

2011

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Article

Privatization and the Sale of Tax Revenues

Julie A. Roin[†]

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Complaints regarding the appropriate scope of government action come from both directions. Many complain about the ever-increasing scope of governmental action; other complaints attack the opposite phenomenon: the privatization of formerly government-run activities and operations. Private, profit-making corporations now own and run schools,¹ prisons,² airports,³ toll roads,⁴ and even parking meters.⁵ Advocates contend that the privatization of government functions increases the efficiency of providing, and thereby decreases the cost of de-

1. See Vaughan Byrnes, *Getting a Feel for the Market: The Use of Privatized School Management in Philadelphia*, 115 AM. J. EDUC. 437, 439 (2009), available at <http://journals.uchicago.edu/doi/pdf/10.1086/597486> (describing the decision to hire Edison Schools to run some of Philadelphia's public schools).

2. See William Sabol et al., *Prisoners in 2008*, BUREAU JUST. STAT. BULL., Dec. 2009, at 32, 38 app. tbl.18, available at <http://bjs.ojp.usdoj.gov/content/pub/pdf/p08.pdf> (claiming eight percent of state and federal prisoners held in private correctional facilities in 2008).

3. The privatization of airports "has been a significant worldwide trend" since the 1980s. Richard de Neufville, *Airport Privatization: Issues for the United States*, 1662 TRANSP. RES. REC. 24, 24 (1999), available at <http://trb.metapress.com/content/f27u52582j22787v/>. In the United States, though major commercial airports are technically owned by governmental entities, many have always been "run through a form of partnership between the federal government, local civic interests, and private companies." *Id.* at 27. In 1996, Congress authorized a pilot program under which the FAA may permit up to five airports to be fully privatized. The agency has accepted preliminary privatization applications for four airports, though none has yet finalized an agreement with a private contractor. See *FAA Accepts Preliminary Privatization Application for Georgia GA Airport*, AVIATION NEWS TODAY (May 27, 2010), http://www.aviationnews.net/?do=headline&news_ID=179741.

4. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-44, HIGHWAY PUBLIC-PRIVATE PARTNERSHIPS: MORE RIGOROUS UP-FRONT ANALYSIS COULD BETTER SECURE POTENTIAL BENEFITS AND PROTECT THE PUBLIC INTEREST 15-16 (2008) [hereinafter GAO REPORT], available at <http://www.gao.gov/new.items/d0844.pdf> (listing current and contemplated U.S. public-private highway projects); Celeste Pagano, *Proceed with Caution: Avoiding Hazards in Toll Road Privatizations*, 83 ST. JOHN'S L. REV. 351, 355-56 (2009) ("So far, twenty-three states and Puerto Rico have passed laws to allow for road privatization."). Such partnerships exist in many other nations as well. See GAO REPORT *supra*, at 18 fig.4. These arrangements cover the full gamut of highway infrastructure, from roads to bridges and tunnels.

5. See CITY COUNCIL, CITY OF CHI., JOURNAL OF THE PROCEEDINGS OF THE CITY COUNCIL OF THE CITY OF CHICAGO, ILLINOIS, SPECIAL MEETING (2008) [hereinafter CHICAGO PARKING METER CONCESSION], available at [http://www.chicityclerk.com/journals/2008/dec4_2008/120408_SP.pdf#search=parking meter lease 2008](http://www.chicityclerk.com/journals/2008/dec4_2008/120408_SP.pdf#search=parking%20meter%20lease%202008) (enacting an ordinance that authorizes a contract for sale/lease of Chicago parking meters and reprinting the lease agreement). Other cities are considering similar proposals. See Mick Dumke, *Spreading the Privatization Gospel*, CHI. READER BLOG (Feb. 9, 2010), <http://www.chicagoreader.com/TheBlog/archives/2010/02/09/spreading-the-privatization-gospel> (discussing cities such as Pittsburgh, Los Angeles, and Las Vegas).

livering public goods and services. They argue that between the incentive provided by the profit motive and the absence of legal and political restrictions typically imposed on public enterprises, private entrepreneurs will innovate their way to streamlined operations and more effective management techniques.⁶ Which, if any, of the many privatization arrangements have actually resulted in this desirable state of affairs is a subject of debate.⁷ What is not debatable, although, is that many recent privatization deals have been motivated less by the possibility of achieving efficiency advantages than by politicians' desire to

6. See, e.g., JOHN D. DONAHUE, *THE PRIVATIZATION DECISION: PUBLIC ENDS, PRIVATE MEANS* 217 (1991) ("When it works well, privatization can boost efficiency through accelerated innovation, more appropriate technologies or management styles, or a more sensible scale of operation."); Ellen Dannin, *Red Tape or Accountability: Privatization, Public-ization, and Public Values*, 15 CORNELL J.L. & PUB. POL'Y 111, 113 (2005) ("[T]hose who advocated privatization argued that markets and competition could always be relied upon to provide the highest quality services at the lowest cost."); Michael Schill, *Privatizing Federal Low Income Housing Assistance: The Case of Public Housing*, 75 CORNELL L. REV. 878, 902 (1990) ("Several studies have noted that the absence of market discipline may contribute to the increased cost of public housing."); Dru Stevenson, *Privatization of Welfare Services: Delegation by Commercial Contract*, 45 ARIZ. L. REV. 83, 83–84 (2003) ("Advocates of privatization argue that market forces automatically bring more efficiency to any government undertaking . . .").

7. This is not a debate I am prepared to enter, though it is worth noting that the evidence of effectiveness is mixed. Compare DENNIS C. MUELLER, *PUBLIC CHOICE II* 262–66 (1989) (finding that in only two of more than fifty comparisons of similar service provisions by public and private firms were public firms found to be more efficient), with Dannin, *supra* note 6, at 113–14 ("Federal employees won 90% of all competitions conducted under the regulations in Office of Management and Budget Circular A-76 in FY-2004 and FY-2003."), *id.* at 120 ("To be credible, privatization proponents need to account for phenomena, such as persistent evidence that government services are superior to those of private contractors on both cost and quality."), Stevenson, *supra* note 6, at 87 (describing how President Johnson's 1966 downsizing of the executive branch caused "numerous consulting firms [to spring] up, manned by the former federal employees, which in turn received lucrative contracts[, the costs of which] exceeded the personnel costs they replaced"), and *id.* at 89–90 (providing examples of disastrous privatization projects). Also worth noting is that before privatization can benefit citizens in their role as customers, the operational gains generated by privatized operations must throw off enough additional cash to cover both a return to the private investors and the income tax due on its profits. Otherwise, privatization merely affects a wealth transfer from public employees to private investors, a slightly less attractive shift than the one recognized as "debatable" by one of privatization's leading proponents. See John D. Donahue, *Privatization and Public Employment: An Essay on the Current Status and the Stakes*, 28 FORDHAM URB. L.J. 1693, 1712 (2001) (calling for "informed public deliberation" over the "virtues and drawbacks . . . of shift[ing] resources from citizens-as-producers to citizens-as-consumers").

