1991

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STATE AND LOCAL GOVERNMENT FISCAL RESPONSIBILITY: AN INTEGRATED APPROACH

Charles W. Goldner, Jr.*

INTRODUCTION

The anecdotal evidence paints a dark picture: there will be no short-term easing of the fiscal problems of state and local governments. Consider recent newspaper headlines: “New York City Budget Gap Is Even Worse Than It Looks”;1 “Localized Pain: States Increase Taxes And Curtail Services As Revenues Dwindle”;2 “New York City’s Finances Look Bleak, State Official Warns Regan”;3 “Squeezed Suburbs: Boomtown Budgets Suddenly Are Pinched As Tax Takes Dwindle”;4 “Bridgeport’s Bankruptcy Petition Offers Reminder of the Plight of Cities, States.”5 In June 1991, the director of the Center for the Study of the States at the State University of New York predicted state tax increases of $17,000,000,000 to $19,000,000,000 in 1991.6 The projection includes $7,000,000,000 of additional taxes for California alone.7 The states’ fiscal problems hit hard; state employees in some states were told to stay home in early July, 1991, when state legislatures and governors were unable to adopt balanced budgets by the beginning of the fiscal year of their respective states.8

Does this anecdotal evidence contain only bad news? In one sense, no—there is good news in the same headlines. The states, municipalities, investment bankers, debt rating agencies, and residents all realize that serious fiscal problems exist. However, one unanswered question remains. Will the fiscal problems be resolved in a timely, responsible and economically efficient way? A review of recent history does not offer much encouragement.

Twentieth century scholars released a small-scale avalanche of articles and books analyzing expenditures by state and local governments, especially with regard to expenditures funded by governmental borrow-
ing. Journalists extensively covered the financial problems facing New York City and Cleveland, Ohio, in the 1970's; more recently, journalists have chronicled the deficits and resulting budget problems facing the states in the 1990's. Scholars and journalists, however, were not the only critics monitoring the continuing state and local government fiscal crisis. Voters have imposed affirmative limitations on the growth of particular sources of revenue and on the total growth of expenditures of state and local governments by amending state constitutions; state legislatures have imposed similar restrictions statutorily. During the period of greatest activity in enacting growth and expenditure limitations, New York City teetered on the brink of bankruptcy, while Cleveland, Ohio, defaulted on its scheduled debt payments. The causes of the New York City fiscal crisis have been well documented; solutions have been proposed to avoid a recurrence.


10. See infra notes 118-23 and accompanying text.

11. See supra notes 1-8 and accompanying text.


16. After months of debate on methods to prevent a default by New York City, President Ford announced support for federal assistance. N.Y. Times, Nov. 14, 1975, at A1, col. 6. The next day, the New York Legislature passed a three year moratorium on repayment of $1,600,000,000 of New York City short term notes. Id., Nov. 15, 1975, at A1, col. 8.


18. See, e.g., Gelfand, Seeking Local Government Financial Integrity Through Debt Ceilings, Tax Limitations, and Expenditure Limits: The New York City Fiscal Crisis, the Taxpayers' Revolt, and Beyond, 63 Minn. L. Rev. 545 (1979).

Limitations have been enacted to control the source of funds for, and the increase in, government expenditures. These limitations and the proposals in the wake of the New York City and Cleveland fiscal crises raise fundamental questions concerning appropriate and effective means of achieving fiscal responsibility and integrity that do not impair a representative system of government. To date, the treatment of these issues has been bifurcated. Whereas TELs are treated as one distinct species, fiscal responsibility issues are treated separately. This scenario is further complicated by the generally accepted approach of dividing fiscal responsibility into two separate issues: exercise of the power to borrow and exercise of the power to spend. To make a unified whole of this existing patchwork, this article will survey the nineteenth century approaches to debt limitation and expenditure controls, the twentieth century application of those approaches, and the most recent attempts to limit the growth of state and local government expenditures. Unconventional tools available, but not normally considered as directly involved in achieving fiscal responsibility, will also be analyzed. Based on this analysis, recommendations will be developed for an integrated approach that (1) results in fiscal responsibility of state and local governments, (2) allows a check on the unrestrained growth of expenditures, but (3) does not deny a representative government the flexibility it must have in order to function. The current laws of Missouri and Texas will then be surveyed as useful gauges against which to measure the proposals in the future.

I. NINETEENTH CENTURY DEBT LIMITATIONS AND EXPENDITURE CONTROLS

In the early 1800's, states actively financed the expansion of the transportation network and other commercial activity by issuing state bonds. As a result of defaults, suspended payments and, in some cases, actual repudiation of state indebtedness, voters in several states approved state constitutional provisions that severely limited the ability of the state to incur debt. Strict limitations, including very minimal dollar restrictions on authorized indebtedness, have been included in many state constitutions.
constitutions since the mid-nineteenth century.\textsuperscript{24}

Dollar limitations were not the sole means used to restrict the various states’ desire to finance commercial enterprises. In order to discourage state government from financing commercial transactions, constitutional provisions were adopted which specifically denied the state the right to invest in privately owned enterprises\textsuperscript{25} or to lend its credit.\textsuperscript{26} The effect and the effectiveness of these provisions will be further explored below.\textsuperscript{27}

The constitutional amendments adopted in the mid-nineteenth century were targeted directly at state government. In the last half of the nineteenth century, however, municipalities decided to use their financial strength to influence the location of railroad expansion. These municipalities not only donated municipal land to the railroads, but also incurred substantial debt in order to finance loans which the railroads needed for expansion purposes.\textsuperscript{28} As a result of improvident investment in railroad companies and the extensive borrowing needed to help railroads in their expansion efforts, the municipalities defaulted on a number of bond issues in the 1870’s.\textsuperscript{29} Voters once again amended the constitutions of various states to provide a shield for the public fisc.\textsuperscript{30} The existing prohibitions applicable to the state on the lending of credit and investment in private enterprise were extended to municipalities, while prohibitions on making gifts of public property were also added.\textsuperscript{31} But the limitations on municipal indebtedness often were expressed differently from those previously imposed on the state. Permissible municipal indebtedness was normally capped at a principal amount equal to a maximum percentage of the assessed valuation of property in the municipality\textsuperscript{32} or at a principal amount repayable from a maximum tax rate.\textsuperscript{33} Occasionally both limitations were employed.\textsuperscript{34} Prior voter ap-

\begin{itemize}
\item \textsuperscript{24} See A. Heins, \textit{supra} note 9, app. A.
\item \textsuperscript{25} See, \textit{e.g.}, the prohibition contained in the Ohio Constitution, which provides that “nor shall the state ever hereafter become a joint owner, or stockholder, in any company or association in this state, or elsewhere, formed for any purpose whatever.” \textsc{Ohio Const.} art. X, § 4.
\item \textsuperscript{26} See, \textit{e.g.}, the prohibition set forth in the Ohio Constitution, which provides that “[t]he credit of the state shall not, in any manner, be given or loaned to, or in aid of, any individual association or corporation whatever.” \textsc{Ohio Const.} art. VIII, § 4.
\item \textsuperscript{27} For a discussion of these constitutional provisions, see \textit{infra} notes 78-86 and accompanying text.
\item \textsuperscript{28} Gelfand, \textit{supra} note 18, at 547.
\item \textsuperscript{29} Id.
\item \textsuperscript{30} Id. at 547-49.
\item \textsuperscript{31} See, \textit{e.g.}, the prohibitions imposed by the constitution of the State of Texas: Except as otherwise provided by this section, the Legislature shall have no power to authorize any county, city, town or other political corporation or subdivision of the State to lend its credit or to grant public money or thing in value in aid of, or to any individual, association, or corporation whatsoever, or to become a stockholder in such corporation, association or company. \textsc{Tex. Const.} art. III, § 52(a) (1876, amended 1989).
\item \textsuperscript{32} See, \textit{e.g.}, Mo. \textsc{Const.}, art. X, § 12 (1875, amended 1980).
\item \textsuperscript{33} See, \textit{e.g.}, \textsc{Tex. Educ. Code Ann.} § 20.04 (Vernon 1987).
\item \textsuperscript{34} Id.
\end{itemize}
MUNICIPALITY LAW

approval of indebtedness was another common requirement.\textsuperscript{35} Furthermore, judicial treatment of these limitations on and requirements for municipal debt and expenditures, as is the case for comparable state government limitations, has affected their practical scope and effect.\textsuperscript{36} A review of twentieth century practices demonstrates this point well.

A. Application of Nineteenth Century Debt Limitations and Expenditure Controls in the Twentieth Century

The state constitutional provisions limiting indebtedness to a specific and often minimal dollar amount have resulted in the adoption of a continuing series of constitutional amendments\textsuperscript{37} which authorize the issuance of state bonds for specified purposes.\textsuperscript{38} The magnitude of indebtedness authorized by the constitutional amendments and the apparent ability to obtain voter approval suggests that this is not a significant impediment to borrowing for financing of specific projects. Constitutional amendments approved by the voters in Ohio authorized the issuance of $300,000,000 of state bonds to fund payments to World War II veterans,\textsuperscript{39} $90,000,000 of state bonds to fund payments to Korean War veterans,\textsuperscript{40} $1,000,000,000 to fund highway improvements,\textsuperscript{41} $400,000,000 for buildings and related development,\textsuperscript{42} $290,000,000 for general development purposes,\textsuperscript{43} and $120,000,000 of state debt to fund capital improvements for political subdivisions of the state.\textsuperscript{44}

The state constitutional ban on state debt other than debt specifically approved by voters has not even been as restrictive as the above analysis might suggest. Numerous judicial interpretations of what constitutes an indebtedness subject to the constitutional restriction have allowed the creation of significant state obligations which were not approved by the voters.\textsuperscript{45} Furthermore, courts have also applied these same definitional exceptions of debt to municipal obligations.\textsuperscript{46}

\textsuperscript{35} See, e.g., Mo. Const., art. X, § 12 (1875, amended 1980).
\textsuperscript{36} For a discussion of state courts’ treatment of attempted restraints on public expenditures, see infra notes 91-100 and accompanying text.
\textsuperscript{37} The recent history of constitutional amendments authorizing the issuance of bonds in Ohio is illustrative. Amendments were approved in 1947, 1953, 1955, 1956, 1963, 1964, 1965, 1968, 1974, and 1987. Ohio Const. art. VIII, §§ 2b, 2c, 2e, 2d, 2f, 2g, 2h, 2i, 2j, 2k (1947, amended 1987).
\textsuperscript{39} Ohio Const. art. VIII, § 2b.
\textsuperscript{40} Id. art. VIII, § 2d.
\textsuperscript{41} Id. art. VIII, §§ 2c, 2g.
\textsuperscript{42} Id. art. VIII, §§ 2e, 2f.
\textsuperscript{43} Id. art. VIII, § 2h.
\textsuperscript{44} Id. art. VIII, § 2k.
\textsuperscript{45} For a discussion of significant “non-debt” state obligations created without voter approval, see infra notes 91, 92, 94-100 and accompanying text.
\textsuperscript{46} For a discussion of “non-debt” municipal obligations, see infra notes 91-100 and
The constitutional limitations imposed on the indebtedness of political subdivisions of a state are normally not framed as a complete ban with stated exceptions; rather, municipalities are allowed certain levels of indebtedness.\textsuperscript{47} Constitutional provisions often direct the legislature to establish the actual debt limitation.\textsuperscript{48} Occasionally, limitations are expressed as a maximum rate of tax that can be levied for purpose of paying principal and interest on the debt of the political subdivision.\textsuperscript{49} More typical limitations allow a total indebtedness equal to a stated percentage of the total assessed valuation of property in the political subdivision.\textsuperscript{50}

At the same time total indebtedness was being contained by adoption of the constitutional provisions described, other limitations directed toward the source of the funds and the purposes of the expenditure were developing. In an approach paralleling the imposition of dollar limitations on total indebtedness, maximum rates of ad valorem taxation were established either constitutionally\textsuperscript{51} or legislatively.\textsuperscript{52} Since, at the time these limitations were enacted, the primary source of revenues for state and local governments was the ad valorem tax, the imposition of maximum ad valorem rates also served as a practical limitation on total government expenditures. As recently as 1932, property taxes were the major source of local government revenues. In that year, local governments collected total revenues of $6,643,982,000. Of that amount, all taxes produced $4,715,897,000 while property taxes alone produced $4,361,307,000.\textsuperscript{53} State revenues in 1932 totalled $2,140,896,000; all taxes accounted for $1,719,316,000 of that amount, and property taxes alone accounted for $426,953,000.\textsuperscript{54} But as other sources of revenues were developed and exploited, the effect of the rate limitation as a check on total government expenditures became less significant, particularly at the state level. New schemes of taxation, including sales and use taxes and income taxes, have surpassed the ad valorem tax on real and personal property as a revenue source in many jurisdictions. In 1960, state and local government revenues totalled $60,277,000,000. All taxes provided $36,117,000,000 of that amount; however, property taxes provided only $16,405,000,000 of the total tax revenues.\textsuperscript{55} By 1980, state and local government total revenues had

\textsuperscript{47} For a discussion of the limitations on permissible municipal indebtedness, see supra notes 32-34 and accompanying text.

