources which currently make funds available to finance industrial development in South Dakota were determined through a questionnaire sent to all industrial firms in the state.\textsuperscript{23} Once a list of supply sources was obtained, the first study objective, a description of supply sources, could be accomplished. Descriptions of the supply sources are based on information obtained from publications and from personal interviews with state supervisors of the various sources of financial capital. Included in the descriptions are legal requirements regarding the types of loans or investments each source can make, outlines of various programs available through each source, size of loan which can be made, and where supply sources themselves obtain funds.

In order to accomplish Objective Two, data concerning the amount of financial capital each source had furnished for industrial development projects from 1970 to 1974 were compiled from statistics supplied by each source. This five year data interval was selected primarily because several of the major sources being studied were first used or originated within the last five years. Another factor suggesting the use of this five year time span was that prior to 1970

\textsuperscript{22}Ibid., p. 102.

\textsuperscript{23}The questionnaire is included in Appendix A.
data on new capital expenditures, a proxy for demand for financial capital, were not restricted to only new capital expenditures in manufacturing, as were the data from 1970 to 1974. A third factor was the subjective judgment that data covering the past five years would be more indicative of the current industrial development potential and mood in South Dakota than would data from earlier years.

Once the current availability of financial capital was estimated, projections as to future availability of financial capital were made. Projections were made to 1980 and 1985 using the least squares method to fit straight lines to the time series data which had been compiled. The amounts of financial capital supplied and demanded in 1980 and 1985 were estimated by the equations of the trend lines:

\[ y = a + bx \]

where \( y \) = the amount of funds being demanded or supplied

\[ a = y \text{ intercept} \]

\[ b = \text{the slope or rate of growth of supply or demand} \]

\[ x = \text{the number of years measured from base year.} \]

To achieve the third objective the data compiled for Objective Two on a state basis were broken down according to planning district. This was done to illustrate the industrial activity in South Dakota on a regional basis, to show whether flows of funds occur among these regions, and, if flows are occurring, to examine the effect on capital availability in the various regions.

Objective Four was pursued by comparing the investment capital supply and demand trends estimated to accomplish Objective Two. This
comparison was made to determine whether or not a gap between supply and demand for investment capital exists now or is likely to occur within the next 10 years.

The procedure used to accomplish Objective Five involved pointing out methods available to state governments desiring to help finance industrial development. These methods were identified to show what programs are available to the state of South Dakota, should it decide insufficient capital is being supplied by other sources thereby suggesting a need for state funds to help finance industrial development.
CHAPTER II

DESCRIPTION OF SOURCES SUPPLYING INDUSTRIAL DEVELOPMENT CAPITAL

This chapter describes the various nonpersonal sources currently furnishing investment capital to industrial firms in South Dakota. The description includes such information as where sources obtain funds, who can and does borrow from each source, the types of investment that each source can finance, and the loan size and interest rate structure for each source.

Determination of Supply Sources

The sources examined in this study are primarily those which were indicated on the questionnaire sent to all manufacturing and processing firms in South Dakota. One section of the questionnaire asked each firm to indicate where it obtained funds to finance the establishment of its plant, to finance the expansion of the existing plant, to finance current assets, and where it plans to obtain funds for future expansion. The firms which responded then indicated what percentage of their total capital needs were met by the sources listed or by other sources which they indicated by writing in.

From these responses it was determined which sources are making funds available for industrial development projects in South Dakota. The nonpersonal supply sources indicated were commercial banks, industrial revenue bonds, Small Business Administration, Farmers Home Administration, and the Economic Development Administration. These
sources along with another known source, the School and Public Lands Fund, make up the major supply sources being examined in this study.

The reason these sources are being studied and not personal and corporate sources is that it would be virtually impossible to obtain any accurate figures as to how much investment capital comes from such sources as personal friends, churches, or such internal financing methods as retained earnings, factoring and accounts receivable. Investment capital obtained through these personal and corporate sources can be estimated as the total amount of capital expended for industrial development less the amount of investment capital supplied by the nonpersonal supply sources being studied.

Major Supply Sources

South Dakota Commercial Banks

The most widely known and most often used source of financial capital for industrial development is the commercial bank. In 1974 there were 159 commercial banks in South Dakota, 126 having state charters and 33 having national charters.1

Commercial banks are permitted to make loans to any industrial project provided the project has sufficient collateral and equity to meet charter requirements. Two restrictions limit the amount any South Dakota bank can loan for industrial development or any other purpose. The first requirement, that being a reserve requirement,

1According to Department of Commerce and Consumer Affairs, Office of Banking and Finance, Pierre, South Dakota.
limits the amount of deposits a bank can have and hence indirectly limits its loans, since loans create deposits. This requirement is determined by the Federal Reserve for its member banks, state or national, and by state laws or regulations for those banks which are not members of the Federal Reserve. Reserves may change either by conversion of other assets to cash, or by deposits of outside funds. On the basis of these additional reserves new deposits creating loans may be made.

The second restriction limits the amount a bank may loan any one borrower. The maximum loan a state bank can make to a single individual, partnership, or corporation is 20 percent of the bank's capital and surplus. The loan limit for national banks is 10 percent of their capital and surplus. This requirement thus makes banks a more likely lending source for small businesses and for firms needing funds for current assets.

Since banks face few restrictions as to whom they may lend to or how much they lend, one can see that whether or not a bank makes funds available for industrial development depends on the attitude of each individual bank. This attitude appears to be conservative in South Dakota as in other states. This conservatism may partly be due to the unpredictability of business cycles. Even though banks show a conservative attitude, they still must be considered the primary lending source for most firms seeking industrial development capital.

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Industrial Revenue Bonds

A source of funds which is becoming more widely used in South Dakota for financing industrial development is the industrial revenue bond. Industrial revenue bonds may be issued by local governmental units to finance the construction of buildings for industrial purposes and to purchase land to be used as industrial sites. The sites or buildings are then leased to private firms which pay rentals sufficient to cover the principal and interest of the bond and the maintenance of the facility. Revenue bonds are secured only by the property acquired with the proceeds of the bond sale and the income produced under terms of the lease contract. These bonds are not obligations of the governmental unit issuing them, so the bonds are retired only by the revenues obtained through the leasing agreement and not with public tax dollars. Another attractive feature of these bonds is that they are subject to no legal debt limit since they are not governmental obligations. The amount of bonds issued must still be within limits the bond market will accept.

The interest rate of industrial revenue bonds depends on the rating of the firm rather than on the rating of the municipality. A low rating of a firm would mean a higher interest must be paid to those buying the bonds. Originally all interest earned on industrial revenue bonds was tax exempt, but this was changed for new issues in 1968 when Congress decided to allow tax-free interest only
on those issues of under five million dollars.³

Industrial revenue bonds are allowed at the local level in all but seven states and the District of Columbia.⁴ The South Dakota legislature authorized the use of industrial revenue bonds by any municipality in 1964.⁵ Later, changes were made in the law to allow counties and special water districts to use industrial revenue bonds.⁶ Since the facility financed by industrial revenue bonds is municipally owned and thus pays no taxes, South Dakota has also ruled that payments in lieu of taxes may be made if negotiated with the firm leasing the facility.⁷ This provision usually allows a few years of tax relief before the payments in lieu of taxes have to be made.


⁶Ibid., 9-54-10.

From 1970 to 1974, there were 21 industrial revenue bond issues in South Dakota and all but four of these issues included tax relief for a period of two to 20 years.

Although the industrial revenue bond is an excellent source of funds for industrial development purposes, it does have some drawbacks. One of these drawbacks is the minimum amount which can be raised through industrial revenue bonds, $350,000, without the cost of issuing the bond becoming too high. Even though bonds can be issued for less than $350,000, small industries would probably not be able to use this method of finance. They could not pay the high cost or the high rate of interest which would be expected due to the low bond ratings usually given to small firms.

Even with the drawbacks of industrial revenue bond financing, these bonds would have to be considered a major source of funds for industrial development. Through industrial revenue bond financing municipalities can participate in the development of their communities rather than wait for development to come to them.

Small Business Administration

The Small Business Administration (SBA) was created by Congress in 1953 to help small businesses so that they can contribute to the economic growth of the country. At that time a permanent revolving

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8 Statement by Robert Martin, Department of Economic and Tourism Development, Industrial Division, Pierre, South Dakota, June, 1975.

9 Information for this section is based on the Small Business Administration's SBA - What it is . . . What it does, (Washington: Government Printing Office, 1974).
funds was established through which the SBA loan programs were funded. In 1966 this revolving fund was divided into two separate revolving funds, a Business Loan and Investment Fund and a Disaster Loan Fund. In addition to the revolving funds, additional capital appropriations can be authorized by Congress in order to carry out authorized SBA functions. In lieu of appropriations, additional capital may be provided by the sale of participation certificates in loan pools.

According to the SBA, to qualify a small business's receipts or employment must fit into certain defined categories. To be eligible for SBA assistance a manufacturing firm can employ a maximum of 250 to 1,500 persons depending on the industry, whereas wholesale, retail, service, and construction firms are judged according to receipts.