surreptitiously borrow money. The upfront payments received by jurisdictions entering into privatization agreements, such as the City of Chicago's recent "lease" of its parking meters,⁸ are, at best, the present value⁹ of what would have been future tax (fee) revenue. Rather than true privatization transactions,¹⁰ it is more accurate to describe these deals as loans repayable out of future governmental revenues. If unchecked, they are likely to expand in quantity and context. Today, parking meters are the subject of these deals; tomorrow, jurisdictions may enter into similar deals involving car registration fees, hunting licenses, and other user fees. In the not-so-eventual future, jurisdictions may even "sell" the rights to collect property and income taxes to investors alleging better collection techniques and expressing a willingness to accept the risk that future revenues will fall.¹¹

There is nothing inherently wrong with governmental debt. Indeed, there are many situations in which governments

8. See generally CHICAGO PARKING METER CONCESSION, *supra* note 5 (reprinting the lease contract). Although denominated the "lease" and a "concession," section 2.6 of the Concession provides:

[The] Agreement is intended for United States federal and state income Tax purposes to be a sale of the Metered Parking System and the Metered Parking System Assets to the Concessionaire and the grant to the Concessionaire of a right for and during the Term to collect and retain Metered Parking Revenues.

Id. at 50,563.

9. Present value is the value on a given date of a future sum of money or stream of cash flows, discounted to reflect the time value of money. See David R. Henderson, *Present Value*, in THE CONCISE ENCYCLOPEDIA OF ECONOMICS 408, 408 (2008), available at <http://www.econlib.org/library/Enc/PresentValue.html>. A present value calculation is essentially the reverse of a compound interest computation. See WILLIAM A. KLEIN ET AL., FEDERAL INCOME TAXATION 30-31 (14th ed. 2006). Choosing the discount or interest rate usually is the most fraught and contested part of a present value calculation.

10. For purposes of this Article, a "true privatization transaction" is a transaction primarily intended to achieve managerial and efficiency gains. Again, as discussed *supra* note 7, I have no position on whether "true privatization transactions" do generate such gains, even when they are intended to do so.

11. This would resemble the medieval practice of "tax farming" in which governments auctioned off the right to collect a group's tax obligations. See Myriam E. Gilles, *Representational Standing: U.S. ex rel. Stevens and the Future of Public Law Litigation*, 89 CALIF. L. REV. 315, 356 n.222 (2001) (tracing tax farming to the Roman era); Timur Kuran, *The Absence of the Corporation in Islamic Law: Origins and Persistence*, 53 AM. J. COMP. L. 785, 824 (2005) (describing this practice as "known in antiquity and, under Islam, used from an early period . . . to maximize the ruler's tax revenue, which he received partly in advance, in the form of a down payment").

should use debt to finance their spending priorities.¹² Yet, not all forms of debt are created equal, and, as this Article argues, debt masquerading as privatization is a particularly noxious form. Debt masquerading as privatization costs governments more than conventional debt on two main fronts. First, governments are unlikely to borrow at rates as favorable as the rates they would obtain when issuing conventional debt.¹³ Second, privatization debt limits government flexibility more significantly than other forms of debt. Further, privatization debt is less transparent to voters, and perhaps even politicians. While one might have hoped that these disadvantages would discourage jurisdictions from engaging in debt-masquerading-as-privatization transactions, these transactions seem to be becoming more, rather than less, popular. This Article proposes a set of legal changes that would help steer governments away from privatization debt and toward more conventional debt transactions.

Part I of this Article examines the use and abuse of debt in government finance and outlines the legal constraints that have been imposed on government debt in reaction to the abuses. Part II looks at the techniques developed to avoid those constraints, including the development of camouflaged transactions. Part III details the peculiar harms of privatization debt and compares them to the harms generated by prior avoidance techniques. Finally, Part IV proposes legal rules that, if adopted, would discourage debt-masquerading-as-privatization transactions.

I. THE ROLE OF DEBT IN STATE AND LOCAL GOVERNMENT FINANCE

The phenomenon of government, or sovereign, debt is as old as government.¹⁴ It has always been a mixed blessing. Government debt is a mechanism for funding government projects that deliver long-term benefits and for mitigating the effects of short-term cyclical budget fluctuations, but it also allows politi-

12. For examples of beneficial uses of debt, see *infra* Part I.A.

13. See GEORGE K. YARROW & PIOTR JASIŃSKI, *PRIVATIZATION: CRITICAL PERSPECTIVES ON THE WORLD ECONOMY* 193 (2004) (noting that governments that sell off nationalized industries generally find less favorable returns).

14. See JAMES MACDONALD, *A FREE NATION DEEP IN DEBT: THE FINANCIAL ROOTS OF DEMOCRACY* 36 (2003) (“From the end of the fifth century until the middle of the first century B.C., more than one hundred records of civic borrowing exist.”).

cians and their constituents to postpone making hard decisions, leading to default and future economic crises. The history of debt issued by U.S. states and municipalities follows this general pattern of use and abuse. The abuses have led to the adoption of specific limitations on the powers of most states and localities to issue debt.

A. THE CASE FOR DEBT

Government debt transfers the cost of providing current governmental services to future years.¹⁵ As with private debt, the hope is that money will become available in the future to repay the borrowed money because future taxpayers will be either better able or more willing than current taxpayers to pay the cost of these services through the necessary taxes or fees. In many cases, allocating government costs to a later set of ratepayers can be seen as appropriate or even “fair.” There is no particular reason why construction-era ratepayers or taxpayers¹⁶ should bear the full cost of a bridge, school, or some other long-lived asset.¹⁷ Given ratepayers’ geographic mobility and demographic characteristics, it seems reasonable to force later generations of ratepayers to absorb the costs of benefits that they enjoy. Such a division of costs is easily obtained when projects are financed through debt. This debt can be repaid through taxes or fees levied on the beneficiaries of the project as they take advantage of it.¹⁸ Indeed, if governments cannot

15. See William G. Bowen et al., *The Public Debt: A Burden on Future Generations?*, 50 AM. ECON. REV. 701, 702 (1960) (arguing that the public debt “shifts the burden” to future generations).

16. Governments may extract money through the imposition of taxes or fees and the payers may be variously denominated as feepayers, ratepayers, or taxpayers. Since nothing in this Article turns on the distinction between these various groups, the terms are used interchangeably to refer to persons or entities subject to governmental exactions.