\textsuperscript{48} See, e.g., \textsc{Ohio Const.} art. XIII, § 6 (1851).

\textsuperscript{49} See, e.g., \textsc{Tex. Educ. Code Ann.} § 20.04 (Vernon 1987). This type of limitation is not favored by the bondholders for obvious reasons. While the bond supported by such a tax is generally characterized as a “full faith and credit” obligation of the issuer, in fact, it is not. If the tax levy allowed is insufficient to repay principal and interest, the issuer has no ability to increase the rate to that required to make full and timely payment.

\textsuperscript{50} See e.g., \textsc{Mo. Const.} art. VI, § 26(b) (1875, amended 1962).

\textsuperscript{51} See, e.g., \textsc{Tex. Const.} art. XI, § 4 (1876).

\textsuperscript{52} See, e.g., \textsc{Tex. Educ. Code Ann.} §§ 20.02, 20.04(d) (Vernon 1987).

\textsuperscript{53} \textsc{Bureau of the Census, U.S. Dep’t of Commerce, Statistical Abstract of the United States: 1940, Table No. 215 (1941).}

\textsuperscript{54} \textit{Id.} Table No. 216.

\textsuperscript{55} \textsc{Bureau of the Census, U.S. Dep’t of Commerce, Statistical Abstract of the}
soared to $451,537,000,000. All taxes provided $223,463,000,000, while property taxes only provided $68,499,000,000. Thus, in 1932 property taxes provided 54.5% of total revenues of state and local governments. By 1980 property taxes provided only 15.2% of state and local government total revenues. In fact, not all states even continue to impose ad valorem taxes on the state level. The voters of the State of Texas recently adopted a constitutional amendment abolishing the state’s ad valorem tax. When the increased property values caused by the inflationary real estate market of recent years were accurately reflected in the assessed values of the ad valorem tax rolls, rate limitations became even less significant as a means of limiting ad valorem taxes as a source of funds. This scenario in turn inspired some of the more famous taxpayer reactions embodied in the “taxpayers’ revolt” between 1976 and the early 1980’s.

Tax rate limitations, however, were only one of the limits on tax revenues affecting total expenditures. It has been well established by the courts that taxes may be levied only for a public purpose and that public funds may be expended only for a public purpose. Indeed, it has been suggested that this result is required by the concept of due process in order to avoid a taking without just compensation. The public purpose doctrine is specifically imposed by some state constitutions. As was the case with constitutional debt limitations, the practical effect of requiring a public purpose as a limitation on raising and spending revenue has been affected by judicial interpretations of “public purpose.”

Tax rate limitations and the public purpose doctrine have failed to limit the tax burden on property owners or control the increase in government expenditures. This failure has contributed to the adoption of TELs,


56. Id.
57. Tex. Const. art. VIII, § 1-e (1876, amended 1982).
58. Efforts at having true equalization of property values have been undertaken by various taxing jurisdictions. The State of Texas has adopted legislation requiring that assessments be done on a county-wide basis and that all taxing jurisdictions in the county use that valuation. Tex. Tax Code Ann. § 6.01 (Vernon 1982 & Supp. 1991). Assessment ratios were also ended; all property is to be assessed at its fair market value. Id. § 23.01.
59. For a discussion of taxpayer reactions and the resulting consequences, see infra notes 65-72, 202, 203 and accompanying text.
60. See, e.g., Garland v. Bd. of Revenue, 87 Ala. 223, 6 So. 402 (1889); City of Daytona Beach v. King, 132 Fla. 273, 181 So. 1 (1938); State ex rel. Walton v. Parsons, 58 Idaho 787, 80 P.2d 20 (1938); City of Cleveland v. Ruple, 130 Ohio St. 465, 200 N.E. 507 (1936); Pickelsimer v. Pratt, 198 S.C. 225, 17 S.E.2d 524 (1941).
62. See, e.g., Cochran v. Louisiana State Bd. of Educ., 281 U.S. 370 (1930) (state law which provided free school books to children in private schools did not violate fourteenth amendment as taking of private property for public purpose).
63. See, e.g., Tex. Const. art. VIII, § 3 (1876) (taxes shall be levied and collected by general laws and for public purposes only).
64. For a discussion of the judicial interpretations of “public purpose,” see infra notes 74-77 and accompanying text.
which are generally defined as constitutional or statutory restrictions on increases in assessed valuations, and detailed constraints on the growth of government expenditures. TELs tend to vary in their reach. Some TELs are designed so tightly that they essentially remove all flexibility from the legislative body. Other TELs, which are drawn more loosely, leave so much discretion in the legislative body that they are almost meaningless as restrictions on the growth of government expenditures. States that have a partial TEL, that is, a limitation only on the assessed valuations on real property or on the tax rate, are not necessarily going to reduce total expenditures or even decrease the rate of growth of total expenditures. A marked increase of other sources of revenue, together with distortion in the proper level and use of those other sources, is at least as likely to produce a change in total expenditure patterns. TELs are subject to the same objections as other partial approaches that address only one part of the fiscal responsibility framework. If the approach does not deal with all aspects of expenditures, borrowing, and sources of revenues, the cure may prove worse than the perceived ailment. While the desirability and utility of such constraints can only be determined with the passage of time, analysis suggests that reliance on such provisions alone is not warranted or advisable.

In addition to the public purpose doctrine, other restrictions have been incorporated into state constitutions to control public expenditures. However, analysis of these restrictions reveals that the restrictions may have actually exacerbated the evil which they were intended to cure. A brief review of the restrictions and their effect can aid in predicting what the possible effects, and effectiveness, of the new generation of tax and expenditure controls will be.

Taxation and expenditure for public purposes only is a concept that has been both durable and effective. Courts have had ample opportunity to consider the scope of the public purpose doctrine. The normal judicial review gives great deference to a legislative finding of public purpose, striking down an expenditure only upon a showing of a clear abuse of

65. For a discussion of restrictions on increases in assessed valuations, see Comment, supra note 9, at 270-71.

66. The controls on the growth of government expenditures enacted in the last fifteen years have been thoroughly analyzed and categorized. For a discussion of this phenomena, see supra note 20.

67. For an example of a restrictive TEL, see infra notes 232-41 and accompanying text.

68. For an example of a flexible TEL, see infra notes 267-71 and accompanying text.

69. For an example of a state TEL which limits only assessed valuations on real property, see CAL. CONST. art. XIII A, §§ 1-2 (1978, § 1 amended 1986, § 2 amended 1990).

70. For an example of a state TEL which limits only real property, see TEX. CONST. art. VIII, § 21 (1978, amended 1981).

71. For a discussion of how other sources of revenue can produce a change in total expenditure patterns, see Hagman, supra note 20, at 134.

72. For a discussion of provisions which address only one part of the fiscal responsibility framework, see infra notes 202, 203 and accompanying text.
discretion. While this deference has led to differing conclusions as to what constitutes a public purpose for which funds may be legally expended, the test remains consistent: Does the expenditure promote the public health, safety, morals or general welfare? Alternatively, the test has been expressed as a question of whether the expenditure confers a direct benefit of reasonably general character to a significant part of the public, as distinguished from a remote or theoretical benefit. All in all, there have been few major public initiatives stymied by the public purpose doctrine. For instance, the issuance of industrial development bonds has been recognized as a legitimate public purpose. The public purpose test has not limited the growth of expenditures in any meaningful way, but it has provided an important check by making governmental undertakings financed by public funds subject to judicial scrutiny.

An attempt to control governmental activity in private enterprise, which has proved to be more troublesome, is the general prohibition of a state or political subdivision lending its credit. As noted earlier, this prohibition was a reaction to municipalities' involvement with railroads in the 1800's. Hence, such activities as guaranteeing corporate debt are clearly prohibited. But the clauses have been the source of confusion, leading to differing conclusions not only among states, but even within a single state. In some instances, the clause has been vitiated judicially by applying a public purpose analysis to determine whether an impermissible lending of credit was present. This analysis is inappropriate, as an expenditure can serve a public purpose, but the means of financing the expenditure can be challenged.

73. For examples of courts striking down expenditures only upon a showing of a clear abuse of discretion, see City of Glendale v. White, 67 Ariz. 231, 194 P.2d 435 (1948); State ex rel. McLure v. Hagerman, 155 Ohio St. 320, 325, 98 N.E.2d 835, 838 (1951); City of Tulsa v. Williamson, 276 P.2d 209 (Okla. 1954).

74. For differing conclusions as to what constitutes a "public purpose" for which funds may be legally expended, compare Ferrie v. Sweeney, 34 Ohio Op. 272, 72 N.E.2d 128 (Ct. of Common Pleas 1946) (stating that providing child care at public expense, regardless of need, is not public purpose) with City of Boca Raton v. Gidman, 440 So. 2d 1277 (Fla. 1983) (stating that provision of day-care center is proper municipal purpose).

75. For examples of cases utilizing the test of whether the expenditure is intended to promote the public health, safety, morals, or general welfare, see Barnes v. City of New Haven, 140 Conn. 8, 98 A.2d 523 (1953); Bowling v. Brown, 57 Md. App. 248, 469 A.2d 896 (1984); State ex rel. McLure v. Hagerman, 155 Ohio St. 320, 325, 98 N.E.2d 835, 838 (1951).

76. For examples of cases utilizing the test of whether the expenditure confers a direct benefit of reasonably general character to a significant part of the public, see Opinion of the Justices, 384 So. 2d 1051 (Ala. 1980); Opinion of the Justices, 349 Mass. 794, 208 N.E.2d 823 (1965); United States v. Town of N. Bonneville, 94 Wash. 2d 827, 834, 821 P.2d 127, 131 (1980).

77. For an example of the recognition of the issuance of industrial development bonds as a legitimate public purpose, see Kennecott Copper Corp. v. Town of Hurley, 84 N.M. 743, 745, 507 P.2d 1074, 1076 (1973).

78. For a discussion of the general prohibition of a state or political subdivision lending its credit, see Gelfand, supra note 18, at 547.

79. Spitzer, supra note 9.

80. State v. City of Tampa, 146 So. 2d 100 (Fla. 1962); Ezelle v. City of Paducah, 441 S.W.2d 162, 164 (Ky. 1969); Hoglund v. City of Summit, 28 N.J. 540, 147 A.2d 521 (1959).
penditure could still involve a prohibited lending of the government’s credit. In order to serve their true role, lending-of-credit provisions should be subjected to the private area analysis which governs the creation of debtor-creditor relationships. Other constitutional provisions directed at particular evils, such as those prohibiting gifts of public property or investing in private businesses, have served their purposes without creating the interpretational problems caused by the lending-of-credit prohibitions.

Broad prohibitions like that against the lending of credit create a need for exceptions; these exceptions may be included in the state constitution, or, as has been the case for debt limitation clauses, may be judicially created. States barred from making grants of public funds cannot provide welfare and other social benefits to individuals; constitutional provisions are required to allow these needs to be met. The lending-of-credit prohibition is usually accompanied by authorization for loan programs and, on the municipal level, authorization to purchase insurance from mutual insurance companies.

