These contracts would be binding obligations of the United States. Once executed, appropriations to liquidate them would be automatic.

2. These contracts could be pledged by the States or local public bodies as security for bonds issued by them to cover the cost of the treatment plants, including the Federal share.

3. Under the contracts the Federal Government would pay the principal and interest on that portion of the bonds that represents the normal Federal grant share under the present Act. The contracts would also provide a Federal guarantee of the non-Federal share and the payment of an interest subsidy to reduce the net effective interest rate to States and localities to a rate reasonably comparable to rates on tax-exempt municipal bonds.

4. The bill provides that the interest on bonds issued to construct these plants shall not be exempt from Federal income taxation.

Let me emphasize that this non-tax-exempt feature is a major element of this very important legislation. It is, however, not intended as an "opening wedge" precedent, as some have contended, to do away with tax-exempt bonds. I cannot emphasize this point too strongly.

This provision is important for three reasons:

First, the bill provides for a Federal guarantee of the entire bond, even the local share, and for an annual Federal payment of principal and interest on part of them. It would not be good policy to apply this guarantee to tax-exempt bonds.

We believe that the Federal guarantee would have the effect of lowering the risk, equivalent to a triple-A bond rating for the communities concerned.

Second, without this provision, we are convinced that the proposal could add substantially to the volume of new issues of tax-exempt bonds by State and local public bodies. This would be particularly undesirable in view of the already large volume of municipal bond issues and the current high interest rates which States and localities are required to pay. Making the proposed new bonds taxable rather than tax-exempt would avoid adding to pressures on the municipal bond market and would thus result in significant savings in interest costs to States and localities on their borrowings for other urgent needs such as schools, roads, and other public facilities.

Third, the use of taxable rather than tax-exempt bonds would also be significantly cheaper for the Federal Government, even with the interest subsidy. The reason is that, as public and private studies have demonstrated, tax-exemption costs more to the Federal Government in lost revenues than communities gain in lower interest costs. Therefore it is possible for the Federal Government to give communities an equivalent interest subsidy and still save money.

5. The contracts would be available where the waste treatment system, not the particular project, serves 125,000 people or more or serves all or part of a standard metropolitan statistical area.

In our cost study, we indicated that there is a pressing need to upgrade waste treatment facilities in our major metropolitan areas. The program, which is designed primarily to meet urban requirements, also would cover smaller communities which form a part of, or are contiguous to, larger metropolitan areas. It is our hope that this legislation will encourage metropolitan or regional waste collection and treatment.

6. The bill would also require the establishment of a system of user charges which would be sufficient to amortize the local share, pay operation and maintenance costs, and establish a reasonable reserve to meet planned expansion needs.

The term, user charge, implies a utility function and consequently a relationship between the payment required and the cost of providing the service. In addition, economic efficiency and equity would be more fully served if the charge paid by users of the system reflected the costs which this use imposes on the system.

The user charge has attained particular validity in current times because of the movement from old practices in waste disposal to a new level of municipal sanitation reflected in the provision of sewage treatment works, and because of the high costs of local government in general. The charge permits the separation of sewage treatment function from the much pressed property tax. It relates the costs of service more closely to the users, manifesting a more equitable distribution of the costs of government among the members of the community. As the costs of local government continue to rise, and as the pressures on the overloaded tax bases of local government mount, the merits of user charges for sewerage service should become increasingly apparent. Further, user charges require