17. See, e.g., RICHARD BRIFFAULT & LAURIE REYNOLDS, CASES AND MATERIALS ON STATE AND LOCAL GOVERNMENT LAW 792 (7th ed. 2009) (“[B]orrowing is a means of achieving intergenerational equity.”); E. Donald Elliott, *Constitutional Conventions and the Deficit*, 1985 DUKE L.J. 1077, 1092–93 (“[W]hen the government borrows money to build a highway, future generations receive a capital asset that offsets the liability incurred to build the highway.”).

18. Fees, rather than taxes, may be used to generate the funds necessary to pay off the debt if access to the debt-financed project or service can be restricted and there is no philosophical or political objection to excluding those unwilling or incapable of paying the fee. While relatively few would cavil at the prospect of imposing user fees on tickets to sports events to cover the cost of the sporting arena, for example, taxes are used to defray the costs of debt-

use debt as a financing mechanism, they may not undertake many worthy but long-lived projects.¹⁹

Further, debt financing can be used to smooth the periodic fluctuations in government receipts caused by the normal business cycle. As is often noted, the need for government services generally increases in times of fiscal stress while tax revenues fall.²⁰ Judicious levels of debt allow government actors to play a countercyclical financial role, thereby compensating for, rather than accentuating, the business cycle.²¹ Governments can borrow in bad times and repay those debts in better times, leaving fiscal room to borrow during the next downturn.²²

financed school projects. *See, e.g.*, BRIFFAULT & REYNOLDS, *supra* note 17, at 727 (“If there is a broad social interest in universal availability of a particular service, the fee might have to be set below the cost of providing the service—or dropped altogether—to avoid excluding people who cannot otherwise afford to pay.”); Clayton P. Gillette & Thomas D. Hopkins, *Federal User Fees: A Legal and Economic Analysis*, 67 B.U. L. REV. 795, 817 (1987) (describing the special case of “merit goods”); Laurie Reynolds, *Taxes, Fees, Assessments, Dues, and the “Get What You Pay For” Model of Local Government*, 56 FLA. L. REV. 373, 388 (2004) (“In general, though, commonly accepted values about the government’s obligation to provide essential services and deeply held convictions about the public benefit of those services will operate to restrain the zeal with which local government seeks to recoup the cost of some services from the user.”); *id.* at 387 n.63 (citing cases holding that public education must be “free,” which is to say financed by tax revenues).

19. *See* ROBERT S. AMDURSKY & CLAYTON P. GILLETTE, *MUNICIPAL DEBT FINANCE LAW: THEORY AND PRACTICE* 11 (1992) (“In addition, the increased burden on the first generation of users will induce them to undersupply these [long-lived] resources.”).

20. *See* David A. Super, *Rethinking Fiscal Federalism*, 118 HARV. L. REV. 2544, 2609 (2005) (“Declining economic activity unbalances state and local budgets: revenues shrink while demand rises for some public services, such as welfare and Medicaid.”).

21. The federal government is in a better position to engage in Keynesian policies than are state governments because the federal government has more levers of fiscal control. While the federal government has “automatic stabilizers” that “cushion” the economy, *see id.* at 2608 (discussing the role of entitlement programs), state governments often must follow anti-Keynesian policies because they are subject to balanced-budget requirements, *see id.* at 2609 (“[S]tates’ fiscal constitutions not only prevent them from assisting in the execution of countercyclical economic policy, they actually compel states to undermine federal initiatives in this area.”).

22. In theory, governments can run surpluses in good years so that they can avoid borrowing money in bad years; the alternative is constantly raising tax rates. *See* Claire Suddath, *A Brief History of the U.S. Deficit*, TIME.COM, Aug. 25, 2009, <http://www.time.com/time/nation/article/0,8599,1918390,00.html> (“The federal government’s spending oscillated over the subsequent decades [following World War II], running a surplus in the good years and a deficit in the bad ones, until the early 1980s.”).

B. THE CASE AGAINST DEBT

Although debt can spread the costs of government projects more fairly among time-dispersed beneficiaries, it can also spread costs in an unfair or unwise manner. Later generations of ratepayers may find themselves bearing the burden of repaying debt for projects from which they derive little or no benefit. The likelihood of misapportioning the burden of debt repayments is high due to the often perverse incentives politicians encounter when deciding whether to incur debt in the first place.²³ The ready availability of debt can also encourage profligate government spending.

The use of debt entrenches the budget and policy choices of an earlier era on later generations of ratepayers. The generation incurring the debt makes decisions about what and how to spend debt proceeds. While those decisionmakers may try to account for the interests of later generations, they do not have perfect foresight. As a result, their decisions necessarily accord more to their taste (and benefit) than the tastes and benefit of later ratepayers. Benefits to later taxpayers are contingent on whether later developments take place. Technological or economic changes may reduce the value of governmental assets, for example, leaving later ratepayers paying more than their “fair share” of the debt. Further, the economic lifetime of a project may be overstated, resulting in nonbeneficiaries bearing some of the project costs. A debt-financed sports stadium, for example, yields few benefits if the sports team for which it was built moves,²⁴ or the sport falls out of public favor.

Many public projects have limited resale value in the event their public value plummets. Sports stadia are far less marketable than, say, excess office buildings—and even used office buildings may become technologically obsolete and worth less than their outstanding mortgage. Debt-financed projects that appear at the time of construction to properly spread the cost of

23. See *infra* notes 29–30 and accompanying text (describing perverse incentives).

24. Few teams actually move. Instead, they threaten to move unless the host city provides yet another new stadium, rendering an existing (and often fully functional) stadium obsolete. See Mildred Wigfall Robinson, *Public Finance of Sports Stadia: Controversial But Permissible . . . Time for Federal Income Tax Relief for State and Local Taxpayers*, 1 VA. SPORTS & ENT. L.J. 135, 137 (2002) (discussing Pittsburgh providing the Pirates with a new stadium, plus paying for demolition and retirement of outstanding debt on the old stadium); *id.* at 158 (commenting on Memphis building a new basketball stadium to attract a team only ten years after building a \$65 million arena).

a long-lived asset among time-dispersed taxpayers may turn out to be a white elephant for the later taxpayers.²⁵

This problem of potential misallocation is made more serious by the intractability of the question of the “correct” allocation of expenses. The dividing line between governmental expenditures generating future benefits and those providing only current benefits is far from clear. Educational expenses provide a perfect example of this dilemma. On the one hand, current expenditures on education primarily benefit current children (or their families). Further, education is a recurring expense; unless and until people stop having children, it will cost money—often a substantial amount—to educate those children. Financing the education of the current generation of children through debt may leave the next generation bearing the fiscal burden of educating two generations of children.²⁶ On the other hand, later residents benefit somewhat from the education of earlier generations, if only because educated children are more likely to grow up to become gainfully employed adults, adults who will be responsible and taxpaying members of their community (not to mention their families) and who will be unable to capture completely the benefits of their educational investments.²⁷ Underfunding public education now is very likely to generate adverse repercussions for future generations, which these generations might be willing to pay to avoid.