The SBA has many programs available through which a small business may obtain financial or other assistance. The program which is most important to this study is the business loan program through which loans and loan guarantees can be obtained for business construction, expansion, to purchase capital assets, or to provide working capital. Included in the business loan program are:

1. Direct and immediate participation loans allowing the SBA to make direct loans up to $100,000. In participation loans the SBA and a private lending institution each put up part of the funds with the SBA's share not to exceed $150,000. The maximum interest on the SBA share is currently 6 5/8 percent.

2. Loan guarantee plans through which the SBA can guarantee up to 90

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10Interest rates are for fiscal year 1976 and are subject to change.
percent or $350,000, whichever is less, of a bank loan to a small firm. The interest is set by the bank.

3. Pool loans which are SBA loans made to corporations formed and capitalized by groups of small business companies for purchasing materials to be used in their businesses. The SBA, alone or with a bank, may lend as much as $250,000 for each pool member. The SBA interest is 6 5/8 percent, and maturity is up to 10 years, or 20 years if for construction purposes.

4. Economic opportunity loans by which the SBA makes loans to disadvantaged persons who desire to own their own business. A disadvantaged person is one in the low income category or someone who has been denied adequate finances through normal lending institutions due to social or economic reasons. The maximum loan is $50,000 with maturity up to 15 years. Interest on this type of loan is 7 3/4 percent.

5. Handicapped assistance loans allow the SBA to make loans to nonprofit organizations which employ not less than 75 percent handicapped personnel, or to handicapped persons who operate or wish to establish a business.

The SBA also has two lending programs designed to assist development companies. One program lends money to state development companies so that these companies can supply long-term loans and equity capital to small businesses. The SBA may lend these companies an amount equal to their total outstanding borrowing from all other sources, with a maturity of up to 20 years, at variable interest rates. At the present time South Dakota does not have a state development corporation.

The other program involves local development corporations (LDC). To be eligible for these loans private concerns must put up a reasonable share of the cost of a project, usually 20 percent. The LDC may be organized as a profit or nonprofit corporation and must have a minimum of 25 stockholders or members. A maximum of $350,000 may be borrowed from the SBA for each small business to be assisted, with a
loan maturity of up to 25 years. The SBA participates with banks, insurance companies, pension fund groups, state authorities, and commissions and others when making loans to LDC's.

The SBA also has a lease guarantee program for small businesses unable to lease good locations because they do not have top credit ratings. In these cases the SBA will guarantee the payment of the lease so that these businesses may obtain good locations. The guarantee may extend to 20 years on a participatory or direct basis.

The SBA also helps finance small firms through privately owned small business investment companies (SBIC's). SBIC's are SBA-licensed companies which supply venture capital and long-term financing to small firms. The SBIC's must operate within SBA regulations but their transactions with firms are not subject to SBA approval.

Initial minimum private investment in an SBIC may vary from $150,000 to as much as $1,000,000. SBA may make loans or guarantee 100 percent of the loans made by private lending institutions to SBIC's to add to the SBIC's funds for financing small firms. The maximum loan the SBA will make to an SBIC is $15 million or twice the SBIC's private paid-in capital and surplus, whichever is smaller, and the term of the loan may be up to 15 years. SBIC's specializing in venture capital financing which are capitalized at $500,000 or more may qualify for SBA direct or guaranteed loans aggregating up to $20 million. At present there are no SBIC's organized in South Dakota to take advantage of this program.
The Farmers Home Administration (FHA) was authorized by the Rural Development Act of 1972 to provide credit for business and industry. The funding for this program is appropriated by the federal government. The means by which these funds are channeled to businesses and industries are loan guarantees and direct loans. The loan guarantees make credit available to private organizations or individuals from private lending institutions with the FHA guaranteeing up to 90 percent of the loan in case the borrower defaults. The private lender is responsible for writing and servicing the loan, and is also responsible for setting the interest rate.

The second means of FHA financing of industrial development is the direct or insured loan. Those eligible for an insured loan include individuals, public and private organizations, and federally recognized Indian tribal units. To obtain an insured loan one applies directly to the FHA which may then write and service the loan. The maximum repayment schedule for insured loans is 30 years for land and buildings, 15 years for machinery or equipment, and seven years for working capital. The interest rate on these loans as of September, 1975 is 10 3/4 percent. 12


12 This interest rate is for fiscal year 1976 and is subject to change.
The Rural Development Act of 1972 also authorized the FHA to make grants to rural areas or to cities with populations of 50,000 or less. The grants are to be used for financing industrial sites, including such costs as purchasing and developing land, and constructing access roads, parking areas, and utility and service extensions. Only public bodies are eligible for these grants.

Since the program through which the FHA makes funds available for non-farm industries is quite a recent development, it is difficult to say what impact it will have on industrial development in South Dakota. Since the FHA program will be utilized mainly for cases which exceed the SBA loan limit, one might speculate that the FHA will not become a major source of investment capital. Nevertheless, the FHA loan guarantees and direct loans do provide an additional source of funds to assist in the financing of industrial development in South Dakota.

Economic Development Administration

The Economic Development Administration (EDA) is an agency of the U. S. Department of Commerce, authorized by the Public Works and Economic Development Act of 1965.13 The attention of the EDA is directed toward communities and areas suffering high unemployment or low family incomes. The purpose of the EDA is to make funds available so jobs can be created in those areas. Available EDA programs include

public works grants and loans, business development loans, technical assistance, planning grants, and research grants and contracts.\textsuperscript{14} Although all of these programs are helpful to industrial development, only the business development loan program is pertinent to this study.

The business development program offers assistance through direct loans or loan guarantees to finance fixed assets and working capital. Guarantees of rental payments for fixed asset leases from qualified lessors are also authorized. To be eligible for this assistance the businesses must be located in an EDA redevelopment area or economic development district.\textsuperscript{15} Applicants for EDA business loans may include business enterprises, nonprofit organizations, the state or any political subdivision of the state, Indian tribes, and private lending institutions including: banks, savings and loans, insurance companies, factoring companies, investment banks, and venture capital investment companies.\textsuperscript{16}

Although there is no limitation on the amount that EDA may lend any applicant, EDA funding is subject to budgetary discretion so the general guideline is to lend not more than $10,000 per job created or saved. Other limitations also apply to the EDA business development program. The amount of funds which the EDA can supply

\textsuperscript{14}Ibid., p. 1.

\textsuperscript{15}Maps of these areas are included in Appendix B.

for direct fixed asset loans is limited to 65 percent of the total cost of the fixed asset, but working capital loans may be made for the full amount required. Guarantees on loans or leases may not exceed 90 percent of the obligation. The limit on the length of EDA business development assistance is 25 years except for working capital loans, which are limited to five years, and leases on fixed assets, which are limited to the useful life of the fixed asset. The interest rate on EDA loans is determined by the cost of government borrowing, but is usually below the commercial bank prime rate. The equity requirement for all EDA projects is at least 15 percent of the total project costs. One other requirement which must be met by the applicant is a feasibility study to be provided by the applicant at his own expense thus enabling the EDA to analyze the technical and economic feasibility of a project. 17

Although the EDA is authorized to provide assistance for industrial development projects, at the present time the business program is not providing a major share of the industrial development capital expended in South Dakota as is indicated in Chapter III.

School and Public Lands Fund

The School and Public Lands Fund is currently the only source of state money which is available for industrial development purposes. The School and Public Lands Fund obtains its funds through the sale or rental of state owned school and public lands. This money is then put

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17 Ibid.
into a permanent fund which amounts to approximately $63 million at the present time.\textsuperscript{18} According to state laws, this money can be invested in bonds of the United States; securities guaranteed by the Veterans Administration, Farmers Home Administration, Federal Housing Administration or the Small Business Administration; general obligation bonds of the state of South Dakota, any public school corporation, organized county or incorporated city within South Dakota; and loans made under the Federal Higher Education Act of 1965.\textsuperscript{19} Prior to 1970, little or none of the School and Public Lands fund was being invested in development activities in South Dakota because the original law did not allow investments in federal government guaranteed securities. Amendments to the law in 1969 and 1970 authorized purchase of these securities.

The process by which money from the permanent school fund becomes available for development purposes is somewhat difficult for the firm who is trying to obtain the capital. The firm must be able to convince the lending agency, usually a bank, the guaranteeing agency, usually the SBA or FHA, and the directors of the School and Public Lands that his project is worthwhile. The three financing parties are in close contact with each other to be sure that each party is doing its function. Once the directors of the School and

\textsuperscript{18}Information obtained from phone interview with George Kane, Commissioner of School and Public Lands, Pierre, South Dakota, August, 1975.

Public Lands Fund make a commitment with their funds, the bank can then write the loan with the SBA or FHA guaranteeing the loan. The money from the permanent school fund is used to purchase the loan from the bank. One requirement which must be met is that the loan must be 100 percent guaranteed before the permanent school fund can be invested.

Although this source of funding for industrial development is not now supplying a major percentage of capital investment needs, it has the potential to become important. Also it shows that state money can assist development while earning interest at the same time.