While not explicitly meant to control the level of expenditures, these provisions, and similar ones, do control the expenditure of the public fisc as well as protect it. These provisions are important since they accomplish their intended purposes. These provisions were not designed, however, to constitute restrictions on growth of expenditures and will not serve that particular goal, as is demonstrated by applying the provisions to a hypothetical appropriations bill. Assume that a state legislature decides to double the state’s expenditure on higher education, increase welfare payments, refurbish all state office buildings, and purchase a major telecommunications system linking all state facilities. Further, assume that the state legislature, recognizing that the state is required to operate on a balanced budget, determines that state revenues must increase twenty percent in the next fiscal year in order to pay for the increased expenditures. Following all required procedures, the legislature approves the appropriations bill and adopts legislation increasing all state taxes and fees by thirty percent, the amount necessary to increase total state revenues by twenty percent. Neither the public purpose doctrine, prohibi-

81. For a discussion of such a provision, see supra note 31.
82. Id.
83. For a discussion of judicially created exceptions to debt limitation clauses, see infra notes 92-97.
84. E.g., Tex. Const. art. III, § 51-a (authorizing assistance for needy).
87. The provisions contained in the Texas constitution concerning extra compensation are illustrative. The Legislature may not grant “extra compensation to any officer, agent, servant, or public contractors, after such public service shall have been performed or contract entered into, for the performance of the same . . . .” Tex. Const. art. III, § 44. Nor may the legislature “authorize any county or municipal authority to grant any extra compensation, fee or allowance to a public officer, agent, servant or contractor, after service has been rendered, or a contract has been entered into, and performed in whole or in part.” Tex. Const. art. III, § 53.
tions on lending the state's credit, nor provisions relating to the use of state funds for gifts are a bar to the actions of the state legislature. These provisions accomplish their intended purposes, but limiting the growth of state expenditures is not one of these purposes.

An additional expenditure control that is widely employed in state and local government should be considered. Most states and political subdivisions are required to operate on a balanced budget for each fiscal period. This requirement may be embodied in the state constitution or it may be the result of judicial interpretation of debt limitation clauses. If the state or local government may only incur debt as authorized by state law, it must either have current funds available to pay budgeted expenses or have raised the funds through borrowing. Implementation of a budget that causes expenditures to be made in excess of current funds and the proceeds of authorized borrowing creates an unfunded obligation, or, in other terms, an unauthorized indebtedness.

Although the balanced budget requirement was meant to be a positive force in achieving fiscal responsibility, it has had a negative impact as well. It has not only acted as a restraint on current expenditures, but also has been a major impetus to creativity in both accounting and "non-debt" borrowing. Questionable accounting practices have been cited as a major cause of the New York financial crisis and the growth of borrowing not subject to constitutional limitations has been a factor in the lack of fiscal responsibility by state and local governments.

Fueled by the explosive growth in what protections and services the public demands, as well as the concomitant determination that these protections and services are indeed in compliance with the requirements of the public purpose doctrine, the pressure on balanced budgets and debt limitations increased. The government's need for funds, coupled with a willingness by the courts to interpret the reach of constitutional debt ceilings narrowly, has undermined the usefulness of debt limitations. The cure that debt limitations aimed to achieve has become part of the problem. A review of the narrow interpretation given to the debt limitation clauses by the courts is necessary in the effort to design workable controls. When one reads the debt limitations imposed by state constitutions, one can only deduce that state and local governments have a very limited ability to incur debt. Understanding why these apparently restrictive limitations on the growth of debt have proven to be illusory is necessary to avoid similar problems when developing a future framework that will result in fiscal responsibility of state and local governments.

The inventiveness and creativeness of municipal and state finance officers, their fiscal advisors and bond counsel, has been embraced by state

90. Gelfand, supra note 18, at 575.
91. See, e.g., Tex. Const. art. III, § 49. For a discussion of such limitations, see Heins, supra note 9, app. A.
courts. The special funds doctrine, use of overlapping political subdivisions, creation of special authorities, use of true leases and service contracts, and more recently, the use of lease-purchase financing have all received judicial blessing. By employing several of these techniques, governments avoid the burden of constitutional debt limitations, and as a result, these limitations cease to be a meaningful restraint on the growth of public expenditures. Commentators not only question whether the in-

92. Indebtedness repayable solely from the revenues of the project being financed was the first to be excluded from the constitutional debt limitations. 15 E. McQuillen, The Law of Municipal Corporations § 41.31 (3rd ed. 1985). This doctrine has been expanded to include indebtedness repayable from particular non-tax sources, even though not generated solely from the project being financed. See, e.g., White v. Common Council of Middlesboro, 414 S.W.2d 569 (Ky. 1967); State ex rel. Gordon v. Rhodes, 158 Ohio St. 129, 136, 107 N.E.2d 206, 210 (1952); DeFazio v. Washington Pub. Power Supply Sys., 296 Or. 550, 679 P.2d 1316 (1984).

93. Multi-layered political subdivisions are each recognized as having their own existence, and thus each having their own debt limitations. See, e.g., State ex rel. Webster Groves Sanitary Sewer Dist. v. Smith, 337 Mo. 855, 871, 87 S.W.2d 147, 154 (1935); Albuquerque Metro. Arroyo Flood Control Auth. v. Swinburne, 74 N.M. 487, 394 P.2d 998 (1964); Stackhouse v. Floyd, 248 S.C. 183, 149 S.E.2d 437 (1966).

94. A state creates a public authority that has the power to construct facilities for lease to the state, financing the construction by issuing bonds of the authority that are repayable from the lease revenues generated by leasing the facility to the state. No constitutional debt is created. See, e.g., In re Request for Advisory Opinion, 400 Mich. 311, 254 N.W.2d 544 (1977); Clayton v. Kervick, 52 N.J. 138, 244 A.2d 281 (1968); Texas Pub. Bldg. Auth. v. Mattox, 686 S.W.2d 924 (Tex. 1985); State ex rel. Kanawha County Bldg. Comm'n v. Paterno, 160 W. Va. 195, 233 S.E.2d 332 (1977).

95. As under the law no obligation exists to pay the lease payment unless the lessor also performs, courts have held that there is no obligation created beyond that for the current fiscal year and thus no indebtedness. See, e.g., Stephenson v. State, 219 Ga. 652, 135 S.E.2d 380 (1964); Ambrozich v. City of Eveleth, 200 Minn. 473, 482, 274 N.W. 635, 639 (1937).

96. Under the same theory as for true leases, it has been determined that no future indebtedness is created. See, e.g., Buck v. City of Eureka, 124 Cal. 61, 56 P. 612 (1899); State ex rel. Mitchell v. City of Silkoek, 555 S.W.2d 281 (Mo. 1977). But see Hamilton Test Sys., Inc. v. City of Albuquerque, 103 N.M. 226, 704 P.2d 1102 (1985); Board of Com'rs v. Summers, 181 Okla. 312, 73 P.2d 409 (1937).

97. In typical lease-purchase financings, the contract provides that it terminates at the end of any fiscal period if adequate funds are not appropriated to make required payments in the next fiscal period. This type of nonappropriation lease purchase financing has been used extensively in recent years. Blak, State and Municipal Lease-Purchase Agreements: A Reassessment, 7 HARV. J.L. & PUB. POL'Y 521 (1984).

98. In 1880 state and local government net indebtedness was $392,743,357. BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF THE UNITED STATES: 1890, Table No. 7 (1891). By 1932 state and local government net indebtedness had reached $17,680,176,000. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES: 1940, Table No. 229 (1941). A further dramatic increase occurred between 1932 and 1960. Total state and local government debt equalled $40,031,000,000 in 1960; of that total, only $23,385,000,000 or 58.4%, was full faith and credit indebtedness. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES: 1982-83, Tables No. 482, 494 (1982). But the increase between 1960 and 1980 dwarfed the previous periods. In 1980 state and local government indebtedness totalled $202,167,000,000; full faith and credit indebtedness totalled only $88,334,000,000, or 44%, of the outstanding amount.
tergenerational transfer of costs of government is equitable, but also whether there is actually an increased dollar cost in employing the alternative financing techniques described.

Coupled with the expansion of the concept of public purpose and the continuing development of "non-debt" indebtedness, there has been what can only be characterized as an abuse of short-term borrowing. Short-term borrowing, when exploited for its intended purpose, is both beneficial and necessary. Governments often collect revenues in a cyclical fashion; this is especially true of ad valorem taxes and income taxes which are normally collected on an annual basis. Payment of bills is not as cyclical, since operating expenses must be funded throughout a fiscal period. For this reason, many political subdivisions are authorized to borrow short term in anticipation of expected tax or other revenues. With proper controls requiring repayment out of the sources anticipated in that fiscal period or the next, problems should not be encountered. However, immediate repayment from and segregation of the revenues anticipated is not always statutorily mandated. The absence of these crucial limitations allows short-term borrowing to be refinanced indefinitely by borrowing again in the next fiscal period against other anticipated revenues in order to repay the outstanding short-term borrowing. As the review of the Cleveland fiscal crisis demonstrates, the abuse of short-term borrowing by rolling over the borrowings can obscure the true financial status of a government. Other abuses, such as overestimating anticipated sources and including exempt property on the tax rolls, increases the effects of short-term borrowing power misuse. Again, although statutes were in place to prevent the abuses, they were ineffective.

In summary, the combination of different types of debt and expenditure controls, together with the judicial interpretations of the various provisions, has not had entirely positive effects. Substantial obligations have been incurred in spite of the strictures of the constitutional debt limitations, while at the same time, obligations have been voided by the courts as violations of those same debt limits. More importantly, it seems that some expenditure and borrowing decisions are driven not by the merits,

100. For a further discussion of these concerns, see infra notes 107-08 and accompanying text.
103. For a discussion of the importance of a meaningful reporting scheme, see infra text accompanying note 156.
104. New York City engaged in both practices during the years preceding its fiscal crisis. Gelfand, supra note 18, at 567, 575.
105. For a discussion of the fiscal crisis in Cleveland and New York, see infra notes 117-92 and accompanying text.
but instead are controlled by legal concerns. The legislative body is denied the ability to fully perform its obligations when it is forced to ignore the dollar cost of the different types of financing because as a matter of state law some structures of borrowing are denied to it.

At the other end of the spectrum is the suggestion that substantially all state government borrowing should be general obligations of the state because that type of borrowing is the most efficient (least expensive) in terms of the total interest cost. This position merely adopts the opposite extreme because it focuses on only one of the policy considerations that must be made by a legislative body when analyzing a proposed borrowing. While total cost is of obvious importance, it is conceivable that protection of the issuer's other revenue sources will be considered of sufficient importance to warrant the increased cost associated with the use of revenue bonds.

The financing of advanced technology cogeneration facilities is illustrative. A local government could very reasonably conclude that a $200,000,000 cogeneration project was desirable if the project could generate sufficient revenues to cover both the operating costs and debt service on funds borrowed to acquire the facility. The use of revenue bonds, which apportions part of the risk of the project's feasibility to the bondholders, allows the local government to use innovative solutions to problems without subjecting taxpayers to the burden of repayment if the project fails to produce the anticipated revenues. The increased interest cost on the revenue bonds is the payment the issuer makes in order to limit its liability. Neither a requirement that all borrowings be general obligations of the issuer nor a scheme of legal restrictions that denies local government the ability to use the most cost efficient financing vehicle available is the solution.

B. Ancillary Aids to Achieving Fiscal Responsibility

Predictions of the effect of TELs and development of a structure for avoiding future crises resulting from other than non-external factors beyond the control of the state or political subdivision necessitates the employment of additional means of promoting fiscal responsibility.

Fiscal responsibility in government is encouraged by many statutory requirements that are directed toward protection of the public fisc. Some of these requirements have only a tangential effect on efforts to limit total government expenditures, but are nonetheless important to achieve fiscal responsibility and should not be overlooked. For example, model procurement codes, public advertising and award of bids for services, supplies and capital improvements, and the prohibition of the use of public

107. Wolman & Peterson, supra note 9, at 779.
108. Hollman & Primeaux, supra note 9, at 443.
funds to lobby for bond referenda all serve useful purposes in terms of controlling public expenditures and making government responsible. Model procurement codes and public advertising and award of bids increase the competitiveness of prices obtained by the purchasing government and also inhibit the use of public purchases to reward political friends. Prohibition of the use of public funds to lobby for approval of a proposed bond referendum helps maintain a balance between those in favor of approval and those opposed to approval, which increases the probability that the issue will be judged on its merits.

Statutes mandating the use of responsible accounting standards and government in the sunshine have a significant effect on efforts to achieve fiscal responsibility. Critical analyses, or at least conscious awareness by the electorate of expenditures and borrowing can serve as a powerful check in a representative system of government. If the electorate is not informed, it cannot serve as an effective check on government expenditures and borrowing devices; the electorate must know what is being done in the state house or at city hall. Open meeting statutes should provide meaningful notice requirements and have sanctions for violation of the statutory notice requirements. Financial reports must be timely, understandable, and prepared pursuant to required guidelines that accurately reflect the government’s fiscal condition.