It is possible to make a similar argument for the future utility of virtually any governmental expenditure. Current public safety expenditures prevent jurisdictions from descending into chaos, which would be expensive, and perhaps not even possible, to remedy at some future date. Allocating between the current and future benefits of particular expenditures would in most cases be practically and even theoretically impossible.²⁸

25. See, e.g., Seymour Harris, *Postwar Public Debt*, in *POSTWAR ECONOMIC PROBLEMS* 169, 177 (Seymour Harris ed., 1943) (“The net effect of . . . public debt will depend on the value of the assets created in the process of public investment . . .”).

26. Of course, the second generation may decide to push the cost of educating its children onto the third generation.

27. See Walter McMahon, *The Social and External Benefits of Education*, in *INTERNATIONAL HANDBOOK ON THE ECONOMICS OF EDUCATION* 211, 217 (Geraint Johnes & Jill Johnes eds., 2007) (noting that the economic advantages of education “operate very slowly and are long delayed, most primarily affecting future generations”).

28. See Elliott, *supra* note 17, at 1093 (questioning whether it is possible to measure “the benefits to future generations from the ‘human capital’

This leaves considerable room for current taxpayers, and the politicians representing them, to justify to themselves the shifting of the economic burden of financing current governmental expenditures to future generations.

Unfortunately, both politicians and their constituents have an incentive to shift the economic burden of financing current governmental expenditures to future generations of ratepayers. Even the most public-spirited politician must worry about the next election, and there is no question that forcing constituents to live within a particular budget is bad for a politician's future. Fed an incessant diet of tales about governmental waste and abuse, the public regularly punishes officials with the temerity to point out that a desired level of public services is incompatible with budget constraints, necessitating either a tax increase or a decrease in government services.²⁹ Issuing debt is one way to bridge the gap between public expectations and fiscal reality.

Debt also allows politicians to finance new, politically popular projects without imposing the corresponding cost on their current constituency. They may begin job-generating projects and construct other public goods in the short term, with the bills coming due only after the next election (or the politician's retirement).³⁰ Profligate spending often increases politicians' popularity in the short run.³¹

created by a school lunch program, or for that matter, the alleged increase in national security that comes from building an additional MX missile").

29. See Nancy C. Staudt, *Constitutional Politics and Balanced Budgets*, 1998 U. ILL. L. REV. 1105, 1128 ("[O]ne of the surest ways for congressional representatives to lose political support is to impose costs upon their constituents through tax increases or spending decreases."); Catherine Rampell, *Stifening Political Backbones*, N.Y. TIMES, Feb. 14, 2010, at WK-5, available at 2010 WLNR 3111739 ("[P]oliticians see fiscal profligacy as a prerequisite for re-election . . ."). The story is no different at the state and local level. See Matt Bai, *State of Distress*, N.Y. TIMES, Oct. 25, 2009 (Magazine), at MM-38, available at 2009 WLNR 21157948 (describing how governors "find themselves retreating to a kind of fiscal Honalee, a make-believe world in which the state can magically raise less revenue and spend ever more of it"). Nor is this a peculiarly American phenomenon. See *Staring into the Abyss*, ECONOMIST, July 10-16, 2010, at 23, 24 ("As Jean-Claude Juncker, prime minister of Luxembourg, said memorably in 2007: 'We all know what to do, but we don't know how to get re-elected once we have done it.'").

30. See Clayton P. Gillette, *Fiscal Home Rule*, 86 DENV. U. L. REV. 1241, 1259 (2009) ("Debt can be a dangerous tool in the hands of local officials who have incentives to spend money in the short term, especially money that has to be repaid only when they have left office.").

31. See A. Prskawetz, *Government Debt, Budget Surplus, and Popularity of Politicians*, 98 J. OPTIMIZATION THEORY & APPLICATIONS 131, 146 (1998) (noting that over the long term "it is optimal for the politician to alternate phases

C. THE DEVELOPMENT OF LEGAL CONTROLS ON GOVERNMENT DEBT

Both current events and history provide examples of unwise borrowing by all levels of government. These fiscal disasters resulted in constitutional and statutory restrictions on the ability of governments to incur debt. Such restrictions come in many forms, from balanced-budget requirements (which arguably reduce or eliminate the need to take out debt),³² to volume caps and procedural restrictions on incurring debt, to prohibitions against extending credit to private corporations or individuals.

Constitutional limitations on the use of state government debt did not appear until the 1840s.³³ The first limitations were a response to fiscal crises caused by overbuilding of railroads and canals.³⁴ State governments,³⁵ directly or indirectly, funded much of this overbuilding and when the projects failed to generate profits, state governments were left responsible for paying off massive amounts of debt.³⁶ Nineteen states enacted constitutional restrictions on state debt between 1840 and 1855.³⁷ Many southern states enacted similar constitutional restrictions on state debt in the 1870s following the excesses of the Reconstruction period.³⁸ Virtually all of the limitations required specific voter approval before state debt could be in-

of savings (primary surplus) and spending (primary deficit), since the marginal gain in popularity from an additional dollar spent is sufficiently large”).

32. Whether a balanced-budget requirement actually reduces debt depends in part on whether the funds required to pay for budgeted expenses can be raised through debt or must come from current tax or fee exactions. *See infra* text accompanying notes 204–08 (describing Chicago’s balanced-budget requirement).

33. *See* Stewart E. Sterk & Elizabeth Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 WIS. L. REV. 1301, 1309 (“[P]rior to 1840 no state constitution contained a limitation on debt . . .”).

34. *See id.* at 1308 (describing interstate competition leading to duplication of facilities).

35. State support was provided in the form of loans, complimentary loan guarantees, and stock subscriptions financed by debt. *See id.* (describing methods of state support of railroad and canal projects).

36. *See id.* (noting that “several states ultimately repudiated their debts” as a result of this fiscal crisis).

37. *Id.* at 1309.

38. *Id.* at 1311–12.

curred³⁹ and proscribed the grant of state credit to private corporations or enterprises.⁴⁰

Almost incredibly, local governments then fell into the same fiscal trap, often involving the same industries, as the states had a few years earlier. With states ruled out as a source of financing, railroads turned to local governments as a source of funds. Repeating history, many local governments issued bonds and made other debt-financed investments on behalf of railroads, only to see the investments (and their own finances) sour.⁴¹ This led, by the 1870s, to the inclusion of constitutional and statutory restrictions on the authority of municipalities to issue debt similar to those imposed on states.⁴² Like the provisions applicable to state-issued debt, those applicable to local debt consisted of a hodgepodge of restrictions, including monetary limits on the amount of outstanding debt,⁴³ referendum

39. See B.U. RATCHFORD, *AMERICAN STATE DEBTS* 433–35 & tbl.38 (1941) (categorizing state restrictions and explaining the differences between the categories). Some state debt was exempted from the requirements. For example, New York's constitution gave its legislature the right to issue unlimited debt "to repel invasion, suppress insurrection, or defend in time of war." See Sterk & Goldman, *supra* note 33, at 1309. See generally A. JAMES HEINS, *CONSTITUTIONAL RESTRICTIONS AGAINST STATE DEBT* 11 tbl.4 (1963) (outlining exceptions to state limitations on debt); D. Roderick Kiewiet & Kristin Szakaly, *Constitutional Limitations on Borrowing: An Analysis of State Bonded Indebtedness*, 12 J.L. ECON. & ORG. 62, 67 tbl.1 (1996) (charting state constitutional limitations on state-guaranteed long-term debt).