**Potential Sources of Investment Capital**

The above six sources were the major sources of investment capital which were indicated on the replies to the questionnaire sent to South Dakota industries. In addition, there are several minor sources which are able to supply some funds to help finance industrial development in South Dakota. Included are local development corporations, the Department of Housing and Urban Development, South Dakota based insurance companies, and the Bureau of Indian Affairs.

**Local Development Corporations**

Local development corporations (LDC's) are able to supply capital to firms but are usually more involved with the public relations aspect of industrial development, although they sometimes buy and hold land for industrial development so that new industries are not forced to pay the higher price land speculators may charge. LDC's are
usually independent groups of private citizens which fund their operation by selling stock if a profit corporation, or from dues and other contributions if a non-profit corporation.

The amount of capital contained in most LDC's would not be sufficient to finance the construction of most industrial facilities so their primary financial role is to assist firms in obtaining financing from other sources, primarily commercial banks and the SBA. If the funds go directly to the LDC, they can then make arrangements to construct a building which they lease to a firm. They could also loan the funds directly to the firm and allow the firm to construct the building themselves.

Another way for LDC's to obtain capital is from local governments. South Dakota laws allow municipalities and counties to appropriate tax dollars to non-profit LDC's for the purpose of promoting the city or county. A city can levy a tax up to one mill each year on each dollar of taxable property, and a county can levy a tax of up to one-eighth mill.

Although local development corporations do have the authority to provide funds for industrial development, they do not generate sufficient capital to make them a major source of industrial development capital. The LDC's are useful though in facilitating the obtaining of capital from other supply sources.

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20 Ibid., 9-12-1 and 7-18-11.
South Dakota Based Insurance Companies

Because of the large amount of money controlled by the 74 South Dakota based companies, the insurance industry might be considered a potential source of funds for industrial development. These insurance companies have approximately $12.5 million currently invested in South Dakota in the form of real estate, stocks and bonds. According to responses to the questionnaire sent to all the industries in South Dakota, none of this money goes directly to industrial development projects, although insurance funds may indirectly go to industrial development if some of the bonds held by these insurance companies are industrial revenue bonds.

There are various means by which insurance companies could be influenced to invest some of their capital in industrial development projects. One possible way to encourage investment in industrial development would be to offer a tax credit for any investment in industrial development projects in South Dakota. This method has been used successfully by other states as a device for keeping insurance investments in the state. If this method or any other similar method were adopted in South Dakota, another minor source of investment capital could be tapped to add to the total supply picture.

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21 Data based on Insurance Commissioners work sheets for the annual report, December 31, 1974, Pierre, South Dakota.

22 Texas was the first state to offer such a tax credit, according to a statement by Don Graham, Acting Insurance Commissioner of South Dakota, Pierre, South Dakota, June, 1975.
Housing and Urban Development

The U.S. Department of Housing and Urban Development (HUD) is currently able to make funds available for industrial development, but only on a very limited basis. These funds which are available for industrial development purposes are available to a firm only if that firm is located in a designated urban renewal area and is required to rehabilitate its present property or move to a new location because of urban renewal activities. HUD funds can then be obtained to finance the rehabilitation or the cost of a new plant.

The likelihood of a South Dakota firm obtaining funds from HUD is rather small since 80 percent of HUD development funds go to cities designated as standard metropolitan statistical areas, and Sioux Falls is the only such area in South Dakota. So unless it is located in an urban renewal area in Sioux Falls, a firm in South Dakota has little chance of obtaining funds from HUD for industrial development purposes.

Bureau of Indian Affairs

The Bureau of Indian Affairs (BIA), under the United States Department of Interior, is authorized to provide loans for Indian economic, social, industrial, and tourism development. Prior to


24 Ibid.
1974 there were three revolving loan funds operating to provide loans to Indians. The Indian Financing Act of 1974 consolidated those three funds into one fund administered by the Secretary of the Interior, and authorized an additional $50 million be appropriated to the fund.25 The Act also established a loan guarantee program which can guarantee up to 90 percent of a loan made to private Indian organizations or individuals. A grant program was also authorized by the Act. This program authorizes federal grants of up to $50,000 per business to aid small Indian businesses.26

Since the SBA is the major source of investment capital supplied by the federal government, the BIA programs will probably remain relatively minor sources of investment capital. The uncertainty of the political process always leaves open the possibility that Congress will increase appropriations to the BIA for the purpose of making industrial loans, but then again there is the possibility that Congress may cancel the lending program entirely.

25 Information provided by Arthur Bridwell, Bureau of Indian Affairs, Aberdeen, South Dakota, in phone interview on October 3, 1975.

26 Ibid.
CHAPTER III

DEMAND AND SUPPLY OF INDUSTRIAL DEVELOPMENT CAPITAL

As stated in the introduction to this study, knowledge about the demand and supply for industrial development capital in South Dakota is limited. In order to assess whether and, if so, to what extent inadequate financing affects industrial development, it is important that a complete picture of the demand and supply situation of investment capital be presented. The purpose of this chapter is to inventory and appraise the present and projected magnitudes of investment capital demanded and supplied for industrial development in South Dakota.

Demand for Industrial Development Capital

The first step in the analysis of the supply and demand of industrial development capital was to determine the magnitude of the demand for these funds. The data used to estimate demand in this study were the capital expenditures of new and expanded industries in South Dakota (Table III-1). Although these estimates show only known demand, experiences of commercial banks, Small Business Administration, Farmers Home Administration, and the Office of School and Public Lands indicated that more funds were available than were requested over the past few years. Since the supply of industrial investment funds probably exceeded demand for these funds, the capital expenditures of new and expanded industries is probably an adequate
Table III-1: Capital Expenditures of New and Expanded Industries in South Dakota

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<td>$1.74</td>
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<td>18.19</td>
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<td>1.09</td>
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</tr>
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<td>Total</td>
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<td>$15.44</td>
<td>$21.60</td>
<td>$36.20</td>
<td>$29.98</td>
<td>$117.24</td>
</tr>
</tbody>
</table>

SOURCE: Department of Economic and Tourism Development, Industrial Division, (Pierre, South Dakota).
indicator or proxy for the effective demand for industrial development capital.¹

According to the demand estimations presented in Table III-1, known demand for investment capital has grown from $14 million per year in 1970 to $30 million per year in 1974.² South Dakota's total industrial capital investments over the past five years amounted to $117.2 million with over half of that amount occurring in 1973 and 1974.

The capital expenditures were also tabulated according to planning district in order to show where the main industrial growth is occurring in South Dakota.³ Planning District Two was the most

¹The concept of effective demand presumes that more than just desire for investment capital must exist, people must also be willing and able to pay the costs of obtaining this capital. In other words most everyone has some demand for interest-free money, but as interest becomes higher much less investment capital is demanded. Effective demand then is the amount of capital demanded at the going rate of interest.

²A previous study by Loren Tauer, "The Role of Commercial Banks in Industrial Development in South Dakota", (unpublished Master's thesis, Economics Department, South Dakota State University, 1975), also used capital expenditures of new and expanded industries to determine demand. There is some discrepancy between the two estimations of demand due primarily to the sources of the data. Tauer relied on summary data of the U. S. Bureau of Census and the South Dakota Department of Economic and Tourism Development while this study obtained a listing of all capital expenditures by industries over the past five years from the South Dakota Department of Economic and Tourism Development. The discrepancy between the data reported by the Department of Economic and Tourism Development and the actual lists were due to errors in addition along with the inclusion of some commitments even though they would not be realized for a few years.

³In 1970 South Dakota was divided into six planning and development districts for the purpose of encouraging cooperation among the
active with over $41 million expended for new plants and equipment. South Dakota's largest population and industrial center, Sioux Falls, is located in District Two. Expenditures ranged from about $8 million to about $15 million in the other planning districts.

In order to estimate the rate of growth of demand for use in projecting into the future, a linear trend was derived from the five-year data by using the method of least squares. This trend line indicates that demand for investment capital has been increasing at a rate of $5.27 million per year (Figure III-1). At this rate of growth of capital investments, demand for investment capital would be about $66 million in 1980, an increase of over 100 percent over 1974. By 1985 demand would be about $92 million. The question then remains as to whether the capital necessary to meet this demand can be provided by the various capital sources currently available in South Dakota.

various governmental units within each district in solving problems which cross local government boundaries. A map of these districts is presented in Figure III-8.

4 Trend lines in this study are used to show the rate at which demand and supply of investment capital have grown over the past five years and to also show the amount which would be demanded and supplied should present trends continue. When examining the projections which were made, it must be realized that such things as business cycles are not accounted for. It must also be realized that when making projections to five and 10 years in the future using only five years' data, accuracy of the projections diminishes as these projections are made further into the future.
Figure III-1: Past and Projected New Capital Investments in Manufacturing
Supply of Industrial Development Capital
South Dakota's Commercial Banks

Commercial banks comprise the main source of supply of industrial capital in South Dakota. Although exact data were not available as to the amount of capital supplied by banks, estimates were made using Federal Deposit Insurance Corporation (FDIC) statistics in conjunction with estimates made by Loren Tauer of the industrial development capital supplied by South Dakota banks.  