Once the electorate is informed, it must have a means of using the information. Neither recall of elected officials nor “throwing the rascals out” at the next election is necessarily an effective remedy for unwise, improper or even illegal expenditures or borrowing. Neither will make the public fisc whole, nor will either necessarily be timely. However, an adequate remedy has been recognized in many jurisdictions: taxpayer “watchdog” suits. This taxpayer suit should be regarded as the public equivalent of the stockholders’ derivative action; it should be treated as vindication of the taxpayers’ interest in the proper application of public funds. To be effective, the taxpayer should be able to challenge an ac-

112. While analyses and proposed cures for inadequate and even nonexisting accounting standards are not within the scope of this article, any attempt to structure constraints imposing fiscal responsibility must include required accounting standards that cause financial reports of the government to reflect its actual status. Steps have been taken to address this problem. E.g., Ohio Rev. Code Ann. §§ 117.11-12 (Anderson 1990).
113. The Texas Open Meetings Act is instructive. It requires that notice be posted in a public place for a period of 72 hours prior to the meeting, except in the case of an emergency. Emergency meetings may be held after a two hour posting, but the emergency must be stated, only those matters constituting the emergency may be considered, and the media must be informed if they have requested notice of emergency postings. Tex. Rev. Civ. Stat. Ann. art. 6252-17 (Vernon 1970 & Supp. 1991).
115. For a discussion of “watchdog” suits, see 18 E. McQuillen, The Law of Municipal Corporations, §§ 52.29-.32 (3d ed. 1984 & Supp. 1990); Comment, Taxpayer Standing
tion that affects all taxpayers, not only an action from which he personally has suffered a special injury.\textsuperscript{116}

With these constitutional and statutory provisions in mind, undertaking a review of the laws in effect at the time of the Cleveland fiscal crisis to determine what tool, if any, Cleveland was missing will be instructive in structuring a balanced approach to fiscal responsibility.

C. What Was Missing in the Ohio Laws?

Cleveland, unlike its sister city, New York City,\textsuperscript{117} was not responsible for funding public schools, mass transit systems, welfare payments, or sewer systems. All of these functions were instead provided by the county or special districts and authorities.\textsuperscript{118} In other words, items commonly recognized as exerting the greatest financial pressure on a city were not Cleveland's problem. Moreover, the city had the lowest income tax rate of all major cities in Ohio.\textsuperscript{119} How does a city end up in default on its municipal borrowings under these circumstances? It has been suggested that Cleveland's problems were actually political, not fiscal.\textsuperscript{120} Even though the problem is understandable from a political perspective, the city had accumulated short term debt that the banks refused to refinance.\textsuperscript{121} The city incurred these debts during a period for which the State of Ohio eventually declared the city's books unauditable.\textsuperscript{122} Because the city's books were in disarray, the city was able to use money raised from the sale of bonds intended to fund capital projects to pay current operating expenses.\textsuperscript{123} As a result, the funds established to pay debt service on the city's outstanding indebtedness operated at a deficit.\textsuperscript{124} This background provides the milieu in which to study the laws of Ohio in effect at the

\begin{footnotes}
\item[117] Early cases viewed the taxpayers' suit as an equitable right, requiring the existence of a property interest to be protected. See 18 E. McQuillen, supra note 115, § 52.14. This idea was expressed in terms of a requirement that the taxpayer have a special interest, distinct from interests shared by taxpayers as a group. Id. As a result, illegal actions or expenditures that affected the entire class of taxpayers could not be challenged by any individual taxpayer, thereby eviscerating the remedy. The current trend is to eliminate the special interest requirement, but it is still the rule in some states. Id.
\item[119] Id.
\item[120] Id.
\item[123] Id.
\item[124] Id.
\end{footnotes}
time of the crisis.

The Ohio Constitution contained provisions which addressed public debt and expenditures. For example, state indebtedness was limited to $750,000 to cover casual deficiencies in revenues. However, a series of constitutional amendments permitted the state to incur debt for construction and acquisition of improvements such as highways, parks, and schools. To insure payment of the debt, the state and its political subdivisions were required to levy and collect taxes on an annual basis sufficient to pay debt service on all outstanding indebtedness. As additional security, the constitution prohibited the State from lending its credit to any individual association or corporation or investing in private companies or associations. Likewise, cities, towns and counties were subject to a similar prohibition.

Although no constitutional provision specifically states the purposes for which the state is permitted to issue public debt, the courts established purposes based on the right of private property guaranteed by the constitution. Expenditures by the state constitute public purposes if they promote “the public health, safety, morals, general welfare, security, prosperity, and contentment of all the inhabitants or residents within the municipal corporation.” The public purpose requirement necessitated a constitutional amendment to designate projects funded by industrial development bonds and housing revenue bonds as proper public purposes. Generally, the legislature is to determine what constitutes a public purpose, and the courts are to reverse a legislative determination of public purpose only for abuses that are “palpable and manifestly arbitrary and incorrect.” The legislature is also required to restrict the power of taxation, assessment, borrowing money, and contracting of debts so as to prevent the abuse of such power by cities and villages. Furthermore, there is a permissive constitutional provision authorizing the legis-

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125. Ohio Const. art. VIII, § 1.
126. For a discussion of the constitutional amendments, see supra notes 37-44 and accompanying text.
127. Ohio Const. art. VIII, § 2c.
128. Id. art. VIII, § 2f.
129. Id.
130. Id. art. XII, § 11.
131. Id. at VIII, § 4.
132. Id.
133. Id. art VIII, § 6 (1851, amended 1912). Article 8, § 6 allows cities, towns, and counties to acquire insurance on public buildings or property through mutual insurance companies. Id.
134. City of Cleveland v. Ruple, 130 Ohio St. 465, 469, 200 N.E. 507, 509 (1936).
lature to limit the powers of municipalities to incur debt and levy taxes and allowing it to require reports on the cities' financial condition. The constitution further limits the ad valorem tax to a total of one percent for all purposes unless the voters in the taxing jurisdiction approve a higher rate. And most significantly, given what the city did, no current operating expenses are to be financed by the use of indebtedness; bonds are to be issued for permanent improvements only, subject to exceptions that authorize tax anticipation notes and revenue anticipation notes. Tax anticipation notes are limited in amount to one-half of the anticipated taxes in the current fiscal year and are to be repaid in six months; revenue anticipation notes are similarly restricted in an amount equal to one-half of the anticipated revenues. Judicial interpretation of the constitutional and statutory debt limitations has resulted in holdings that revenue bonds are not debt for the purpose of the limitations; that a pledge to use taxes, if necessary, to meet future lease payments creates a debt of the entire amount payable under the lease that is subject to the constitutional debt limits; and that lease purchase financing with a non-appropriation clause does not create debt under the debt limitations. The power to tax can only be exercised to raise money for purposes that are public in nature.

With regard to the other statutory provisions that were identified above as encouraging fiscal responsibility, Ohio law allows taxpayer watchdog suits without requiring the plaintiff to show irreparable harm or individualized interest. While an open meetings statute was in effect during the period leading up to Cleveland's crisis, the appellate court determined that it did not apply to home rule cities like Cleveland as it was not a general law relating to the police power.

The legislature has exercised its right statutorily to address tax limi-

140. Id. art. XVIII, § 13.
141. Id. art. XII, § 2.
143. Id. § 133.10(A) (Anderson 1990).
144. Id. § 133.10(B).
145. Id. § 133.10(C).
146. Id. § 133.10(B).
147. State ex rel. Gordon v. Rhodes, 156 Ohio St. 81, 98, 100 N.E.2d 225, 233 (1951).
149. See id. at 285 N.E.2d at 367-69 (where city uses lease purchase financing and promises to appropriate funds from operating expenses to meet lease revenue shortfalls, the city is contractually bound to appropriate out of future budgets (tax years)). The Kitchen court classifies the total amount of the lease as "debt" for the purpose of the limitations. Accordingly, where a city utilizes lease purchase financing that includes a non-appropriation clause (i.e., does not promise to meet lease payment shortfalls out of tax revenue), the arrangement is not "debt" for purpose of the limitations.
151. Brauer v. City of Cleveland, 119 Ohio App. 159, 191 N.E.2d 847, 850 (Ohio Ct. App. 1963) (in taxpayer suit it is "unnecessary for the plaintiff to show irreparable harm to herself").
tations as well as the debt limitations discussed above. The net indebtedness of a municipal corporation is limited to 5 1/2% of all property listed and assessed for taxation without the requirement of an approving referendum.\textsuperscript{153} If approved by the voters, net indebtedness can be increased to 10 1/2%.\textsuperscript{154} However, not all debts are included in the limitation. Generally, revenue bonds, urban redevelopment bonds, and bonds covenanted to be paid by annual appropriation of the municipal income tax are not included in the limit.\textsuperscript{155}

What was missing that allowed Cleveland to end up in municipal default? As the above review indicates, the pieces of the fiscal responsibility puzzle were there, but were ineffectively and incompletely implemented in some instances and were ignored or abused in other cases. Despite authorization by the Ohio Constitution, the legislature failed to adopt meaningful financial reporting requirements.\textsuperscript{156} The absence of meaningful financial reporting allowed Cleveland officials to ignore the constitutional prohibition on the use of bond proceeds for payment of current expenses and further allowed them to abuse the limitations imposed on the use of short term borrowing. The state needed an enforcement mechanism to put teeth in the constitutional and statutory mandates. The state legislature apparently reached the same conclusion, as indicated by the legislation enacted in a response to the Cleveland default. Political subdivisions are now required to file annual financial reports with the state auditor using accounting standards prescribed by the state auditor.\textsuperscript{157} This annual report must be published in a local newspaper, thereby informing the residents of the financial status of the municipality.\textsuperscript{158} Detailed budgets are required for setting tax rates.\textsuperscript{159} As the ultimate control, the state grants itself the right to assume a direct and active role in control of a municipal corporation’s borrowings and expenditures. By an Act effective November 29, 1979, the legislature adopted a detailed statutory scheme to deal with fiscal emergencies of municipal corporations in the state.\textsuperscript{160} All municipalities are now subject to the provisions of the Act, including those that have adopted a charter under the home rule provisions of the state constitution.\textsuperscript{161} The legislature, aware of the fate of the sunshine law vis à vis home rule cities,\textsuperscript{162} included findings of public policy and public purpose to support the constitutionality of applying the Act’s provisions to home rule cities.\textsuperscript{163} Relying on its “au-

\begin{itemize}
\item \textsuperscript{153} \textit{Ohio Rev. Code Ann.} § 133.05 (Anderson 1990).
\item \textsuperscript{154} \textit{Id.}
\item \textsuperscript{155} \textit{Id.}
\item \textsuperscript{156} \textit{Ohio Const.} art. XVIII, § 13.
\item \textsuperscript{157} \textit{Ohio Rev. Code Ann.} § 117.38 (Anderson 1990).
\item \textsuperscript{158} \textit{Id.}
\item \textsuperscript{159} \textit{Id.} §§ 5705.28-30 (Anderson 1990 & Supp. 1990).
\item \textsuperscript{160} \textit{Id.} § 18.01-99 (Anderson 1990).
\item \textsuperscript{161} \textit{Id.} § 118.01 (Anderson 1990).
\item \textsuperscript{162} For a discussion of statutory application to home rule cities, see \textit{supra} note 152 and accompanying text.
\item \textsuperscript{163} \textit{Ohio Rev. Code Ann.} § 118.02 (Anderson 1990).
\end{itemize}
authority . . . to provide for the public health, safety, and welfare and to limit and restrict the powers of municipal corporations to borrow money, contract debts, and levy taxes to prevent the abuse of such powers and to require reports and examination of their financial condition, transactions, operations, and undertakings . . . ,

the legislature declared that fiscal integrity of municipal corporations is required. The legislature noted that the failure to so act affects "the health, safety, and welfare not only of the people of the municipal corporation but also of other people of the state." Given the constitutional provisions allowing the legislature to restrict tax levies and to require financial reporting, application of the provisions to home rule cities should be constitutional.