40. See HEINS, *supra* note 39, at 11 ("Indirect pledging of a state's credit for the benefit of local governments or private individuals is generally prohibited.").

41. Sterk & Goldman, *supra* note 33, at 1312–13.

42. See Clayton P. Gillette, *Direct Democracy and Debt*, 13 J. CONTEMP. LEGAL ISSUES 365, 371 (2004) [hereinafter Gillette, *Democracy and Debt*] (discussing restrictions on local government debt enacted subsequent to the Panic of 1873); Gillette, *supra* note 30, at 1255–56 ("Virtually every state constitution imposes limits on the amount of debt that its political subdivisions can issue in order to fund capital projects . . ."); Sterk & Goldman, *supra* note 33, at 1313 & n.72 ("Today municipal debt limitations are nearly as common a feature in state constitutions as are limitations on state debt."); Paul K. Bardack, Comment, *State Constitutional Prohibitions Against the Lending of State Credit to Municipal Corporations*, 26 AM. U. L. REV. 657, 667 (1977).

43. See, e.g., ALA. CONST. art. XII, § 225 (limiting debt to twenty percent of the value of the property in the jurisdiction in municipalities of fewer than 6000 people); ARIZ. CONST. art. IX, § 8 (limiting debt to six percent of assessed property value, rising to fifteen percent or twenty percent if approved by majority vote); GA. CONST. art. IX, § V, para. I (limiting debt to ten percent of assessed property value); HAW. CONST. art. VII, § 13 (limiting debt to fifteen percent of assessed values); IND. CONST. art. XIII, § 1 (limiting debt to two percent of taxable property); KY. CONST. § 158 (depending on type of local entity, limiting debt to two, three, five, or ten percent of assessed property value); N.M. CONST. art. IX, § 13 (limiting debt to four percent of the value of taxable

requirements for issuing debt,⁴⁴ and public-purpose or credit-lending clauses.⁴⁵

It is easier to enact restrictions than to enforce them in a meaningful fashion. As Part II describes, both state and local governments have found myriad ways to circumvent applicable constitutional debt limitations. Privatization debt is only the latest in a long series of evasive techniques.

II. THE AVOIDANCE OF RESTRICTIONS ON DEBT

The constitutional debt restrictions imposed on state and local governments have a limited effect on actually controlling the amount of governmental debt. Some restrictions are overtly procedural in nature, requiring, for example, a voter referendum before the issuance of debt (or debt in excess of a certain amount), rather than limiting the amount of government debt.⁴⁶ Even explicit constitutional restrictions on the amount

property); N.D. CONST. art. X, § 15 (limiting debt to five percent of assessed value of property, but allowing some entities to increase indebtedness by another three or five percent by referendum); WASH. CONST. art. VIII, § 6 (limiting debt to 1.5 percent of taxable authority, which may be raised to five percent if approved by three-fifths of voters in an election); WIS. CONST. art. XI, § 3 (limiting debt to five percent of assessed value of property, except for certain school districts that are allowed ten percent); CAL. GOV'T CODE § 43605 (West 1983) (limiting city debt for public improvements to fifteen percent of assessed property); DEL. CODE ANN. tit. 22, § 106 (2005) (limiting debt to sixteen percent of assessed value of real estate); ME. REV. STAT. tit. 30-A, § 5702 (1964) (limiting debt to 7.5 percent of assessed property value, or up to fifteen percent if loans are for school, sewer, water, or airport purposes); MINN. STAT. § 475.53 (2010) (depending on the type of local entity, limiting debt to two to 3.67 percent of property value and fifteen percent for school districts); MISS. CODE ANN. § 21-33-303 (1972) (limiting debt to fifteen percent of property value); MONT. CODE ANN. § 7-7-4201 (2009) (limiting debt to 2.5 percent of assessed property value); R.I. GEN. LAWS § 45-12-2 (Supp. 2008) (limiting debt to three percent of assessed value of property).

44. See Gillette, *Democracy and Debt*, *supra* note 42, at 370 (“The constitutions of approximately twenty-seven states require a vote of the electorate prior to the issuance of municipal debt.”).

45. See Bardack, *supra* note 42, at 664 (“[F]orty-four states generally forbid loans of credit to or on behalf of any public or private corporation . . .”); Gillette, *supra* note 30, at 1256 (noting the addition of constitutional public purpose requirements).

46. See Gillette, *Democracy and Debt*, *supra* note 42, at 370 (noting that twenty-seven states have these constitutional voting requirements); *see also*, e.g., ALA. CONST. art. XI, § 213 (stating that state debt must be authorized by a two-thirds vote of each house of the legislature); *id.* art. XII, § 222 (stating that debt must be authorized by a majority vote); ALASKA CONST. art. IX, § 9 (stating that bonds must be authorized by the locality’s governing body plus majority vote of electorate); CAL. CONST. art. XVI, § 18 (stating that, in most cases, local bonds must be authorized by a two-thirds majority in bond elec-

of state debt can be effectively waived by strategically amending the constitution; in many states the barriers to such amendment are the same voter (or legislative majority or supermajority) approvals required under the state's procedural debt restrictions.⁴⁷ However, obtaining legislative or voter approval for debt transactions can be expensive and inconvenient⁴⁸ or, not always for good reasons, impossible.⁴⁹ Consequently, instead of going this route, both state and local jurisdictions often enter into transactions with economic effects similar if not identical to debt but which are deliberately structured to avoid debt restrictions. As elaborated below, they may avoid restrictions by creating new jurisdictions or by engaging in transactions which are economically similar to debt but which courts have not treated as debt. Privatization techniques are merely a recent addition to this long-established tradition of avoidance.

A. CREATING NEW JURISDICTIONS

State and local governments can often avoid debt limitations by creating "new" jurisdictions. In many states, some types of jurisdictions are not subject to prevailing limitations (including referendum requirements) on government debt and states avoid the limitations by creating those special types of

tion); IDAHO CONST. art. VIII, § 3 (stating that local bonds must be authorized by a two-thirds majority in bond election); N.C. GEN. STAT. § 142-83 (2008) (stating that local bonds must be authorized by majority vote).