Estimates of the amount of investment capital supplied by banks were obtained by adjusting the total bank commercial and industrial loans made in the state, by Tauer's estimate that 46 percent of the value of all commercial and industrial loans in South Dakota are for industrial purposes. Once the commercial and industrial loans were separated, the loans going to industry had to be broken down further to allow estimation of the loans for fixed capital as opposed to those for working capital.

The industrial loans were broken down by assuming the amount of industrial loans going to finance fixed capital is 50 percent. This assumption relied again on estimates made by Tauer. According to


7Tauer, op. cit., p. 63.
Tauer's study, 64 percent of bank industrial loans have a duration of one year or more. Usually loans for fixed capital are for over one year while most loans for working capital are for one year or less. Adjusting the 64 percent to take account of loans for working capital which may be for over one year suggested 50 percent as an approximation of the proportion of industrial loans going to finance fixed capital. These data were then broken down by planning district by assuming that the percentage of statewide industrial loans made in each district would equal the percentage of total bank deposits in the state held within the respective districts.

According to data in Table III-2, commercial banks have made industrial loans amounting to $40 million over the past five years with 70 percent of these loans occurring in 1973 and 1974. The amounts of industrial loans varied by planning district from a low of $5.2 million in District Five to a high of $8.8 million in District Two. The amounts of industrial loans made by planning districts may be overestimated in some districts and underestimated in others due to such banking practices as branch banking and correspondent banks. In cases of branch and correspondent banking, bank deposits may be made in smaller banks and then transferred to accounts with the main office.

\[8\text{Ibid., p. 64.}\]

\[9\text{Jane Bodmer, bank examiner, office of the Regional Administrator of National Banks, Minneapolis, Minnesota, and Van Fishback, Vice President of First National Bank, Brookings, South Dakota were questioned as to the validity of this assumption and both found it to be sound.}\]
Table III-2: Estimate of the Amount of Industrial Development Capital Supplied by South Dakota Commercial Banks

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<td>I</td>
<td>$0.64</td>
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<td>$0.77</td>
<td>$2.39</td>
<td>$1.51</td>
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<tr>
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<td>III</td>
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<td>0.71</td>
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<td><strong>Total</strong></td>
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<td><strong>$2.06</strong></td>
<td><strong>$5.42</strong></td>
<td><strong>$17.07</strong></td>
<td><strong>$10.83</strong></td>
<td><strong>$40.00</strong></td>
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</table>

bank or the correspondent bank where it may then be used to make loans. It is also possible that the smaller banks may obtain funds from the main office or correspondent bank when a loan request is too large for the smaller bank to finance. Thus a two-way flow exists making it difficult to tell which districts' estimates of industrial bank loans are overestimated and which are underestimated.10

As was done with demand, a linear trend in the growth of bank industrial capital loans was determined using the method of least squares (Figure III-2). Industrial capital loans by banks increased at a rate of $2.7 million per year during the 1970-1974 period. Projections using this rate indicate that by 1980 banks would be supplying about $30 million for capital investments, an increase of about three times the 1974 amount. By 1985 about $43.6 million would be supplied by banks, at the current rate of expansion.

The potential amount of investment capital supplied by banks could be greater than these projections. More rapid increases in industrial loans by banks could be effected through such means as an increase in the loan-to-deposit ratio of the banks, increased use of the Federal Reserve's seasonal borrowing privilege, an increase in the

10 The percentage of capital investment which is supplied by nonpersonal sources presented in Figure III-8 indicates that the Districts One, Two, and Six receive less capital from the nonpersonal supply sources than do Districts Three, Four, and Five. This is possibly due to industrial bank loans being underestimated in Districts One, Two, and Six. As stated above, this underestimate may be due to branch banking and correspondent banking and the flow of funds caused by these practices.
Figure III-2: Past and Projected Supply of Industrial Development Capital by South Dakota Commercial Banks
rate of growth of deposits, or by a state industrial loan guarantee.\textsuperscript{11}

\textbf{Industrial Revenue Bonds}

Even though industrial revenue bonds (IRB's) were first used in South Dakota in 1969, they already are the second most important nonpersonal source of capital for industrial development purposes. One of the main advantages of these bonds is that they can finance development projects which may be too large for banks or the Small Business Administration to handle.

Since 1970, IRB's have supplied about $33 million of industrial development capital in South Dakota (Table III-3). Seventy percent of that amount has been supplied in the last two years. The data in Table III-3 show a rather large variation in the use of IRB's among the state's six planning districts. In District Two, IRB's were used to raise $14.7 million in investment capital, accounting for 45 percent of the state's total. Communities in District Six did not use the bonds at all during the past five years, and District Five had only one issue amounting to $0.8 million. The apparent lack of interest in IRB financing by District's Five and Six would seem to indicate that adequate amounts of investment capital are being generated by other supply sources.

Figure III-3 illustrates the growth rate of industrial revenue bond financing. The linear trend shows a rate of increase of bond issues of $2.86 million per year. With continued expansion at this

\textsuperscript{11}Tauer, op. cit., p. 102.
Table III-3: Amount of Industrial Development Capital Supplied by Industrial Revenue Bonds

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<tr>
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<td>$0.40</td>
<td>$7.60</td>
<td>$12.78</td>
<td>$9.30</td>
<td>$32.78</td>
</tr>
</tbody>
</table>

SOURCE: Department of Economic and Tourism Development, Industrial Division, (Pierre, South Dakota).
Figure III-3: Past and Projected Supply of Industrial Development Capital by Industrial Revenue Bonds

\[ y = -2.02 + 2.86x \]

- 29.44 mill.
- 43.74 mill.
rate, by 1980 IRB's would supply about $30 million for investment capital, or three times the amount supplied in 1974. By 1985 industrial revenue bonds would be supplying about $43.7 million, slightly more than the $43.6 million which would be supplied by commercial banks in 1985. Thus industrial revenue bonds might well become the main source of investment capital in the state.

Since industrial revenue bonds have only been used in South Dakota since 1969, one would expect this source of supply to increase in use as more municipalities become aware of the bonds. Although there is no limit as to the amount of IRB's which can be issued, the unlimited potential of IRB's may not be reached. A factor which may restrict the use of IRB's is that municipalities may become reluctant to issue IRB's because of the concern that interest rates on other municipal issues may be forced up. Rather than increase the cost of municipal bonds which are necessary to help finance public services, cities may reduce the number of industrial revenue bond issues. Nevertheless, industrial revenue bonds appear to be the most promising new source of industrial development financing in South Dakota.

Small Business Administration

The Small Business Administration (SBA) is the major source of supply of federal funds which are available for industrial development purposes. The SBA is able to provide financing for industries by making direct loans to firms, or by guaranteeing loans made by other institutions.
Most of the SBA assistance to industries comes through loan guarantees. These guarantees accounted for approximately $8.4 million, 60 percent, of SBA assistance to industrial development in South Dakota over the past five years (Table III-4). Direct loans accounted for $5.54 million of the SBA assistance being examined in this study. It is the direct loans which are of major concern to this study, since the amounts guaranteed by the SBA are included in the amounts loaned by banks and state government.

In order to make projections as to the amount of capital which can be expected to come from the SBA, linear trends were derived from total SBA assistance as well as from the five year data on direct loans (Figure III-4). With a continuation of present trends, total SBA assistance could increase at a rate of $250,000 per year, amounting to $4.8 million in 1980. With the same assumptions direct SBA financing would be decreasing at a rate of $2,000 per year.

By looking at the linear trends of SBA assistance one may get the idea that the SBA is very conservative about making loans for industrial development to South Dakota industries. Also the Sioux Falls SBA office delinquency rate of 4.35 percent while the national average delinquency rate is 9 percent would seem to indicate a conservative attitude by the SBA in South Dakota. According to SBA officials this has nothing to do with SBA loans to industries in

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12 Percentages furnished by Small Business Administration, Sioux Falls, South Dakota.
Table III-4: Amount of Industrial Development Capital Supplied by the Small Business Administration

<table>
<thead>
<tr>
<th></th>
<th>In Millions of Dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBA Guarantees for</td>
<td></td>
</tr>
<tr>
<td>Industrial Development</td>
<td>$1.44</td>
</tr>
<tr>
<td>SBA Direct Loans for</td>
<td></td>
</tr>
<tr>
<td>Industrial Development</td>
<td>0.51</td>
</tr>
<tr>
<td>Total SBA Loans and</td>
<td></td>
</tr>
<tr>
<td>Guarantees</td>
<td>1.95</td>
</tr>
</tbody>
</table>

SOURCE: Small Business Administration, (Sioux Falls, South Dakota).
Figure III-4: Past and Projected Supply of Industrial Development Capital by the Small Business Administration
South Dakota. As a matter of fact, SBA officials say that any firm or development group that has come to the SBA needing financial assistance and meeting SBA requirements has been able to obtain it through the help of the SBA. The SBA officials contend that the SBA is underutilized in South Dakota and that more money is available than is being requested. If this is the case, the SBA’s potential as a source of supply for investment capital may possibly be much greater than the projections shown in Figure III-4.

State Funds (School and Public Lands)

One area of supply which is seldom thought about as being a current source is state funds. The state currently has funds available to be loaned for industrial development purposes. Over the past four years, South Dakota’s School and Public Lands Office has loaned $3.75 million to industrial development projects in South Dakota. Forty thousand dollars was loaned in 1971, $180,000 in 1972, $320,000 in 1973, and $3.21 million in 1974 (Table III-5).