The fiscal emergency provisions relative to state supervision of a municipality's finances are activated by a determination that a fiscal emergency exists. That determination is made by the auditor of state on his own initiative or upon the filing of a written request by the governor, the county budget commission, the mayor of the municipal corporation, or the presiding officer of the legislative body of the municipal corporation if authorized by a majority vote of that body. A fiscal emergency exists if: (1) debt obligations are in default and have been in default for more than thirty days; (2) funds are not available to pay timely and in full all employees of the municipal corporation and nonpayment has persisted for more than thirty days (subject to extension by the employees up to an additional sixty days); or (3) deficits in the accounts of the municipality are greater than that allowed by statute. If a fiscal emergency exists, a financial planning and supervision commission is established with its constituent members including the treasurer of the state, the director of budget and management, the mayor of the municipal corporation, the presiding officer of the legislative body of the municipal corporation, and three persons appointed by the governor with the advice and consent of the senate. Within a few months after the commission is formed, the municipality must submit a financial plan to the commission for approval. If the municipality fails to submit a financial plan as required, it must limit its general fund expenditures to "eighty-five percent of expenditures from the general fund for such month in the preceding fiscal year." Once the plan is submitted and pending approval, no expenditures may be made contrary to the plan proposed by the municipality nor can expenditures contrary to the plan be made once approval is given.

164. Id.
165. Id.
166. For a discussion of these constitutional provisions, see supra note 140 and accompanying text.
168. Id. § 118.04(A).
169. Id. § 118.03(A).
170. Id. § 118.05.
171. Id. § 118.06(A).
172. Id. § 118.12.
173. Id.
Additionally, no debt obligation may be issued except with the prior approval of the commission.\textsuperscript{174} Debt obligations include "[b]onds, notes, certificates of indebtedness, bond anticipation notes, current revenue notes, local government fund notes, or other obligations issued or incurred in borrowing money, or to renew, refund, fund, or refinance, . . . such obligations."\textsuperscript{175}

As this survey of the act's major provisions illustrates, the state, acting through the commission, enjoys considerable powers and discretion to control the municipality's finances. The commission, established to supervise Cleveland's recovery from default, reported in 1987 that its work was completed.\textsuperscript{176}

D. Was New York Any Different?

The financial practices and abuses engaged in by New York City have been well documented.\textsuperscript{177} For purposes of the current analysis, it is worthy to note that even though the state constitution initially appears extremely restrictive with regard to indebtedness and taxation by the City of New York, numerous constitutional exceptions exist, some of which are applicable solely to New York City.\textsuperscript{178} New York City has a general debt limitation equal to ten percent of the full valuation of its taxable property.\textsuperscript{179} No indebtedness is to be "contracted for longer than the period of probable usefulness of the object or purpose for which such indebtedness is to be contracted."\textsuperscript{180} The city is prohibited from lending its credit, making gifts of public property, or investing in private business.\textsuperscript{181} Combined real estate taxes for New York City and the counties therein are currently limited to two and one-half percent; prior to 1985, the limit was two percent.\textsuperscript{182} Indebtedness incurred for making water and sewer,\textsuperscript{183} commuter railroad,\textsuperscript{184} and hospital improvements,\textsuperscript{185} however, is not treated as part of the general debt limitation; the tax limitation does not apply to taxes levied for the payment of debt service.\textsuperscript{186} The provision limiting bonds to the probable life of the improvement or project also provides that a legislative finding as to the probable life is conclusive.\textsuperscript{187} Furthermore, the legislature allowed New York City to issue bonds to

\textsuperscript{174} Id. § 118.15(A).
\textsuperscript{175} Id. § 118.01(K).
\textsuperscript{177} Gelfand, supra note 18 at 545.
\textsuperscript{178} N.Y. Const. art. VIII, § 2.
\textsuperscript{179} Id. art. VIII, § 4(C).
\textsuperscript{180} Id. art. VIII, § 2.
\textsuperscript{181} Id. art. VIII, § 1.
\textsuperscript{182} Id. art. VIII, § 10 (1938, amended 1949, 1985).
\textsuperscript{183} Id. art. VIII, § 2-a (1953, amended 1955).
\textsuperscript{184} Id. art. VIII, § 7(B) and (D) (1938, amended 1949, 1951, 1953).
\textsuperscript{185} Id. art. VIII, § 7(C) (1938, amended 1949, 1951, 1953).
\textsuperscript{186} Id. art. VIII, § 11 (1938, amended 1949, 1951).
\textsuperscript{187} Id. art. VIII, § 2 (1938, amended 1949, 1953, 1985).
fund pension obligations.\textsuperscript{188} The city also engaged in extensive shifting of current expenses to its capital budget by determining that items such as job training programs, park maintenance, and salaries for employees of the City Planning Commission were capital in nature.\textsuperscript{189}

Most likely a means which would have required the city to establish and follow proper accounting procedures would have disclosed the true state of its financial health prior to what eventually developed. Timely financial reporting which accurately reflected the ever increasing short-term borrowing and that disclosed the characterization of significant amounts of current expenses as capital expenses might have provided an early warning of the looming fiscal crisis. One must assume that the true facts were not widely known, as the two principal rating agencies awarded investment grade ratings to New York City debt until the defaults occurred.\textsuperscript{190} Again, an early warning system is indicated as the necessary cure, implemented by the adoption of meaningful accounting and financial reporting requirements. This is not to suggest that the lack of accurate financial reporting caused the crisis, or, conversely, that its presence would avert any future crisis. New York City is in a category by itself, with enormous financial requirements both imposed and undertaken by it.\textsuperscript{191} The numerous provisions of New York law applicable only to New York City make a thorough analysis of what was undesirable, under-enforced, abused, ignored, or completely missing beyond the scope of this article. Suffice it to say that the absence of a workable all-inclusive debt limitation and the lack of uniform accounting standards enforced by a requirement for timely financial reporting were significant factors in the creation of the fiscal crisis.\textsuperscript{192}

II. A PROPOSAL FOR A BALANCED APPROACH TO ACHIEVING FISCAL RESPONSIBILITY

Ideally, a carefully crafted constitutional and statutory construct could allow the public to be fully aware of the fiscal state of its various governmental entities so that it can exercise meaningful control over the financial burdens placed on it and future generations by those governments. However, this construct should also permit the governmental entity to make its fiscal decisions and policy decisions without being unduly restricted in its options. When a representative body has decided that it is desirable to fund a program or make capital improvements, it should be free to elect what it considers the most appropriate and efficient means of financing the cost. At the same time, the residents have a legiti-

\textsuperscript{188} See Gelfand, supra note 18, at 573.

\textsuperscript{189} Id. at 573 n.150.

\textsuperscript{190} Moody's Investors Service rated the city's short term notes MIG-1 (its highest rating) for a sale in May, 1975. N.Y. Times, May 17, 1975, at 1, col. 2. Standard & Poor's rated the city's bonds "A" until it suspended the rating on April 2, 1975. Id., Apr. 3, 1975, at 1, col. 1.

\textsuperscript{191} See Gelfand, supra note 18, at 556-57.

\textsuperscript{192} Id. at 574.
mate interest in controlling the overall cost of government without having to remain constantly on the alert. The following suggestions are proposals which represent the minimum elements necessary to achieve fiscal responsibility while meeting these express goals.

A. The Proposal

1. Debt limitations for a state should be established by the state's constitution by stating a maximum dollar amount of indebtedness to be incurred for financing enumerated projects or programs. Debt limitations should be mandated by the state's constitution for all political subdivisions (and all other issuers of obligations on behalf of political subdivisions) of the state, but the actual limitation should be established by the state legislature.

State debt limitations should be imposed by the state's constitution and should be expressed as a maximum dollar amount of indebtedness that can be incurred. The constitutional provision should also establish what projects or programs can be financed by the issuance of the authorized debt. Assuming that any constitutional amendment requires approval by the state's electorate, limitations imposed in this manner allow the electorate to serve as a meaningful check on the intergenerational transfer of the cost of government. If voter approval is not required for amendments to the state's constitution, the requirement should be imposed for the adoption of amendments authorizing additional indebtedness. This type of debt limitation restricts the ability of the legislature to take the easy way out: provision of a service or improvement without making those enjoying the benefit pay for it. Regardless of the type of restriction, the process itself need not be cumbersome. The legislature should develop long-term plans and determine what borrowing it considers appropriate for implementation of the plan. This process not only eliminates the need of constant amendments to increase the debt limit, but procures the added benefit of forcing the legislature to look beyond the short term. The voters should enjoy this limited control over the imposition of a financial burden on state residents. A total absence of limitations eliminates a vital check on legislative action. Conversely, requiring voter approval of every specific project or program effectively eliminates the representational form of government by removing all discretion from the elected representatives. The proposed debt limitation for a state avoids both of these undesirable results.

On the other hand, the same approach is not required to achieve a check on the irresponsible intergenerational transfer of costs by political subdivisions. Requiring that an overall limit be established by the legislature assures that the check exists. No additional purpose is served or benefit gained by requiring amendment of the state constitution or a city charter when it is determined that, with respect to any particular class of political subdivision, an increase in the debt limitation is justified.

A legislative determination of necessity and statutory amendment of the debt limitation serves the same external check function that an elec-
tion serves. Although this approach allows the state to determine the maximum indebtedness that any political subdivision, including a home rule city, may incur, state dominance in this area is justified by legitimate state interests. As set forth in this proposal, debt limitations must be all-inclusive—that is, they must include all future obligations and must focus on the total indebtedness of overlapping political subdivisions. The absence of state dominance in establishing maximum debt levels makes coordination among overlapping political subdivisions difficult, if not impossible, to achieve. The state should consider not only the relative needs of each subdivision for borrowing, but also should focus on the total debt burden placed on the residents of the state by that borrowing. The available total debt ceiling must be allocated accordingly. Allowing a political subdivision to set its own maximum debt limitation would prevent the state from achieving an equitable distribution of the available total debt limitation among competing political subdivisions.

Moreover, a fiscal crisis in one political subdivision may have an effect on residents of other parts of the state. A local default or crisis may require the expenditure of state resources to maintain a minimum level of services in the defaulting political subdivision; it may also cause increased borrowing costs for other political subdivisions in the state if the financial markets view them as similarly situated.

For these reasons, the state should have the ability to establish maximum debt limitations for political subdivisions. It is equally important to consider what the state is not doing when it establishes the maximum debt limitation for political subdivisions. The legislature is not telling the local government that it must borrow. It is also not making policy decisions as to which projects or programs should be implemented and financed by borrowing. These decisions are appropriately left to the local legislative body and local electorate. Any limitation on local self-determination resulting from state legislative establishment of debt limitations for political subdivisions is minimal and is justified by compelling state interests.

Debt limits, to be meaningful, should be all-inclusive. All future obligations, with the exception of limited short-term borrowings, should be subject to the debt limitation. The definition should be expansive enough to include multi-year employment contracts and the actuarial value of accrued but unfunded retirement benefits. All direct obligations of the political subdivision, together with all obligations issued by authorities, agencies or other "on behalf of" issuers on behalf of a political subdivision should be included as debt of that political subdivision. This does not mean that authorities and other types of "on behalf of" issuers should not be used. Their use can be an effective and appropriate means to protect a local government’s revenues and operations from liability flowing from a particular project or to establish a separate governing entity for a desired project. But the total future obligations of such issuers must be included in calculations of the political subdivision’s debt.

The traditional approach of basing debt limitations on a percentage of the tax base is unworkable if all continuing obligations are included in
the limitation. The tax base is too narrow a measure of the total resources available for repayment of future obligations. All probable sources of revenue available to the issuer should be included in the calculation of the appropriate limit. For a limit to work, it will be necessary that (1) the functions and services provided by the particular level of government be considered and (2) permissible debt levels be adjusted if a function or service is transferred to a different political subdivision. This mechanism, coupled with the requirement that the debt of all “on behalf of” issuers be attributed to the political subdivision, will have the effect of causing the total future obligations to be considered as a part of the debt burden a resident feels from all sources of local and regional government. Additionally, it will inhibit manipulation of the debt limit that is caused by transferring functions among entities or creating new entities to finance the transferred function.

Logically, some types of future obligations can be excluded from the debt limitation. Short-term borrowings that are used to match revenue flow to expenditures should be excluded from the calculation of outstanding indebtedness. But the amount of tax anticipation notes that may be issued should be limited to an amount that can be expected to be collected based on historical collection percentages. Revenue anticipation notes should be limited to a percentage of the total revenues that the chief financial officer of the political subdivision certifies are reasonably anticipated in the then current fiscal period. Anticipated funds should be required to be separately accounted for and used to retire the short-term borrowings as collected. Short-term borrowings should be repayable solely from identified current year revenues being anticipated. If the identified revenues are not collected by the maturity date of the obligation, any extension of the due date or refinancing of the obligation should be repayable only from the same anticipated revenues. In addition to preventing the accumulation of what constitutes, for all practical purposes, long-term debt, these limitations have a desirable side effect. Market forces should help control abusive short term borrowing when a lender knows that it can only be repaid from the designated anticipated revenues.