47. See Kiewiet & Szakaly, *supra* note 39, at 68 (noting instances where state constitutional provisions regarding guaranteed debt become "substantially altered" over time); Sterk & Goldman, *supra* note 33, at 1316 ("[I]f a state's constitution permits amendment whenever a public referendum ratifies a proposal made by the legislature, an outright constitutional prohibition is not significantly different from a provision that permits borrowing after approval by the voters."). Though constitutional and statutory restrictions on local debt issuances presumably also could be waived by state legislatures, local governments may lack the necessary power in the state legislature to obtain such waivers.

48. See Gillette, *Democracy and Debt*, *supra* note 42, at 374-75 ("Finally, bond elections themselves impose significant costs on the localities that hold them. These are not only the costs related to the bond election itself, which frequently occurs at times other than the general election and thus requires marshalling the resources of election officials and inducing constituents to turn out to vote on a single issue, but also delay in issuing debt and the risk that voters will fail to represent the preferences of constituents as a whole.").

49. See *id.* at 401 (summarizing benign and malignant stories explaining referenda outcomes).

jurisdictions.⁵⁰ In others, the cap on debt may not affect a new jurisdiction because it has no preexisting debt. Most critically, these new jurisdictions may overlap, or even have boundaries identical to, the territorial boundaries delineating the older jurisdictions, thereby circumventing the older jurisdictions' referendum requirements or debt restrictions.⁵¹ In one infamous case, after the voters of King County voted down the tax increase necessary to finance the bonds needed to construct a new stadium for the Seattle Mariners' baseball team, the Washington State legislature simply created a new "public facilities district" with the power to issue bonds to build a stadium without the necessity of a taxpayer referendum.⁵²

The creation of overlapping jurisdictions permits a given piece of property to be subject to debt at levels far in excess of those allowed in any single jurisdiction. Repayment of such high levels of debt may necessitate tax levies that in the best case make it difficult for future governments to fund their own priorities and in the worst case are financially unsustainable. Stated simply, taxpayers may rebel against paying taxes sufficient both to defray the costs of past obligations and new spending initiatives. Future governments, bound by their obligation to pay off past debts, may have little if any money left over to spend on their own projects. Yet courts repeatedly accede to this method of avoiding debt limitations.⁵³

50. Governmental entities denominated "public building authorities" are often exempt from state debt-limitation rules. See BRIFFAULT & REYNOLDS, *supra* note 17, at 776 ("Early on, public authority debt was held not to be the debt of its parent government, and was, thus, not subject to the parent government's debt restrictions."); CLAYTON P. GILLETTE & LYNN A. BAKER, *LOCAL GOVERNMENT LAW: CASES AND MATERIALS* 639-40 (2d ed. 1999) (describing the use of public authorities and problems posed by them); C. Robert Morris, Jr., *Evading Debt Limitations with Public Building Authorities: The Costly Subversion of State Constitutions*, 68 *YALE L.J.* 234, 234 (1958) (describing building authorities as "the most recent" of the "evasive devices and fine distinctions [that] are employed to escape debt limitations"); Sterk & Goldman, *supra* note 33, at 1333 (describing the use of "public 'authorities'" to evade debt restrictions).

51. AMDURSKY & GILLETTE, *supra* note 19, at 213-14.

52. See *CLEAN v. Washington*, 928 P.2d 1054, 1056-58 (Wash. 1996) (describing events leading up to the formation of the public facilities district).

53. See, e.g., *Pinion v. Walker Cnty. Sch. Dist.*, 45 S.E.2d 405, 407 (Ga. 1947) (stating that "the frequently applied construction of this provision is that each separate political division of the State which has authority to issue bonds is authorized to incur an indebtedness up to 7% of the assessed valuation of its taxable property independently of any existing indebtedness of another distinct and separate municipality or other political body whose territory might be coextensive in whole or in part with that of its own," and holding

Creating new jurisdictions is only the first of many escapes from the impact of debt limitations. Another time-honored method⁵⁴ of avoiding the restrictions on debt is to use debt that does not count as "debt" subject to constitutional or statutory restrictions.

B. THE SPECIAL-FUNDS EXCEPTION

Many courts have held that debt payable out of a dedicated revenue source or "special fund" does not constitute "debt" subject to constitutional restrictions.⁵⁵ There is some logic to ex-

that a consolidated school district was not required to take into account the indebtedness of former local school districts in computing the amount of indebtedness it was authorized to incur); *McLain v. Phelps*, 100 N.E.2d 753, 757 (Ill. 1951) (observing that "if the rule [limiting debt] were applied to the *property*, and not to the *power* of each separate taxing district, municipal corporations would be hampered and restricted far more than ever contemplated" and upholding a levy that would raise total bond principal to 7.3 percent of assessed value); *Indianapolis v. Buckner*, 116 N.E.2d 507, 509 (Ind. 1954) ("But this [two-percent debt] limit applies to each corporation individually, not in the aggregate to all properly created municipal corporations which may cover the same area or include the same taxpayers."). See generally AMDURSKY & GILLETTE, *supra* note 19, at 213-14 ("Cook County, Illinois seems to be a perennial favorite of commentators concerned with overlapping political entities, many of which appear to have been created primarily to avoid tax and debt limitations. . . . [F]ew jurisdictions have limited the ability of overlapping jurisdictions to extend debt beyond apparent constitutional limits.").

54. See RATCHFORD, *supra* note 39, at 446 ("Arguments in favor of the special fund doctrine were first advanced in New York in 1852 . . .").

55. See, e.g., *Opinion of the Justices*, 49 So.2d 175, 181-82 (Ala. 1950) (holding that bonds are not "indebtedness of the municipality" when payable out of revenues derived by the corporation from the lease or sale of its facilities); *State ex rel. Atkinson v. Planned Indus. Expansion Auth.*, 517 S.W.2d 36, 47 (Mo. 1975) (en banc) ("If the obligation to be incurred is payable solely from income derived from the operation of the proposed improvement, the obligation is not considered to be debt of the city within the meaning of the constitutional restrictions" (quoting *City of St. Louis v. Sommers*, 266 S.W.2d 753, 755 (Ala. 1954))). See generally RATCHFORD, *supra* note 39, at 465 ("Perhaps many courts thought that they were merely making the constitutions flexible and practical when they recognized the special fund doctrine, but in several instances they have practically nullified the limitations by a liberal interpretation of the doctrine."); *Sterk & Goldman*, *supra* note 33, at 1330-31 ("Courts have often construed debt to be repaid out of a 'special fund,' derived solely from revenues of a specific project, as falling outside the scope of constitutional debt limitations."). Indeed, some state constitutions now expressly exempt revenue bonds from the limitations applicable to other government debt. See, e.g., ALASKA CONST. art. IX, § 11 ("The restrictions on contracting debt do not apply to debt incurred through the issuance of revenue bonds"); FLA. CONST. art. VII, § 11(d) (exempting revenue bonds from referendum requirement); GA. CONST. art. IX, § 6, para. 1 (providing that revenue bonds "shall not be deemed to be a debt of the issuing political subdivision").