The trend line of state loans for industrial development is shown in Figure III-5. These loans have been increasing at a rate of $670,000 per year, and at that rate would equal about $6 million in 1980 and approximately $9.5 million per year by 1985. These projections may be misleading—though, since the School and Public Lands

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13 Statement of Gerald Bruget, Small Business Administration, in a personal interview, Sioux Falls, South Dakota, August 12, 1975.
Table III-5: Amount of Industrial Development Capital Supplied by the State (School and Public Lands Fund)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>0</td>
<td>0</td>
<td>$0.18</td>
<td>0</td>
<td>$1.05</td>
<td>$1.23</td>
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<tr>
<td>II</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0.40</td>
<td>0.40</td>
</tr>
<tr>
<td>III</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0.30</td>
<td>0.30</td>
</tr>
<tr>
<td>IV</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0.35</td>
<td>0.35</td>
</tr>
<tr>
<td>V</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0.48</td>
<td>0.48</td>
</tr>
<tr>
<td>VI</td>
<td>0</td>
<td>0.04</td>
<td>0</td>
<td>0.32</td>
<td>0.63</td>
<td>0.99</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>0</td>
<td>$0.04</td>
<td>$0.16</td>
<td>$0.32</td>
<td>$3.21</td>
<td>$3.75</td>
</tr>
</tbody>
</table>

**SOURCE:** Office of School and Public Lands, (Pierre, South Dakota).
Figure III-5: Past and Projected Supply of Industrial Development Capital by the State (School and Public Lands Fund)
fund has a limited amount of money with which to operate.

Currently the fund contains $63 million with this being invested into such securities as government bonds, federally insured loans, general obligation bonds of South Dakota, and general obligation bonds of any public school, organized county or incorporated city within South Dakota.\textsuperscript{14} Of this $63 million, approximately $14 million goes to industrial and commercial ventures in the form of federally guaranteed loans. According to the office of the Commissioner of School and Public Lands it would be possible to loan an additional $10-13 million of this permanent fund to industrial development projects in South Dakota.\textsuperscript{15}

\textbf{Farmers Home Administration and the Economic Development Administration}

Although the SBA is the main source of federal assistance for industrial development, two other federal agencies have funds available for similar purposes. The Farmers Home Administration (FHA) and the Economic Development Administration (EDA) are both authorized to provide loans and loan guarantees for industrial development purposes.

The program through which the FHA loans money or guarantees loans by other institutions was started in 1974. In the program's

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\begin{flushleft}
\textsuperscript{15}\textit{Statement by George Kane, Commissioner of School and Public Lands, Pierre, South Dakota, in a phone interview, September 8, 1975.}
\end{flushleft}
first year of operation $0.18 million was loaned for industrial development purposes and $1.19 million of loans were guaranteed in South Dakota. In fiscal year 1975 the FHA guaranteed loans of $1.12 million and made no direct loans for industrial development in South Dakota.\(^\text{16}\)

From the two year's data it is impossible to make any meaningful projections as to how much investment capital will come from the FHA.

The EDA has been in operation for 10 years and during that time has supplied only $0.52 million, all in 1970, for industrial development projects in South Dakota.\(^\text{17}\) Based on past experience one might rate the EDA as a very minor potential source of capital, but as with the SBA and FHA the potential amount of capital could be quite large or none at all because of the nature of legislative appropriations.

**Comparison of Supply and Demand**

Table III-6 shows the yearly breakdown of total capital investment by the six nonpersonal supply sources which were studied. Commercial banks are the main supply source, financing 34 percent of the five-year total investment. Industrial revenue bonds were next in importance, supplying 27.9 percent. The SBA supplied 4.7 percent, School and Public Lands 3.2 percent, FHA 0.15 percent, and EDA 0.4 percent of the total five-year industrial investment of $117.24 million.

\(^\text{16}\)Data supplied by Farmers Home Administration, Huron, South Dakota.

### Table III-6: Capital Expenditures Compared to Nonpersonal Supply of Investment Capital*

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td>$14.03</td>
<td>$15.44</td>
<td>$21.60</td>
<td>$36.20</td>
<td>$29.98</td>
<td>$117.24</td>
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<tr>
<td>Expenditures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
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</tr>
<tr>
<td>Nonpersonal</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supply Sources</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S. D. Banks</td>
<td>$4.57</td>
<td>$2.06</td>
<td>$5.48</td>
<td>$17.03</td>
<td>$10.78</td>
<td>$39.92</td>
</tr>
<tr>
<td>(32.6)</td>
<td>(13.4)</td>
<td>(25.4)</td>
<td>(47.1)</td>
<td>(35.9)</td>
<td>(34.0)</td>
<td></td>
</tr>
<tr>
<td>IRB's</td>
<td>1.7</td>
<td>0.4</td>
<td>7.6</td>
<td>13.79</td>
<td>9.30</td>
<td>32.79</td>
</tr>
<tr>
<td>(12.1)</td>
<td>(2.5)</td>
<td>(35.1)</td>
<td>(38.0)</td>
<td>(31.0)</td>
<td>(27.9)</td>
<td></td>
</tr>
<tr>
<td>SBA</td>
<td>0.51</td>
<td>1.90</td>
<td>1.11</td>
<td>1.14</td>
<td>0.88</td>
<td>5.54</td>
</tr>
<tr>
<td>(3.6)</td>
<td>(12.2)</td>
<td>(5.1)</td>
<td>(3.1)</td>
<td>(2.9)</td>
<td>(4.7)</td>
<td></td>
</tr>
<tr>
<td>School and Public Lands</td>
<td>0</td>
<td>0.04</td>
<td>0.18</td>
<td>0.32</td>
<td>3.21</td>
<td>3.74</td>
</tr>
<tr>
<td>(0.2)</td>
<td>(0.8)</td>
<td>(0.9)</td>
<td>(10.7)</td>
<td>(3.2)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FHA</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0.18</td>
<td>0.18</td>
</tr>
<tr>
<td>(0.6)</td>
<td>(0.15)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EDA</td>
<td>0.52</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0.52</td>
</tr>
<tr>
<td>(3.7)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.4)</td>
<td></td>
</tr>
<tr>
<td>Total Supply</td>
<td>$7.30</td>
<td>$4.40</td>
<td>$14.37</td>
<td>$32.28</td>
<td>$24.35</td>
<td>$82.69</td>
</tr>
<tr>
<td>from Nonpersonal</td>
<td>(52.0)</td>
<td>(28.5)</td>
<td>(66.5)</td>
<td>(89.2)</td>
<td>(81.2)</td>
<td>(70.5)</td>
</tr>
<tr>
<td>Sources</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Percentage of Capital Expenditures supplied by each source is given in parenthesis.
Together these sources supplied 70.5 percent of the five-year capital investment total, leaving 29.5 percent to be supplied through personal finances or through internal financing by firms.

The increase in the percentage of investment capital supplied by nonpersonal sources is of importance to those concerned with the problem of financing industrial development in South Dakota. In 1970 these sources financed 52 percent of new capital investment. The percentage of new capital investment supplied by these sources decreased to 28.5 percent in 1971, increased to a high of 89.2 percent in 1973, and fell to 81.2 in 1974. The implication of the increase in industrial financing from these sources can be seen by comparing linear trends for capital investments and capital supplied. Figure III-6 shows the capability of these sources to supply the capital necessary for industrial development provided the present trends continue. By 1980 the nonpersonal supply sources would have $66.2 million available for industrial development while only $65.6 million would be invested. This difference is small and probably not significant due to possible errors in projecting, but if one adds the amount of personal or internal firm finances which will also be available, one would get a picture showing a definite surplus of investment capital in South Dakota.

Figure III-7 is a graphic illustration of Table III-5, showing the increasing amount of investment capital supplied by nonpersonal supply sources and the decreasing amount supplied by personal and internal firm financing.
Figure III-6: Comparison of Projected Capital Expenditures and Nonpersonal Supply of Industrial Development Capital

\[ y = -2.05 + 6.2x \]  
\[ y = 7.65 + 5.27x \]
Figure III-7: Yearly Breakdown of Supply Necessary to Meet Capital Expenditures
South Dakota's Industrial Activity by Planning District

In order to further illustrate the demand and supply picture for industrial development capital, Figure III-8 has been provided. This figure gives a summary overview of the information discussed in the previous sections. It also shows differences in the regional industrial activity in South Dakota.

Information provided by planning district in Figure III-8 includes number of firms, new capital investments, amount of capital supplied from nonpersonal sources and the growth rates of capital investments and supply of capital. An interesting point to note on Figure III-8 is the percentage of new capital investment obtained from nonpersonal supply sources. Districts Three, Four, and Five had 90, 94, and 84 percent, respectively, of their investment capital supplied by these sources while only 66 percent in District One, 54 percent in District Six, and 60 percent in District Two was supplied by these sources. This may indicate that personal and corporate finances are more important in Districts One, Two, and Six, or it may be an indication that a substantial flow of funds exists between planning districts thus overstating the amount of capital being supplied in Districts Three, Four, and Five and understating Districts One, Two, and Six. If this discrepancy in the percentage of investment capital supplied by nonpersonal sources is caused by a flow of funds the only source for which supply could be over or understated would be the banks since exact data were available for the other sources. As
Figure III-8. South Dakota Industrial Activity by Planning District, 1970-1974.