Revenue bonds present a more difficult problem in determining whether it is either appropriate or desirable to include them in the debt limitation. Revenue bonds are obviously a future obligation and as such should be included in the debt limitation. The problem in doing so becomes apparent when attempting to define the debt limitation so that it reflects the revenues anticipated from the operation of the project financed with the proceeds of the bonds. The net revenues of the project, usually considered to be the gross revenues less the costs of operation and maintenance, are a new source of revenue available to the borrower to repay all future obligations. As such, net revenues should increase the total indebtedness that the issuer of the revenue bonds is allowed to incur. The debt limitation is otherwise unduly restrictive. Thus, the political subdivision should have the option of adjusting its debt limitation by the inclusion of a portion of the anticipated net revenues in the total amount of indebtedness that it may incur. That portion should equal the
present value of the reasonably anticipated net revenues as established in a feasibility study for the project prepared by a qualified independent analyst. The discount factor used to determine the present value of the net revenues should be one that results in a determination of the total principal amount of bonds on which all principal and interest could be paid from the anticipated net revenues. The use of this formula is applicable whether or not the bonds are actually issued as revenue bonds. This approach allows revenue bonds to be subject to the debt limitation, thereby closing what has been a significant hole in debt limitation clauses without distorting the measure of an issuer's repayment capacity.

This formula reclassifies certain future obligations that are currently treated as not creating debt, as debt within the ambit of the limitation. Principally, revenue bonds, long term leases, multi-year service contracts, and nonappropriation lease purchase financings would be considered debt for the purpose of the limitation. As these forms of borrowing or contract create future obligations, they represent an intergenerational transfer of the cost of a benefit; thus, inclusion is proper. However, inclusion as debt does not suggest that a referendum is always appropriate prior to issuance of the obligation. In fact, being a "debt" has little to do with whether an approving referendum is appropriate. The current approach of treating revenue bonds as though they are not debt does not support a determination that voter approval is unnecessary. The residents will normally be paying the charges that generate the revenues pledged for repayment of the bonds. Moreover, those revenues would otherwise be available to fund other expenditures of the issuer if not pledged to repayment of the bonds. Voter approval in this circumstance is no less valid than requiring voter approval prior to the issuance of general obligation bonds. The debt limitation should allow political subdivisions to incur a certain level of indebtedness without voter approval. Indebtedness submitted to and approved by the voters would only count against the total debt ceiling, not against the lower level that could be issued without voter approval. This allows the legislative body to choose the form of financing it considers the most appropriate, while still maintaining a check on the total burden imposed on the residents of the political subdivision.

Summarizing, debt limits serve a very real purpose. If there is no expressed limit, there are no reasons other than market forces and politi-

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193. To illustrate this point, assume that City X is permitted at any one time to have total indebtedness of $100,000,000, but no more than $20,000,000 of debt may be outstanding at any one time that was incurred without voter approval. Assume City X issues $50,000,000 Street Improvement Bonds after obtaining voter approval for the issue. City X may still incur debt up to $20,000,000 without voter approval. Assume that while the entire $50,000,000 of Street Improvement Bonds is outstanding, City X incurs $20,000,000 of debt without voter approval by entering into a five year contract with its employees calling for total expenditures of $5,000,000 per annum in years two through five. To incur any additional indebtedness (up to $30,000,000), City X will need voter approval. But, after the third year of the contract term, assuming that it incurred no additional debt without voter approval and that its total indebtedness is $80,000,000 or less, City X may incur an additional $10,000,000 in debt without voter approval.
cal considerations to allocate borrowing among funding priorities, thereby leaving the ability to impose fiscal burdens on future generations open to abuse. There must be an incentive to consider the total burden on state residents without tying the hands of those elected to make decisions. By allowing the incurrence of some level of debt without voter approval and requiring voter approval for debt over that amount, but always subject to the state imposed debt limitation, a workable balance is achieved among the interests of the state, the goal of local self-determination, the ability of the legislative body to perform its representational functions, and the legitimate desire of the electorate to influence the imposition of future burdens represented by indebtedness. The proposal for state debt limitations achieves the same balance, allowing the legislative body to perform its representational functions while allowing the electorate to influence the imposition of future financial obligations.

2. The public purpose doctrine serves a legitimate function; therefore, the approach taken by the courts is appropriate.

The requirement that taxes be levied, obligations incurred, and expenditures made only for public purposes not only makes good common sense, but also serves as a final check on actions of the legislative body to ensure that it is acting in the interests of the community as a whole. Policy makers should not be restricted to what has been done historically. Thus, the courts' deferential approach in analyzing public purpose is logical. As long as the concept is part of the jurisprudence of a state, it does not matter whether it is specifically required in the state constitution or required as a matter of judicial interpretation.

3. Balanced budget requirements are essential.

For fiscal reporting, accounting standards, and fiscal monitoring to be effective in informing the electorate of the government's fiscal status, a balanced or surplus budget can make the information more understandable. With the all-inclusive debt limitations suggested, balanced budgets are necessary for the debt limitation to work properly.

4. Provisions prohibiting the lending of credit by the state and its political subdivisions, as well as the prohibition of gifts of public property and investment in private enterprise, should be employed but narrowly construed.

The norm today does not include government joining with private enterprise to own and operate businesses. While this scenario will not necessarily always be the case, any change in the role of government in this area is not one to be pursued without thoughtful study and review. If the legislative body should decide to change course, it is a matter of

194. For a discussion of the courts' approach, see the text accompanying supra notes 73-76.
enough significance to require residents' approval by means of an author-
izing amendment to the state constitution. At the same time, each of
these doctrines serves a specific function and should be interpreted and
applied accordingly. Courts should not view these clauses as a charter to
look for analogous situations to strike down; the clauses have a purpose
and should be used solely to achieve that purpose.

5. Accounting standards and annual financial reporting should be
required.

The inability of the financial markets, the media, and the electorate
to assess accurately the financial condition of both Cleveland and New
York City contributed to the defaults by these municipalities.\textsuperscript{196} Accounting
standards that treat all similar political subdivisions in the state uni-
formly should be developed and their use required. The enormous growth
in financings such as nonappropriation lease purchase agreements that
are not accrued as debt but have future obligations must be addressed in
order to accurately reflect what lies ahead.

Use of uniform standards, however, will not solve the problem in its
entirety. A system that mandates annual reporting based on those stan-
dards is essential. Reporting serves two crucial purposes. It serves as a
check to make sure that the laws regarding public expenditures and oblig-
ations are being observed and that the accounting standards are being
followed. Equally as important, reporting requirements subject the infor-
mation to public scrutiny.

In order to implement a system that works, the appropriate state
agency should be charged with responsibility for developing rules regard-
ing accounting standards. The same state agency should be charged with
receiving and reviewing annual financial reports from the state and all
political subdivisions and reporting any noncompliance. Sanctions should
also exist for any failure to file or to correct any deficiencies noted by the
agency.\textsuperscript{196}

\textsuperscript{195} For a discussion of problems assessing their financial condition, see supra notes
157-58, 190-92 and accompanying text.

\textsuperscript{196} The model adopted by the State of Ohio has much to commend it. All of the
ingredients suggested above are included. See supra notes 112, 157-58 and accompanying
text. While it is not essential that a single state agency have authority over all political
subdivisions, it is a desirable arrangement due to the importance of applying a uniform
standard. Where a partial system already exists, the right to approve any regulations
adopted by the existing oversight agency could be given to the state agency charged with
overall responsibility. For instance, in Texas, certain special purpose districts are required
to have annual certified financial statements prepared and filed with the Texas Water Com-
mission and the county in which the district is located. \textsuperscript{Tex. Water Code Ann. \textsection{50.374
(Vernon 1988 & Supp. 1991). The Texas Water Commission is directed to adopt regulations
prescribing the audit standards that must be observed. Id. \textsection{50.372 (Vernon 1989). Its regu-
lations should be made subject to the approval of a state agency created to have overall
jurisdiction over audit standards for the state and all political subdivisions.\textsuperscript{196}}
6. Effective sunshine laws should be required for the state and all political subdivisions.

One of the most powerful and effective protections against unwise government spending is provided by the knowledge of the residents. The electorate should be fully informed of not only what has been done, but also of what proposals are being considered. 197 In the current era of intensive press and media coverage of government activity, making the information available may result in its being disseminated to the public. By focusing on the purpose of government in the sunshine, it is not difficult to draft a statute with the necessary elements. Effective and timely notice of actions planned must be made available; 198 care must be taken to avoid legal subterfuges that make it possible to avoid the requirements of the statute; 199 no political subdivision, agency, or authority should be exempt from the requirements. 200

7. Taxpayer suits should be established by legislation and should be liberally permitted.

If the information on what is being planned is made available by means of open meeting laws, and information on what has been done is made available by published annual financial statements, the electorate should be allowed to use the information for purposes distinct from the mere decision of appropriate voting. A resident of a state or political subdivision has legitimate interests to protect; after all, it is the citizens' funds that are being spent. No requirement of a special interest should be imposed on a taxpayer suit. The suit's purpose is to protect the public fisc; it should be considered derivative in nature. Legislation should unequivocally provide the right to the process and the necessary procedures for implementation.

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197. For further discussion of sunshine laws, see Recchie & Chernoski, Government in the Sunshine: Open Meeting Legislation in Ohio, 37 Ohio St. L.J. 497 (1976).
198. For statutory examples, see supra notes 113-14 and accompanying text.
199. Emergency meetings must be limited to the stated emergency issue; the determination of an emergency should be subject to after-the-fact judicial review; and provision of notice to the news media of the intent to call an emergency session should be required. For a further discussion of these requirements, see supra notes 113-14. Penalties for those persons meeting or conspiring to meet in violation of the notice requirements should be included. Actions taken in violation of the statute should be voidable, with a heavy burden on the party seeking to sustain the validity of the action.
200. In states like Ohio, where the home rule provisions have been deemed to prevent the state from adopting sunshine laws that apply to charter cities, the constitution should be amended to overcome this obstacle. The reasoning applicable to this argument is the same as the reasoning advanced for allowing the state legislature to set debt limitations for home rule cities. The interest of the state is sufficient to warrant overriding the judicial interpretation that this is a local matter; little damage is done to local autonomy.
8. A fiscal monitoring agency should be created to serve as a continuing check on compliance and creativity.

If the state or local government truly wants to fund a service or make a capital expenditure, it will be creative, if necessary, and thus achieve its goals within the confines of constitutional limitations. Nothing is inherently wrong in its doing so; but it must be known that it is being done so that the effect of the new approach can be weighed against the structure that has been imposed to maintain fiscal integrity and responsibility. To monitor continually the creativeness of underwriters, bond counsel, and fiscal officers, all agreements that include any obligation, even a contingent obligation, or right to make a payment in a future fiscal period, should be filed with the designated state agency. This would not be a prerequisite to entering into the agreement; the state review agency should not have approval rights. Approval of an agreement is properly left to the political subdivision that will be subject to the terms of the agreement. If the state review agency questions the validity of the agreement, it should refer the matter to the appropriate official for review. Primarily, though, the review agency's charge should be to monitor the agreements so as to be aware of any mechanisms that are employed to avoid, evade, or otherwise creatively comply with the constitutional and statutory scheme. The review agency should publish annual reports in order to highlight potential problems. This information would thereby be available to the state legislature for its use in considering necessary constitutional or statutory changes.

9. Courts should consider the entire structure when interpreting any component thereof.

This is essentially a matter of sound constitutional and statutory construction. Particularly in those parts of the structure relating to tax and expenditures limitations and controls on indebtedness, awareness of the existence and purpose of other parts of the framework can prevent skewing of the part under consideration. The intended balance is lost if one part is misapplied or otherwise subsumed in another. By way of example, it is conceivable that a state legislature could decide in good faith that the state should bail out a failing industry by guaranteeing loans to it because of the disastrous economic consequences to the state's residents if the industry failed. The public purpose is apparent; the means of achieving that purpose is an entirely separate question requiring separate analysis. But if a court analyzes lending-of-credit prohibitions as a question of public purpose, that separate analysis is never made; the lending-of-credit prohibition is thus made redundant.