cluding industrial revenue bonds, which limit municipal liability to interest or rents actually received from the debt-financed property, from debt limitations. After all, the interest or rental income the government receives from the property financed with bond proceeds would not have been derived had the property not been constructed, and the property would not have been constructed absent the government loan. Further, if the investment in the property goes sour, the bondholders rather than the municipality suffer the consequences of any default.⁵⁶ Thus, a government cannot be worse off going forward than it would have been had it not entered into this type of loan transaction.⁵⁷ However, some courts have extended the special-funds exemption to debt financed with the proceeds of taxes that could have been levied, with the same amount of revenue raised, in the absence of the project funded by the debt.⁵⁸ For

56. See KLEIN ET AL., *supra* note 9, at 187 (observing that the local government bears no risk).

57. See AMDURSKY & GILLETTE, *supra* note 19, at 177 (“Risk analysis suggests that no debt within the constitutional provision exists in such a case.”). Such debts do not place preexisting government revenues at risk; bond purchasers (creditors), and not the government issuing the bond, bear the risk that the financed enterprise may fail and the expected rents not materialize. See *id.* at 162 (“Hence, the concern about fiscal overextension of the issuer’s constituents—the concern that generated the trend towards debt limits—does not come into play.”). Indeed, the government’s role is limited to providing access to the federal tax benefits accorded state and municipal debt under § 103 of the Internal Revenue Code. See 26 U.S.C. § 103 (2006); KLEIN ET AL., *supra* note 9, at 187 (“[T]he local government unit that is the purported borrower is strictly an intermediary, with no financial risk.”). By passing the resulting rate advantage along to the enterprise being financed, a municipality encourages investment within its borders. See AMDURSKY & GILLETTE, *supra* note 19, at 30–31 (“These bonds have been used to induce manufacturers to locate in particular areas since they were first employed in Mississippi in the 1930s.”); Norman R. Williams & Brannon P. Denning, *The “New Protectionism” and the American Common Market*, 85 NOTRE DAME L. REV. 247, 252 (2009) (“This favorable tax treatment significantly reduces the private companies’ cost of borrowing, and . . . provides local private enterprises with a substantial economic edge . . .”). Such investment may (or may not) bring desirable jobs and tax revenues with it. See Peter S. Fisher & Alan H. Peters, *Tax and Spending Incentives and Enterprise Zones*, NEW ENG. ECON. REV., Mar./Apr. 1997, at 109, 128 (reviewing literature on the impact of industrial revenue bonds and concluding the results are “mixed”); Sherry L. Jarrell et al., *Law and Economics of Regulating Local Economic Development Incentives*, 41 WAKE FOREST L. REV. 805, 826 (2006) (“Studies on the impact of industrial revenue bonds offer no firm conclusions . . .”).

58. See AMDURSKY & GILLETTE, *supra* note 19, at 183 (“The key distinction, overlooked in these cases, between these situations and true revenue bonds is the independence of the revenue source from the project financed with bond proceeds.”); HEINS, *supra* note 39, at 16 (“The crux of the matter is that, with proper manipulation of borrowing technique to fit the rules of law of

example, gasoline taxes have been deemed “special funds” when “pledged to the payment of bonds issued for roads and bridges,”⁵⁹ even though the jurisdiction could have raised those taxes without expending the corresponding revenue on roads and bridges.

In one recent variation on this theme, tax increment financing (TIF) jurisdictions borrow money by issuing bonds, the proceeds of which are used to provide infrastructure and other improvements in a specific geographic area, the “tax increment district.”⁶⁰ The expectation is that the improvements will increase property values or economic activity in the district; the bonds are expressly made payable only out of the property (or other) taxes attributable either to that increase in value or to increases in economic activity within the district.⁶¹ If there is no increase in value or associated tax revenues, the bondholders—rather than the issuing jurisdiction—suffer the financial loss.⁶² There is no guarantee, however, that an increase in

a particular state, a state may use revenue bonds to finance public improvements that were seemingly prohibited when constitutional debt limitations were adopted.”); RATCHFORD, *supra* note 39, at 465 (“[I]n several instances they have practically nullified the limitations by a liberal interpretation of the doctrine.”); Sterk & Goldman, *supra* note 33, at 1331 (“Excluding special tax debt from constitutional limitations on debt, then, limits the effectiveness of those limitations.”). Not all states extend the special funds exception to its limit. See GILLETTE & BAKER, *supra* note 50, at 625 (describing the “narrow conception of the special fund doctrine” prevailing in some states); Sterk & Goldman, *supra* note 33, at 1331 & n.138 (“Some courts, however, refuse to embrace this application of the special fund doctrine because financing through special taxes creates an obligation out of state taxes that could have been imposed and dedicated to projects other than the ones actually financed.”).

59. AMDURSKY & GILLETTE, *supra* note 19, at 182.

60. See Richard Briffault, *The Most Popular Tool: Tax Increment Financing and the Political Economy of Local Government*, 77 U. CHI. L. REV. 65, 67–68 (2010) (“More commonly for larger TIF districts, the district may issue bonds backed by the projected incremental revenues. The bond proceeds are then used to make major public investments upfront, thus jumpstarting the development process.”).

61. See *id.* at 67 (explaining use of property taxes); *id.* at 68–69 (“In approximately eighteen states, nonproperty taxes, particularly the sales tax or other economic activity taxes, can be committed to TIF programs. These states also rely on the theory that they are using incremental revenues . . .”).

62. See Christina G. Dudley, Note, *Tax Increment Financing for Redevelopment in Missouri: Beauty and the Beast*, 54 UMKC L. REV. 77, 85 (1985) (“[I]nvestors . . . will be left empty-handed if the anticipated revenue does not materialize.”). Whether municipalities actually allow defaults to occur with respect to TIF bonds is an open question. See Josh Reinert, Note, *Tax Increment Financing in Missouri: Is It Time for Blight and But-For to Go?*, 45 ST. LOUIS U. L.J. 1019, 1028 (2001) (“[D]efault is generally considered to be the option of last resort. Prior to taking this step, the municipality may either re-

property values or tax revenues within the district is actually the result of the expenditures financed with the bond proceeds.⁶³ Indeed, jurisdictions can be left significantly worse off when the valuation “increase” is simply the product of inflation, especially if the improvements themselves increase city operating costs.⁶⁴ The tax revenues attributable to the increase go to the bondholders; meanwhile, the jurisdictions are left with the same number of nominal tax dollars as before to pay their higher operational costs. Either they have to reduce the quantum of services provided or raise their tax rates, forcing their residents to pay higher taxes (even in inflation-adjusted terms).⁶⁵ Nonetheless, most TIF statutes expressly exempt TIF

duce its expenditures in the other project areas, or utilize intragovernmental grants or other interest income to service the debt.” (citations omitted)).