1. Number of Manufacturing and Processing Firms in Each District (1974)
2. New Capital Expenditures in Manufacturing and Processing Firms
3. Amount of Capital Expenditures Furnished by Nonpersonal Supply Sources
4. Percentage of New Capital Expenditures Furnished by Nonpersonal Supply Sources
5. Growth Rate of Capital Expenditures
6. Growth Rate of Nonpersonal Supply of Investment Capital
mentioned previously, bank industrial loans could be over or under-
stated because of branch banking and correspondent banking. Since
the data pertaining to commercial banks had to be estimated, it is
also possible that the discrepancy may be explained as an error in
estimate.

Another important point in regards to industrial development
is the growth rate of capital investments for each district. This
rate was determined by estimating the linear trends of capital ex-
penditures in each district over the past five years. According to
the estimates in Figure III-8, District Two is the major industrial
growth area in South Dakota with capital investments increasing at a
rate of $3.1 million per year. District Three has the next highest
investment rate, $1.47 million; followed by District One, $0.96
million; District Five, $0.15 million; and District Four, $0.07
million additional investment each year. District Six experienced
a decrease in capital investments of $0.48 million per year. Of
course these rates are subject to change, but the southeast corner
of South Dakota appears to be where most of the industrial develop-
ment will occur.
CHAPTER IV

STATE PROGRAMS ENCOURAGING INDUSTRIAL DEVELOPMENT

The role of state government in industrial development can range from an all out effort by the state to attract industry, and if need be to finance it also, to a role of letting the state's economy take care of itself. This attitude of letting the state's economy take care of itself appears to have vanished when one looks at the number of devices that state governments employ to attract industry. The variety of programs employed to entice industry to a state indicates that there can be a great amount of competition between states and between regions within a state when it comes to achieving industrial development. Three major methods that a state can use to attract industry are direct financial assistance for industry, tax incentives, and special services for industrial development.

Direct Financial Assistance for Industry

When states become involved in supplying direct financial assistance for industrial development, one might reason that the supply of investment capital was regarded as inadequate to meet the demand for capital, thus the state tries to increase supply. It is also possible that the motive is to assist industrial development to move at a faster pace. State government provides financial capital in hopes that the additional funds will be an added incentive for an industry to locate or expand within that state. Programs which some
states employ include state development authorities, state revenue or general obligation bond financing, state loans, state loan guarantees, or authorization enabling cities and counties to use such programs.

Because of similar economies, populations, natural resources, locations, and methods of transportation, South Dakota's most likely competition for new industry is North Dakota, Montana, and Wyoming. In comparison to these states, South Dakota's involvement in financing industrial development is quite limited. Currently only one of the programs listed in Table IV-1, industrial revenue bond financing at the city and county level, is authorized in South Dakota. State loans and loan guarantees have been considered by the state legislature but have failed to win approval. Perhaps the reason this type of legislation has not passed is because of the well-remembered experience with the South Dakota Rural Credit Act of 1918 where the state made direct loans to farmers only to have many of these loans default.

Montana and Wyoming authorize the use of only two of the methods listed in Table IV-1. One program is industrial revenue bonds at the city and county level, the other is privately sponsored development credit corporations. Neither South Dakota, Montana, nor Wyoming have authorized specific programs which would use state funds for industrial development purposes at this time.

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# Table IV-1: Alternative Methods of Financing Industrial Development

<table>
<thead>
<tr>
<th>State Sponsored Industrial Development Authority</th>
<th>State Sponsored Industrial Development Authority (Continued)</th>
<th>State Authority for Housing Revenue Bond Financing</th>
<th>State Authority for Housing General Obligation Bond Financing</th>
<th>City and/or County Revenue Bond Financing</th>
<th>City and/or County General Obligation Bond Financing</th>
</tr>
</thead>
</table>

*Footnotes on page 71.*

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*Page 65.*

**Note:** The table contains a series of financial assistance methods, including loans, guarantees, and direct financial aid aimed at industrial development. The table spans several pages, starting from page 65. For a complete understanding, the entire table should be reviewed.
North Dakota is more involved in the financing of industrial development than South Dakota, Montana, Wyoming or for that matter most states in the country. Along with authorizing the use of most of the methods listed in Table IV-1, North Dakota has also established a state bank to be the depository of all state funds along with funds from various other political subdivisions.² The state bank cannot make private or commercial loans but it can participate with other banks' commercial loans. North Dakota's state bank may also direct funds to industrial development by making loans to local development corporations in participation with the SBA.

Although there are many methods of financing industrial development available to state governments, availability of local financing does not appear to be of major importance to most firms. According to Tauer's survey of South Dakota industries, local financing rated seventh out of ten factors which influence where a firm locates.³ Factors such as home community of owner, closeness to markets, abundant labor, quality of life, closeness to raw materials, and a favorable tax policy had more influence on where a firm located than did availability of local funds.

²North Dakota Business and Industrial Development Department, North Dakota Industrial Location Facts, Bismark, North Dakota, March, 1974.

Tax Incentives for Industry

Another method of attracting industry to a state is to offer a tax exemption or a tax moratorium. Tax relief can be made on an individual basis and can be allowed on most state and local taxes. Possibilities include exemptions or moratoriums on corporate income taxes, personal income taxes, excise taxes, property taxes, and sales and use taxes. These exemptions reduce the amount of revenues the state would have received, but it is reasoned that the exemptions pay off in the long run and that lost revenues can be made up by increased revenues which occur due to spinoffs of new industries. A new industry may increase revenues by increasing employment, increasing income as firms compete for labor, and by creating a broader property tax base.

South Dakota officials apparently have thought that tax exemptions are very important in attracting industry to the state, as indicated by the variety of tax exemptions South Dakota offers (Table IV-2). South Dakota offers a tax exemption on all state taxes except sales and use taxes. It also allows local governments to exempt new firms from paying property taxes, although a payment in lieu of taxes may be made. Montana, North Dakota, and Wyoming also offer tax exemptions, although not as many types as South Dakota. Montana offers tax exemptions on land, capital improvements, and equipment for those

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4 Although listed as tax exemptions, South Dakota has no personal income tax and the corporate tax is really a bank franchise tax.
Table IV-2: Tax Incentives and Other Legal Means Used to Entice Industry to a State*

| State          | Property Tax Exemption | Personal Income Tax Exemption | State Estate Tax Exemption | Tax Exemption or Deduction on Industrial Revenue Bonds | Tax Exemption or Deduction on Manufacturing Equipment | Tax Exemption or Deduction on Research and Development Equipment | Tax Exemption or Deduction on State Sales Tax | State Aid for Fixed Capital Expenditures | State Aid for Economic Development | State Aid for Public Education | State Aid for Health and Welfare | State Aid for Higher Education | State Aid for Industrial Development | State Aid for Industrial Development | State Aid for Industrial Development | State Aid for Industrial Development | State Aid for Industrial Development | State Aid for Industrial Development | State Aid for Industrial Development | State Aid for Industrial Development | State Aid for Industrial Development | State Aid for Industrial Development |
|---------------|------------------------|-------------------------------|---------------------------|------------------------------------------------------|-------------------------------------------------------|-----------------------------------------------------------------|--------------------------------------------------|---------------------------------------------|-----------------------------------------------|---------------------------------------------|---------------------------------------------|---------------------------------------------|---------------------------------------------|---------------------------------------------|---------------------------------------------|---------------------------------------------|---------------------------------------------|---------------------------------------------|---------------------------------------------|---------------------------------------------|---------------------------------------------|
| Alabama       |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Alaska        |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Arizona       |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Arkansas      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| California    |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Colorado      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Connecticut   |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Delaware      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| District of Columbia |   |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Florida       |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Georgia       |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Hawaii        |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Idaho         |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Illinois      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Indiana       |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Iowa          |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Kansas        |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Kentucky      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Louisiana     |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Maine         |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Maryland      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Massachusetts |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Michigan      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Minnesota     |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Mississippi   |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Missouri      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Montana       |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Nebraska      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Nevada        |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| New Hampshire |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| New Jersey    |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| New Mexico    |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| New York      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| North Carolina|                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| North Dakota  |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Ohio          |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Oklahoma      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Oregon        |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Pennsylvania  |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Rhode Island  |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| South Carolina|                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| South Dakota  |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Tennessee     |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Texas         |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Utah          |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Vermont       |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Virginia      |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Washington    |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| West Virginia |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Wisconsin     |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Wyoming       |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| State Totals  |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| Puerto Rico   |                        |                               |                           |                                                      |                                                       |                                                                |                                                  |                                             |                                              |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             |                                             | |
| **Total**     | 19                      | 14                            | 10                         | 19                                                   | 15                                                    | 27                                                             | 31                                                          | 63                                                        | 7                                                          | 5                                                          | 20                                                          | 20                                                          | 40                                                          | 40                                                          | 40                                                          | 40                                                          | 59                                                          | 59                                                          | 15                                                          | |

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*Footnotes on page 71.*
industries which are based on natural resources. Wyoming is similar to South Dakota in that it also has no corporate or personal income tax. Wyoming also offers a tax exemption on inventories in transit, manufacturer's inventories, and on raw materials used in manufacturing. North Dakota offers tax exemptions on corporate income taxes, excise taxes, real property tax on equipment, inventories in transit, manufacturer's inventories, and on raw materials used in manufacturing.