201. Roberts v. McNary, 636 S.W.2d 332, 335 (Mo. 1982) (primary objective of the provision under scrutiny must be viewed in harmony with all related provisions and considered as a whole); see generally J. Singer, Statutes and Statutory Construction, § 51.01 (4th ed. 1984).
B. Should TELs be a Part of the Structure?

The proposed nine-part plan for fiscal responsibility has what is, at least for this era, a prominent omission. TELs are not included as an essential ingredient for fiscal integrity by state and local governments. The extremely restrictive modern tax limitation provisions such as Proposition 13 and expenditure restrictions such as the Hancock Amendment\textsuperscript{202} are likely to have a decidedly counterproductive effect. Much of the development of undisclosed and abusive financing and accounting was spurred by restrictive debt limitations and the requirement of balanced budgets. A government that has been denied all flexibility, but that has concluded that certain expenditures must be made, will find a way to do it. To deny it the right to adopt an approach that not only achieves the purpose, but achieves it in the most fiscally efficient manner, is not logical. Rather than controlling expenditures, the TELs may have only made the expenditure more costly and distorted the use and amount of other taxes, licenses, or user fees. On the other hand, if the expenditure limitation is so tight that the legislative body is essentially no longer able to govern because all decisions effectively require voter approval, why bother with the legislative branch? The executive branch can develop proposed programs and budgets and the electorate can act as one super-legislature and vote on them. While this is obviously an overstatement of the effect of TELs, it demonstrates the problem.

This is not to say that the electorate should not have a method of expressing its view that government should be financed by a different method (the true effect of tax rate or assessed valuation limitations) or that the growth of the cost of government should be contained (a legitimate goal of expenditure controls). Useful TELs can be structured if the legitimate goals of TELs and the possible counterproductive effect of TELs are considered. Provision for notice of proposed total budgets with a statement of the percentage increase over the current fiscal period, publication and hearing requirements prior to adoption of tax rates, and allowance for rollback of taxes in the next fiscal year if the increase exceeds a stated percentage would allow the legislative function to be carried out while keeping the electorate informed. These practices allow the electorate to respond if it does not approve of the legislative policy choices between services and total cost of government.\textsuperscript{203}

C. Two States to Watch

The value of the proposals made can only be proven by implementation and the subsequent passage of time. No laboratory experiments or computer models exist to test the efficacy of the nine-part proposal. In the absence of such tests, we must look to the real world for situations

\textsuperscript{202} For a discussion of the Hancock Amendments, see \textit{infra} notes 232-41 and accompanying text.

\textsuperscript{203} For a discussion of the important role the electorate plays in Texas, see \textit{infra} text accompanying notes 267-70.
that provide an opportunity for observation. We have already seen several components that were missing in the Ohio and New York laws and analyzed the probable effect of the absence. States that have historically had and currently appear to have adequate revenues do not present the tensions necessary to test fiscal responsibility. Similarly, historically poor states are also not appropriate specimens. However, states which have existing economic tensions, whether historic or of recent vintage, which have many parts of the nine part proposal and which have adopted modern TELs of differing degrees of restrictiveness offer the best opportunity to evaluate the proposal in the near future. Texas and Missouri should be interesting states to watch for this purpose. Given the current economic conditions in Texas and the resulting budget problems, the fiscal responsibility controls in that state are and will continue to be tested until the state's economy rebounds from its current ills. Missouri, on the other hand, has one of the most restrictive TELs and general limitations on indebtedness of any state. For these reasons, it is worthwhile to be familiar with the existing structure in each state so that as events unfold, a basis for measuring the efficacy of the proposed structure for obtaining fiscal responsibility and the predictions regarding the effect of too stringent TELs will exist. Evidence of a marked decline in services, distortion of revenue measures from their useful purpose as a means of increasing total revenue, and creative compliance with, abuse of, or outright disregard for measures relating to fiscal responsibility should be reviewed to determine if they were caused by the absence or presence of any part of the proposal or of modern TELs.

1. Missouri

The citizens of Missouri appear to have not only the benefit of most parts of the structure proposed for fiscal responsibility, but also one of the tightest controls on the growth of governmental expenditures. The Missouri Constitution provides that taxation must be for a public purpose and the courts have adopted a standard of review that grants considerable deference to a legislative determination on that question. The state may incur indebtedness not to exceed $1,000,000 for funding casual deficiencies or emergency requirements; this debt must be repaid within

204. The rapid decline in oil prices has caused a similarly rapid reversal of the Texas state government's fiscal health. In the late 1970's the state treasury enjoyed a $3,000,000,000 surplus; in the mid-1980's Texas was trying to cope with an estimated $3,500,000,000 deficit. See Texas Wages War on the Future, Economist, Aug. 16, 1986, at 15. The magnitude of the problem is demonstrated by an action approved by the Texas Legislature in late 1986. To ease the state's cash flow problem, the state held the December 1986 paychecks of 190,000 state employees until January 5, 1987, with the result that more than 2,000 state employees applied for food stamps. N.Y. Times, Dec. 16, 1986, at A22, col. 3.

205. Mo. Const. art. X, § 3.

five years.\textsuperscript{207} All other state indebtedness requires voter approval.\textsuperscript{208} This stringency has resulted in the voters approving a series of constitutional amendments authorizing bonds for specific purposes.\textsuperscript{209} Local indebtedness, whether in the form of tax-supported bonds,\textsuperscript{210} revenue bonds,\textsuperscript{211} or industrial revenue bonds,\textsuperscript{212} requires voter approval. Tax-supported bonds require either a four-sevenths or two-thirds voter approval depending on the type of election in which the voters approve the proposition.\textsuperscript{213} Revenue bonds require a simple majority voter approval,\textsuperscript{214} as do bonds for industrial development in some instances.\textsuperscript{216} Revenue bonds are not subject to the debt limitation provisions.\textsuperscript{216} Political subdivisions are limited to a total tax-supported indebtedness not to exceed twenty percent of the assessed value of tangible taxable property.\textsuperscript{217} There is a general ten percent limit\textsuperscript{218} with an additional ten percent for street and sewer improvements\textsuperscript{219} and another ten percent for waterworks and light plants and distribution;\textsuperscript{220} however, all are subject to the overall twenty percent maximum.\textsuperscript{221} Voters, however, eased this limitation slightly in 1990 by adopting a constitutional amendment which authorizes the legislature to enact statutes allowing cities and counties, with voter approval, to create neighborhood improvement districts.\textsuperscript{222} Total indebtedness for all improvement districts within a city or county is limited to ten percent of assessed taxable tangible property within the city or county.\textsuperscript{222} While this amendment does allow cities and counties greater flexibility in structuring borrowing, in general, the choices are limited. The Missouri courts have been strict in striking down efforts to avoid debt limitations by examining the substance of the transaction and checking to see if the agreement to pay would necessarily have the effect of making it necessary to

\begin{itemize}
\item \textsuperscript{207} Mo. Const. art. III, § 37.
\item \textsuperscript{208} Id.
\item \textsuperscript{209} See id. art. III, § 37(a) (authorizing issuance of $75,000,000 of bonds for state buildings); Id. art. III, § 37(b) (authorizing issuance of $150,000,000 of bonds for control of water pollution); Id. art. III, § 37(c) (authorizing issuance of $200,000,000 of additional bonds for control of water pollution); Id. art. III, § 37(d) (authorizing issuance of $600,000,000 of bonds for improvements of state buildings and property, including state parks); Id. art III, § 37(e) (authorizing issuance of $275,000,000 of bonds for water pollution control and improvements to drinking water systems).
\item \textsuperscript{210} Id. art. VI, §§ 26(a), (b).
\item \textsuperscript{211} Id. art. VI, §§ 27, 27(a).
\item \textsuperscript{212} Id. art. VI, § 27(b).
\item \textsuperscript{213} Id. art. VI, §§ 26(b)-26(a).
\item \textsuperscript{214} Id. art. VI, §§ 27, 27(a).
\item \textsuperscript{215} Id. art. VI, § 27.
\item \textsuperscript{216} Bell v. City of Fayette, 325 Mo. 75, 87, 28 S.W.2d 356, 360 (1930); State ex rel. Smith v. Mayor of Neosho, 203 Mo. 40, 101 S.W. 99 (1907).
\item \textsuperscript{217} Mo. Const. art. VI, §§ 26(b)-(e).
\item \textsuperscript{218} Id. art. VI, §§ 26(b), (c).
\item \textsuperscript{219} Id. art. VI, § 26(d).
\item \textsuperscript{220} Id. art. VI, § 26(e).
\item \textsuperscript{221} Id.
\item \textsuperscript{222} Id. art. III, § 38(c).
\item \textsuperscript{223} Id.
use tax funds to replace the funds spent.\textsuperscript{224}

The state may not lend its credit or make grants or gifts of public funds or property except for defined welfare expenditures.\textsuperscript{225} Political subdivisions of the state are prohibited from lending their credit, making grants of public property or funds, and investing in private businesses.\textsuperscript{226} To the extent required by law, all political subdivisions are required to have an annual budget, file annual reports of financial transactions, and have audits performed.\textsuperscript{227} The sunshine law applies to the state, its agencies, and its political subdivisions.\textsuperscript{228} The law generally meets the standards suggested above for an effective open meetings act.\textsuperscript{229} While taxpayer suits are recognized in Missouri, generally the taxpayer must show a pecuniary interest, which may be shown by the increased taxation necessary to remedy any misappropriation of funds.\textsuperscript{230} The interest need not be unique to the individual taxpayer (i.e. it does not have to be a tax for which only he will be liable).\textsuperscript{231}

The rights and limitations described thus far are more restrictive than found in some states and are in line with the structure proposed for fiscal responsibility. The citizens of Missouri, however, have added an additional weapon to their arsenal for controlling the growth of government.

\textsuperscript{224} Hight v. City of Harrisonville, 328 Mo. 549, 41 S.W.2d 155 (1931); State \textit{ex rel.} Dexter v. Gordon, 251 Mo. 303, 158 S.W. 683 (1913). The court, however, has upheld nonappropriation financing as not creating constitutionally controlled debt. St. Charles City-County Library Dist. \textit{v.} St. Charles Library Bldg. Corp., 627 S.W.2d 64 (Mo. Ct. App. 1981). This type of multi-year financing has been employed by cities and counties in the state without voter approval to finance such projects as street light improvements and construction of jails. Official Statement dated Dec. 17, 1985, for $4,110,000 Certificates of Participation Evidencing Proportionate Interests of the Owners Thereof in the Lease-Purchase Agreement with the City of St. Louis (available from the author); Official Statement dated June 30, 1986, for $2,420,000 Certificates of Participation Evidencing Interests of the Owners Thereof in Payments to be Made by the City of Arnold as Lease Payments for Certain Property Pursuant to a Master Lease Purchase Agreement and Schedule No. 1 Thereof (available from the author).

\textsuperscript{225} Mo. CONST. art. MI, §§ 38(a), 39. See also id. art. III, §§ 39(1), 39(2), 39(3).

\textsuperscript{226} \textit{Id.} art. VI, §§ 23, 25.

\textsuperscript{227} \textit{Id.} art. VI, § 24.

\textsuperscript{228} Mo. ANN. STAT. § 610.010 (Vernon 1988).

\textsuperscript{229} \textit{Id.} Unless it is not practical, 24 hours notice of all meetings must be given. If it is not practical, the reason must be stated. Notice of the meeting must be posted on the entity's official bulletin board, and, if requested, provided to the news media. While meetings may be closed for some topics, it requires a vote in open session to close the meeting. The statute provides for a civil fine for purposeful violation of the open meeting provisions, and a party bringing suit to challenge a meeting may be awarded attorneys fees. Actions taken at a meeting held in violation of the statute are voidable by the court if the public policy of requiring open meetings outweighs the public interest in sustaining the action taken in violation. \textit{Id.} §§ 610.010 (definition of open meeting and to which entities it applies), .020 (requirements for open meeting notice), .022 (requirements for holding valid closed meeting), .027 (remedies for invalid closed meeting) (Vernon 1988 & Supp. 1991). \textit{See also id.} §§ 610.015 (procedure for open meeting voting), .021 (valid topic for closed meeting), .028 (defense for closed meeting violation), .030 (injunctive relief available) (Vernon 1988).

\textsuperscript{230} Everett v. County of Clinton, 282 S.W.2d 30, 35 (Mo. 1955).

\textsuperscript{231} \textit{Id.} See Comment, \textit{Taxpayer Standing in Missouri Courts: Alleging the Necessary Elements}, 44 Mo. L. REV. 746 (1979).
In 1980, the voters approved a series of constitutional amendments commonly known as the Hancock Amendments, a true TEL as it provides both tax and expenditure limitations.