**Special Services for Industrial Development**

The special services which states and local communities may offer industries are additional methods of inducing industries to locate in their area (Table IV-3). Although these special services do not involve making funds available to industries, they may involve use of state or city funds to provide services. Included in the special services could be state financing for speculative building, state provision of free or low cost land, state or municipally owned industrial parks, state or municipal funds for access roads and other public works projects. City and county master plans, and recreational projects, along with various technical and manpower training services are also important services which could assist in maintaining a sufficient labor force and a content management group.

As shown in Table IV-3, South Dakota supplies most of these special services except for those which call for direct state financing of speculative buildings, state provision of free land, or state owned industrial parks. North Dakota offers almost the same type of services as South Dakota. Montana and Wyoming are more restrictive about the
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<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>West Virginia</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Wyoming</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>STATE TOTALS</strong></td>
<td>4</td>
<td>17</td>
<td>0</td>
<td>13</td>
<td>7</td>
<td>43</td>
<td>21</td>
<td>27</td>
<td>33</td>
<td>8</td>
</tr>
</tbody>
</table>

*Footnotes on page 71.

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types of services they offer, and are more inclined to make technical and manpower training services available then they are to have state funds directly used to promote industrial development.

**Effect of Inducements on Industrial Development**

As one can see from Tables IV-1, IV-2, and IV-3, states can become as involved with industrial development as they think necessary. States such as Montana and Wyoming appear to be taking the attitude that states should not become agencies for promoting industrial development. North Dakota on the other hand has the attitude that states should provide financial assistance as well as tax incentives and special services if industrial development is going to occur. South Dakota's attitude appears to be one in which the state will do all it can to encourage industries to locate within the state except risking state funds for financing firms. This does not preclude using School and Public Lands Funds as long as they are 100 percent guaranteed.

Does it really make much difference which inducement techniques a state uses to encourage industrial development? According to information in Table IV-4 it does not appear to. Tables IV-1, IV-2, and IV-3 indicate that Montana and Wyoming are less involved with industrial development at the state level when compared to surrounding states, but as Table IV-4 indicates they have been able to have growth in manufacturing employment, new capital expenditures, per capita personal income, and private non-farm income. This growth has been equal to or greater than the growth of these categories in
Table IV-4: Comparison of Income and Manufacturing Growth in South Dakota and Neighboring States

<table>
<thead>
<tr>
<th></th>
<th>South Dakota</th>
<th>North Dakota</th>
<th>Montana</th>
<th>Wyoming</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employment in Manufacturing</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>15</td>
<td>10</td>
<td>24</td>
<td>7</td>
</tr>
<tr>
<td>1971</td>
<td>16</td>
<td>10</td>
<td>24</td>
<td>7</td>
</tr>
<tr>
<td>1972</td>
<td>18</td>
<td>11</td>
<td>25</td>
<td>8</td>
</tr>
<tr>
<td>1973</td>
<td>20</td>
<td>12</td>
<td>25</td>
<td>8</td>
</tr>
<tr>
<td><strong>Capital Expenditures for New Plants &amp; Equipment</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>$12.3k</td>
<td>$10.1k</td>
<td>$42.3k</td>
<td>$4.7k</td>
</tr>
<tr>
<td>1971</td>
<td>13.5k</td>
<td>11.3k</td>
<td>50.4k</td>
<td>6.3k</td>
</tr>
<tr>
<td>1972</td>
<td>20.0k</td>
<td>13.0k</td>
<td>75.0k</td>
<td>23.0k</td>
</tr>
<tr>
<td>% increase 1970-1972</td>
<td>63%</td>
<td>29%</td>
<td>77%</td>
<td>389%</td>
</tr>
<tr>
<td><strong>Per Capita Personal Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>$3165</td>
<td>$2990</td>
<td>$3370</td>
<td>$3535</td>
</tr>
<tr>
<td>1971</td>
<td>3446</td>
<td>3383</td>
<td>3479</td>
<td>3753</td>
</tr>
<tr>
<td>1972</td>
<td>3716</td>
<td>3718</td>
<td>3897</td>
<td>4345</td>
</tr>
<tr>
<td>1973</td>
<td>4296</td>
<td>4782</td>
<td>4418</td>
<td>4813</td>
</tr>
<tr>
<td>% increase 1970-1973</td>
<td>36%</td>
<td>60%</td>
<td>31%</td>
<td>36%</td>
</tr>
<tr>
<td><strong>Private Non-Farm Personal Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>$1.17</td>
<td>$1.10</td>
<td>$1.47</td>
<td>$0.79</td>
</tr>
<tr>
<td>1971</td>
<td>1.25</td>
<td>1.19</td>
<td>1.58</td>
<td>.68</td>
</tr>
<tr>
<td>1972</td>
<td>1.30</td>
<td>1.20</td>
<td>1.70</td>
<td>.96</td>
</tr>
<tr>
<td>% increase 1970-1972</td>
<td>11%</td>
<td>14%</td>
<td>16%</td>
<td>22%</td>
</tr>
</tbody>
</table>


*Figures for 1973 have not been published by the Bureau as of this date.
North Dakota and South Dakota where more active policies have been
used as industrial inducements. North Dakota leads only in the
volatile category of growth in per capita personal income, which
increased by 60 percent from 1970 to 1973 (Table IV-4). This in-
crease comes mainly from the agricultural sector. The one category
in which South Dakota led in growth was employment in manufacturing,
where the number of employees increased by 4,000 from 1970 to 1973
while the other states had increases of 1,000 to 2,000 employees.

Striking changes have occurred in industrial development over
the past few years in capital expenditures for new plants and equip-
ment. The purpose of inducements is to encourage capital expendi-
tures by industries, yet the states which used the fewest inducements
showed much greater growth than the states which were more active
in their inducement programs. Montana increased new capital ex-
penditures by 77 percent from 1970 to 1972 and Wyoming had a 389 per-
cent increase largely due to increased coal production. South Dakota
had an increase of 63 percent and North Dakota increased new capital
expenditures by only 29 percent from 1970-1972.

Table IV-4 seems to indicate that state financing of develop-
ment projects, tax incentives, and special inducement services had
little effect on industrial development in South Dakota and neigh-
boring states. Of course Table IV-4 does not show what would have
happened to industrial development in these states had inducements
not been used. A conclusion which can be drawn from data presented in
Table IV-4 though is that location, natural resources, and manpower
advantages are more important than inducement techniques. This conclusion is supported by a survey conducted by Tauer,\textsuperscript{5} of all manufacturing and processing firms in South Dakota. Tauer's survey indicated that favorable tax policies and availability of local funds rated seventh and eighth on a list of 10 factors influencing where a firm locates with home community of owner, closeness to markets, abundant labor, and closeness to raw materials being the top four. Of course neither the data in Table IV-4 nor Tauer's survey is conclusive evidence that inducements are not valuable to states desiring increased industrial development.

\textsuperscript{5}Tauer, op. cit., p. 32.
CHAPTER V

SUMMARY AND CONCLUSIONS

Summary

Industrial development in South Dakota requires annual increments of fixed and working capital. The question naturally arises then whether sufficient funds will become available from internal and external sources to sustain an adequate rate of industrial growth. This study has the purpose of developing better answers to this question.

Objectives of this study were to identify and describe non-personal sources of investment capital and to project the availability of investment capital against anticipated need.

The procedure followed was primarily descriptive. Descriptions of each source included legal and administrative constraints on its use. Such constraints may concern equity investments, direct loans, or loan guarantees. It was also necessary to investigate the variety of programs available through each source, limitations on size of loans which can be made, and in some cases the origin of funds passed through from other sources. Data were collected on new capital expenditures made by South Dakota firms from 1970 to 1974, and on the amounts of investment capital that each major nonpersonal source supplied. These data were used as base information for projections of capital expenditures and supplies.

New capital expenditures by manufacturing and processing firms
were used as a proxy for effective demand for investment capital. From 1970 through 1974 those expenditures amounted to $117 million.

The five-year trend of new capital expenditures indicates that those expenditures have been increasing at a rate of $5.27 million per year. Keeping in mind the limitations of linear projections, these figures indicate that new capital expenditures could amount to an annual rate of about $66 million by 1980 or $92 million by 1985.

Some potential nonpersonal sources of supply for investment capital were identified through use of a questionnaire sent to all manufacturing and processing firms in South Dakota listed in South Dakota's Department of Economic and Tourism Development's Manufacturers and Processors Directory, 1974-75. The major nonpersonal sources indicated were commercial banks, Small Business Administration, Farmers Home Administration, Economic Development Administration, and purchasers of industrial revenue bonds. One other source, that being the state's School and Public Lands Fund, was also studied. Table V-1 illustrates the amount of financial assistance each source has furnished over the past five years and the projected amounts which would be supplied provided current trends continue. From Table V-1 one can see that commercial banks and industrial revenue bonds are by far the largest sources of investment capital and may well continue to be so.

By comparing the amounts of new capital investments with the amount of investment capital supplied by the nonpersonal sources one can see that at present a capital shortage is not apparent. In 1974 the nonpersonal sources which were studied supplied 81 percent of the
funds needed for new capital expenditures, leaving about $5.5 million to be furnished by personal and corporate sources. While the amount of funds which have come from personal and corporate sources has remained fairly constant, the amount coming from nonpersonal sources has increased quite steadily from 50 percent of the amount expended for new capital in 1970 to 81 percent in 1974.

Even though a sufficient amount of capital is being furnished by the sources presently supplying investment capital, the state government might at any time decide to add additional funds to the supply by implementing state programs to help finance industrial
development. Methods of providing assistance which were pioneered in other states but are not used in South Dakota include: state loan and loan guarantees, state revenue or general obligation bond financing, and a state bank. In addition to state financing, tax incentives and special services can be employed to induce industrial expansion in the state.

Conclusions

As a result of the findings of this study, it is believed that a sufficient amount of investment capital is generated in South Dakota to finance a sustainable rate of industrial development. This conclusion was arrived at not merely because estimated demand equalled the amount of funds already forthcoming, but also because of indications by lenders that more capital is available than is demanded. The fact that nonpersonal supply sources have been supplying an increasing percentage of funds for new capital expenditures is also an indication of adequate investment capital being available provided good investment opportunities are available. Based on the recent trends, the potential amount of capital available through personal and corporate sources added to the potential amount available from nonpersonal sources would be more than adequate for projected growth.

Banks will continue to be a major source of fixed capital for smaller new firms and for firms expanding. Industrial revenue bonds can supply much of the funds needed to finance large new firms. Other nonpersonal sources will continue to be useful but not major sources of investment capital.
The adoption of state programs to finance industrial development depends on legislative perception of the adequacy of present sources. Although state financing of industrial development does not seem necessary at present, if state programs were adopted they would add further to the pool of funds available for development. Natural resources and the availability of suitable labor appear to influence industrial development to a greater extent than state financing, tax incentives, or special services.

The adoption of a state loan guarantee program has been suggested in South Dakota, but as long as federal guarantee programs continue to be sufficiently funded, a state guarantee does not seem necessary. Investment of the School and Public Lands Fund in industrial development projects has not met with serious public objection so continuation of that policy seems acceptable.

If such investments draw a lower rate of interest than alternative investments there is an element of subsidy. As with all subsidies, the question is, is the benefit worth the cost? The answer to that question may be yes provided the subsidy was used only as an initial stimulus and then discontinued once it had been successful in generating a sustained industrial growth.

Limitations

This study, as most studies, faced certain limitations. The limitations to this study include: only five years of data with which to base projections on; estimates rather than exact data on the amount of funds supplied by commercial banks; and projections of
funds supplied by federal sources when, due to the political process, it is uncertain if the program will continue to be adequately funded.

Need for Further Study

As South Dakota continues industrial expansion, funds must become available at an increasing rate. In order to insure that funds will be available to finance future industrial expansion, the amount of potential funds available should be known. So that it may be known what amount of funds will be needed in the future, criteria should be established to distinguish between viable types of industrial development and those types which have little chance of continued growth.

These criteria should be developed in light of the problems of an energy shortage, inadequate transportation, and scarce production materials. Any one of these factors could have an important influence on the industrial development of South Dakota. If after determining the types of industries which will demand the resources available in South Dakota, indications of substantial growth are evident, additional studies would be necessary. A study should then be done to see if an increase in the industrial expansion rate can be financed by a release of funds which currently go to other economic sectors. If this study shows that a sufficient amount of funds will not be released before a credit crunch arrives, then a study should be done to analyze the potential amount of funds which could be provided by the state or other currently untapped sources to finance industrial expansion. If these studies are done soon enough, future problems of inadequate financing may be avoided.
SOURCES CONSULTED


Clinton, Ed. Phone interviews. Legislative Research Council, Pierre, South Dakota, Various dates.


Kane, George. Phone interview. Commissioner of School and Public Lands, Pierre, South Dakota, August, 1975.


APPENDIX A
THE QUESTIONNAIRE

The questionnaire used in this study is one prepared under Agricultural Experiment Station Project 7307-664, and was framed with multipurpose use in mind. Many of the results were used in a previous study by Loren Tauer, and the sample which appears in Tauer's thesis is identical with the one shown here for reference.

The questionnaire was mailed to all manufacturing and processing firms in South Dakota in the fall of 1974. At that time there were 336 such firms in the state and a total of 260 firms, or 31 percent, responded. The responses to Question 19 of the questionnaire indicated which sources furnished funds for establishing a firm, expanding a firm, financing current assets, and for financing future expansion. The nonpersonal sources indicated by the respondents as providing funds for financing new firms or expansion of existing firms were used in preparing the list of current and potential supply sources examined in this study.

1. What year was your firm established at the present community?  

2. Is your firm a subsidiary or branch of a parent company? Yes ___ No ___  
   Location of parent company City __________________________ State ______________________  

3. Rank (1, 2, 3, 4,) the four most important factors that were responsible for the location of your firm.  

<table>
<thead>
<tr>
<th>Close to markets</th>
<th>In South Dakota</th>
<th>Present Site in South Dakota</th>
</tr>
</thead>
<tbody>
<tr>
<td>Close to raw materials</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Good transportation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Abundant labor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low labor costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low power costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local funds were available</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Favorable tax policies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Home community of owners</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Quality of life</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other (specify)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4. Annual sales or value of production of your plant  

<table>
<thead>
<tr>
<th>Under $50,000</th>
<th>$50,001 - 100,000</th>
<th>$100,001 - 500,000</th>
<th>$500,001 - 1,000,000</th>
<th>Over 1,000,000</th>
</tr>
</thead>
</table>

5. Over the past five years, has output of your plant:  
   Increased ___ Remain constant ___ Decreased ___  

6. What percent of the plant's product is sold in the following areas?  

<table>
<thead>
<tr>
<th>Local (within 50 miles)</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within South Dakota but outside of local area</td>
<td>%</td>
</tr>
<tr>
<td>Outside of South Dakota</td>
<td>%</td>
</tr>
</tbody>
</table>

7. Of your current investment in plant and equipment, what percentage was added over the last five years?  

   __%  

8. If your plant has not expanded within the last five years, check the reason or reasons why.  

   Satisfied with present size  
   Shortage of labor  
   Shortage of raw materials  
   Lack of market for more production  
   Unavailability of financing  
   Other (specify)
9. Do you have plans for expansion within the next five years? Yes   No

10. What is the population of the community where the expansion will occur?  
    Under 2,500  
    2,500 - 5,000  
    5,001 - 10,000  
    Over 10,000

11. Will the expansion be in the present community? Yes   No
    If not, will the expansion be within South Dakota? Yes   No

12. If this expansion will occur at another city, or if you are planning to move your entire plant to another city, please state the reasons for the relocation.

13. What percentage of borrowed funds from all sources are secured by mortgages on non-business property?

14. Has a shortage of funds restricted:
    (a) size of present plant? Yes   No
    (b) expansion of plant size? Yes   No

15. Has production of your plant been limited because of lack of operating funds? Yes   No

16. If you have experienced problems in obtaining funds, what were the reasons given by the potential lender(s)?
    Insufficient equity of your firm
    Low probability of success of the business
    Prior commitment of loan funds to other uses
    Lack of interest in promoting industry of this type
    Other (specify)

17. Has your experience in acquiring funds indicated that there is a shortage of funds for industrial development in South Dakota? Yes   No

18. What would you recommend to correct this situation?
19. What proportion of funds needed for investment in plant and equipment and for operating costs were or are obtained from each of the following sources?

<table>
<thead>
<tr>
<th>Investment in Plant and Equipment</th>
</tr>
</thead>
<tbody>
<tr>
<td>To establish</td>
</tr>
<tr>
<td>Firm (if within past 10 years)</td>
</tr>
<tr>
<td>%</td>
</tr>
</tbody>
</table>

a. Owner-financed
   - Personal funds
   - By parent firm
   - Stock sales
   - Out of current profits

b. Bank
   - Local home office bank
   - Local branch bank
   - Other South Dakota Bank
     - City
     - Out of state bank
     - State

c. Government
   - Small Business Admin.
   - Industrial Revenue Bond
   - Rural Development Act
   - Other federal, state or local program - (specify)

d. Small Business Investment Corp.

e. Insurance Company
   - South Dakota based
   - Out of state

f. Bond Sales

g. Loans from Individuals
   - Local community
   - Other in state
   - Out of state

h. Factoring

i. Accounts payable and other accruals

j. Other (specify)
APPENDIX B
Figure B-1

EDA QUALIFIED AREAS
JUNE 30, 1974

Figure B-2: ECONOMIC DEVELOPMENT DISTRICTS
JUNE 30, 1974