Under these amendments, the total state revenues cannot exceed a base year amount which is adjusted according to changes in the total personal income of state residents. State revenues include taxes and general and special revenues, such as licenses and fees. Taxes must be adjusted so that total state revenues will not exceed the allowable amount; any surplus of revenues in excess of one percent must be refunded to the taxpayers. The state may exceed this revenue limitation only upon the governor's certification that an emergency exists, an indication of the dollar amount necessary to meet the emergency, and an approval of the funding by a two-thirds vote of the legislature. Total state expenditures for the fiscal year may not exceed the total of the allowable state revenues, federal funds received, and any surplus from the previous year that was not required to be refunded.

In order to prevent the state from shifting the burden to its political subdivisions, the state may not reduce the existing level of state funding to the political subdivisions. Also, the state may not require new or expanded activities and programs by the political subdivisions without providing the necessary funding out of state funds. Political subdivisions cannot increase taxes, licenses or fees without a favorable majority vote at a referendum on the question. To date, the Missouri Supreme Court has taken an expansive view of this limitation. Finally, the total amount raised from property taxes by a political subdivision cannot increase at a rate greater than any increase in the consumer price index for all urban consumers.

The severity of these limitations make it virtually impossible to expand existing programs or create new ones, even if changing times or conditions manifest a need for such expansion, without first obtaining voter approval. For this reason, Missouri should be monitored in order to determine how its ranking fares as compared to the national norm with regard to expenditures in areas such as welfare, education and health care. The Missouri courts' interpretation of the Hancock Amendments and the

233. Id. art. X, § 17.
234. Id. art. X, § 18.
235. Id. art. X, § 19.
236. Id. art. X, § 20.
237. Id. art. X, § 21.
238. Id.
239. Id. art. X, § 22.
240. See, e.g., Roberts v. McNary, 636 S.W.2d 332 (Mo. 1982). The Missouri Supreme Court refused to interpret a county charter provision, adopted prior to the Hancock Amendment, which granted the city council the right to set all charges, as creating a previously authorized fee; thus, voter approval is required to increase such fees. Id. at 336. Park user fees and building inspection fees were held to be included in the amendment's coverage, thereby requiring voter approval for any increases. Id. at 337.
components of the proposal for fiscal responsibility must be analyzed to
determine if the courts are undermining either the TEL or any parts of
the proposal.

2. Texas

In many respects, Texas constitutional provisions parallel those of
Missouri. For instance, in Texas the state may not issue debt other than
in the amount of $200,000 to cover casual deficiencies in revenue or items
as authorized by constitutional amendment.\textsuperscript{242} Also, there can be no loan
or pledge of the state's credit,\textsuperscript{243} no grants of public money or property,\textsuperscript{244}
and no payments post factum.\textsuperscript{245} The state must operate on a balanced
budget unless approved by a four-fifths vote of the legislature.\textsuperscript{246} There
can be no diversion of special funds to another purpose, nor can the state
borrow from its special funds.\textsuperscript{247} All taxes must be levied and spent for a
public purpose.\textsuperscript{248}

Political subdivisions are similarly prohibited from making grants of
public property or funds,\textsuperscript{249} or lending their credit,\textsuperscript{250} making post facto
payments,\textsuperscript{251} investing in private businesses,\textsuperscript{252} or operating on a deficit
basis.\textsuperscript{253} There is not a uniform debt limitation that applies to all political
subdivisions. Cities and counties are required to create a sinking fund for
general obligation indebtedness;\textsuperscript{254} school districts are subject to limitations
in amount imposed by the legislature;\textsuperscript{255} and some special districts
have no limitation whatsoever.\textsuperscript{256} The legislature has imposed a require-
ment of voter approval of debt in some instances where such approval is
not constitutionally required.\textsuperscript{257} Revenue bonds\textsuperscript{258} and bonds issued by
special authorities\textsuperscript{259} do not constitute debt for constitutional purposes.

\textsuperscript{242} TEX. CONST. art. III, § 49.
\textsuperscript{243} Id. art. III, § 50.
\textsuperscript{244} Id. art. III, § 51. The exceptions normally associated with these prohibitions are
provided for in the constitution. See, e.g., id. art. III, § 51-a (welfare); id. art. III, § 50-b (student loans).
\textsuperscript{245} Id. art. III, § 53.
\textsuperscript{246} Id. art. III, § 49-a.
\textsuperscript{247} Id. art. VIII, § 7.
\textsuperscript{248} Id. art. VIII, § 3.
\textsuperscript{249} Id. art. III, § 52 (1876, amended 1886, 1989).
\textsuperscript{250} Id. art. XI, § 3 (1876, amended 1889).
\textsuperscript{251} Id. art. III, § 53.
\textsuperscript{252} Id. art. XI, § 3 (1876, amended 1989).
\textsuperscript{253} Board of Trustees v. Briggs, 486 S.W.2d 829, 833 (Tex. Ct. App. 1972), writ re-
\textsuperscript{254} TEX. CONST. art. XI, § 5.
\textsuperscript{255} Id. art. VII, § 3.
\textsuperscript{256} Id. art. XVI, § 59 (1876, amended 1964, 1973, 1978).
\textsuperscript{257} The constitutional provisions authorizing the issuance of debt by cities does not
require voter approval. Id. art. XI, § 5. By statute, general obligation bonds of a city must
\textsuperscript{258} City of Waco v. McCraw, 127 Tex. 268, 273, 93 S.W.2d 717, 719 (1936).
The validity of many obligations of the state and its political subdivisions must be approved by the State Attorney General prior to issuance.\textsuperscript{260} While this approval scheme does not serve the same function as an oversight agency, it does act as a check on the development of new financing mechanisms. Political subdivisions make extensive use of nonappropriation financings, which have been specifically authorized\textsuperscript{261} and do not create debt subject to the constitutional and statutory provisions.\textsuperscript{262}

The Open Meetings Act applies to the state, its agencies and its political subdivisions\textsuperscript{263} and is a thorough and effective statute.\textsuperscript{264}

While taxpayer suits are entertained by the courts, they are not allowed for the recovery of funds already expended.\textsuperscript{265} To have standing, the taxpayer generally must show some pecuniary interest in the matter.\textsuperscript{266}

The residents of Texas have also taken their turn at adopting a TEL that has several features. The state ad valorem tax has been repealed.\textsuperscript{267} Also, state revenues cannot grow at a pace faster than the growth of the State’s economy; however, it is left to the legislature to give this provision meaning.\textsuperscript{268} The legislature has given this provision a very flexible meaning as it relates solely to rate of growth from taxation. By separate constitutional amendment, tax levies by political subdivisions cannot be increased without publication of a notice and a public hearing.\textsuperscript{269} Tax increases greater than eight percent in any year are subject to an election to roll back the increase in the next fiscal year.\textsuperscript{270} These provisions are not as comprehensive or restrictive as those adopted in Missouri. Particularly on the local level, the provisions serve primarily as a public notice requirement. The ability of both the state and its political subdivisions to make policy decisions without undue restriction from the TEL is much


\textsuperscript{261} Tex. Local Gov’t Code Ann. §§ 271.002-.007 (Vernon 1988).


\textsuperscript{264} For a discussion of the Texas Open Meetings Act, see supra notes 113-14 and accompanying text.


\textsuperscript{267} Tex. Const. art. VIII, § 1-a (1968, amended 1982).

\textsuperscript{268} Id. art. VIII, § 22. The provision simply states that “[i]n no biennium shall the rate of growth of appropriations from state tax revenues not dedicated by this constitution exceed the estimated rate of growth of the state’s economy. The legislature shall provide by general law procedures to implement this subsection.” Id. art. VIII, § 22(a).

\textsuperscript{269} Id. art. VIII, § 21 (1978, amended 1981).

\textsuperscript{270} Tex. Tax Code Ann. §§ 26.06-.08 (Vernon 1982 & Supp. 1991). The implementing legislation is detailed as to required notices and hearings; it further provides for elections to require a roll back in tax increases, with the roll back effective in the next fiscal year for school districts and in the current fiscal year for all other political subdivisions. Tex. Tax Code Ann. §§ 26.04-.08 (Vernon 1982 & Supp. 1991).
greater than in Missouri. It is also a significant difference that in Texas the limitation applies only to tax revenues, and is subject only to an after-the-fact rollback. This is in sharp contrast to Missouri, where all revenue sources are included and increases require prior voter approval.\(^{271}\)

**CONCLUSION**

Two distinct phenomena were occurring during the same period of time from 1975 through the early 1980's. Major municipal defaults highlighted the need for close scrutiny of the financial status of state and local governments and led to the consideration of a means of assuring fiscal integrity and responsibility. At the same time, a taxpayers' revolt was under way, which was not directed so much at fiscal integrity and responsibility as at tax relief for property owners and limitation of the overall growth of government.

Constitutional and statutory controls designed to achieve both fiscal responsibility and rational growth in government can work. The objectives to be served must be accurately determined and each control must be applied to achieve the intended objectives. In the broadest sense, the objective of these controls is to allow representative government to function free of undesirable fiscal constraints while at the same time allowing the electorate to act as a check on the means chosen by the government to achieve its goals. Both parts of this objective are guided by the necessity that state and local government must be fiscally responsible. Services must be provided, improvements made, and programs implemented without subjecting either the current generation or future generations to intolerable or unequitable financial burdens.

A review of the laws in effect in Ohio and New York in the last decade shows that many of the elements which should assure fiscal responsibility were in place. However, the major parts missing were mandated accounting standards and requirements for annual financial reporting that are reviewed for compliance with state laws regarding expenditures and indebtedness. While there are parts of the controls in place that could be made more effective,\(^{272}\) the framework for fiscal integrity and responsibility is largely in place in the four states surveyed.\(^{273}\) These controls have not failed; they have effectively served their purposes to the extent possible when such key elements were missing.

Controls, other than TELs, were never meant to restrain the growth in tax burdens or total governmental revenues and expenditures and thus, they did not fail in that purpose. TELs, if as tightly drafted as the one adopted in Missouri, will probably restrain the growth of state and local government. These TELs are of questionable soundness when viewed in

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271. For a discussion of Missouri's TEL, see supra notes 232-34, 239 and accompanying text.

272. For a discussion of Cleveland's ineffective controls and steps taken to increase their effectiveness, see supra notes 156-61 and accompanying text.

273. For a discussion of the four states surveyed, see supra notes 125-76 (Ohio), 177-92 (New York), 205-41 (Missouri), 242-71 (Texas) and accompanying text.
light of making all major decisions regarding the scope and direction of
government subject to prior voter approval. Also, they have the addi-
tional problem, as do partial TELs such as Proposition 13, of causing ex-
penditure and financing decisions to be made based not on which is the
most appropriate method, but rather on the basis of what can legally be
done in a restrictive environment. This ramification is counter-productive
to fiscal responsibility and integrity, much in the same way as stringent
but incomplete debt limitations have been. If voters feel the need for
more direct control over the growth of either a particular revenue source
or of total expenditures, controls such as those adopted by the State of
Texas should provide the necessary check on unbridled government with-
out suffering the drawbacks of the more restrictive or narrowly focused
TELs.

The nine-part proposal should lead to both fiscal responsibility and
rational growth in government. However, the intended goals must be well
defined and provisions must not be expected to achieve goals which they
were not designed to achieve. To achieve both fiscal responsibility and
rational growth, states should adopt the first eight parts of the proposal
as constitutional and statutory provisions which provide for:

1. the establishment by constitutional provision of state debt limita-
tions which provide that a maximum dollar amount of indebtedness may
be incurred for financing enumerated projects or programs and establish-
ment of all-inclusive debt limitations for political subdivisions by the
state legislature;

2. a requirement that a public purpose exist for all expenditures and
taxes;

3. balanced budgets;

4. prohibitions of the lending of credit, gifts of public property, and
investment in private enterprises;

5. mandated accounting standards and annual financial reporting;

6. effective sunshine laws;

7. taxpayer suits; and

8. creation of a fiscal monitoring agency.

Part nine of the proposal reflects the necessity of judicial interpretation
which considers both the purpose of each of the above components and
the overall structure. This proposal should allow state and local govern-
ments to function as intended while allowing the electorate to exercise
legitimate control in an informed manner.

274. For a discussion of the counterproductive nature of debt limitations, see supra
notes 91-100 and accompanying text.