63. See Briffault, *supra* note 60, at 80–83 (discussing economic studies suggesting TIF’s relative ineffectiveness at spurring economic development).

64. See Rachel Weber et al., *The Effect of Tax Increment Financing on School District Revenues: Regional Variation and Interjurisdictional Competition*, 40 ST. & LOC. GOV’T REV. 27, 27–28 (2008) (speculating that “overlapping governments may raise tax rates to compensate” for TIF revenue losses, unless constrained by tax caps); *id.* at 29–30 (summarizing study results); Joseph F. Luther, Note, *Tax Increment Financing: Municipalities Avoiding Voter Accountability*, 1 DETROIT C. L. REV. 89, 104–05 (1987) (“[T]he school districts will be forced to ask the voters for a new school millage increase just so that they can stay abreast of inflation.”); Alyson Tomme, Note, *Tax Increment Financing: Public Use or Private Abuse?*, 90 MINN. L. REV. 213, 233–34 (2005) (“Municipal-service costs, such as police, fire, sanitation, and transportation, typically rise as TIF projects develop. Since property taxes for those property owners within the TIF district are based upon assessments made before the commencement of the TIF project, property taxes collected within the district are likely to fall short of being able to meet the increasing cost of municipal services. Consequently, taxpayers outside the district may be called on to pay additional taxes to account for lost revenue.”). *But see* Randall V. Reece & M. Duane Coyle, *Urban Redevelopment: Utilization of Tax Increment Financing*, 19 WASHBURN L.J. 536, 542 (1980) (“[A]ny such indirect subsidies may be more than recouped by increased sales taxes from new commercial growth within the redevelopment area.”); Michael L. Molinaro, Comment, *Tax Increment Financing: A New Source of Funds for Community Redevelopment in Illinois—People ex rel. City of Canton v. Crouch*, 30 DEPAUL L. REV. 459, 475 (1981) (“[T]ax increment financing does not necessarily require additional municipal services because substandard property often demands more public services than properly maintained property. Other potential infirmities of tax increment financing may be avoided through carefully drafted statutes.”).

65. Suppose property values in the TIF district start at \$1 million and residents pay a property tax equal to two percent of that value, or \$20,000. That \$20,000 is used to run the local schools. Then, because of inflation (and only because of inflation) the value of the property in the TIF district increases to \$1.1 million. Although (assuming the same tax rate) tax collections go up to \$22,000, the \$2000 increase would go to make payments on the TIF bonds. Although the district would still have \$20,000 to pay school expenses, that

debt from municipal debt limits.⁶⁶ In several (though not all) of the states where the debt limitations are imposed by the state constitution rather than statute, courts have found that TIF bonds fall within the special-funds exception to those limitations.⁶⁷

C. SHORT-TERM DEBT

Another avoidance mechanism involves the use of short-term debt, usually in the form of a “note.”⁶⁸ Governments issue short-term notes to “regulate cash flow”⁶⁹ by evening out the liquidity issues stemming from the irregular collection of tax revenues or delays in the issuance of longer-term bonds.⁷⁰ In many states, either by statute or constitutional provision, such short-term debt is excluded from generally applicable debt limita-

\$20,000 would not go as far as the previous year’s \$20,000 because of inflation. The same package of goods and services would now cost the schools \$22,000. To raise an additional \$2000, the district would have to raise tax rates, and increase the tax burden on its residents not only in nominal terms, but also in inflation-adjusted terms.

66. See Briffault, *supra* note 60, at 76.

67. See *id.* at 76 & n.57 (naming Missouri, Indiana, Colorado, and Florida); Dudley, *supra* note 62, at 103–04 (mentioning Utah, Colorado, and Missouri); Julie A. Goshorn, Note, *In a TIF: Why Missouri Needs Tax Increment Financing Reform*, 77 WASH. U. L.Q. 919, 941 (1999) (identifying Indiana, Colorado, Florida, Utah, and Missouri). Other state courts have disagreed, and held that TIF bonds are real debt subject to the states’ particular constitutional limitations, at least when they are funded by increases in property tax revenues. See Briffault, *supra* note 60, at 76 n.57 (naming Oklahoma, West Virginia, and Wisconsin); Dudley, *supra* note 62, at 104 (discussing Iowa, Arizona, Kentucky, and South Dakota); Goshorn, *supra*, at 938–39 (mentioning Iowa, Arizona, South Dakota, Kentucky, and Wisconsin). Some state legislatures have tried to avoid this issue by fixing assessment values for tax purposes at the inception of the TIF and calling the amounts paid into the special bond repayment fund “payments in lieu of taxes” or “PILOTs.” Reinert, *supra* note 62, at 1026–27. Some states have avoided the issue by mandating or allowing TIF bonds to be funded by incremental sales tax revenues. See, e.g., LA. REV. STAT. ANN. § 33:9033.3 (2009) (allowing these bonds). Wisconsin courts, notwithstanding their adverse holding on TIF bonds funded by incremental property tax revenues, have held that bonds issued by a baseball park district payable out of incremental sales and use taxes did not constitute “debt” subject to that state’s debt limitations. *Libertarian Party of Wis. v. State*, 546 N.W.2d 424 (Wis. 1996).

68. See AMDURSKY & GILLETTE, *supra* note 19, at 33 (describing “tax anticipation notes” (TANs), “revenue anticipation notes” (RANs), “tax and revenue anticipation notes” (TRANs), and “bond anticipation notes” (BANs)).

69. See *id.* at 33–34.

70. See *id.*

tions.⁷¹ Even in the absence of explicit provisions, courts generally hold that such notes do not fall within the definition of “debt” subject to constitutional restrictions because they are expected to be redeemed out of current-year tax revenues.⁷² However, some states have issued debt in excess of the taxes expected to be received by the end of the fiscal year, essentially creating long-term debt by rolling over the short-term debt for several successive years.⁷³ Although some state courts have cracked down on this practice,⁷⁴ other courts have been permissive largely because they have not wanted to be in the business of determining whether the state legislature meant to issue more notes than could be currently repaid or if the excess was accidental.⁷⁵

D. PROPERTY TAX EXEMPTIONS

Property tax concessions are yet another means of escaping debt limitations.⁷⁶ One way for a jurisdiction to attract business

71. Some state constitutions explicitly provide that such notes do not count as “debt” subject to the general limitations. *See* *Georgetown v. Elliott*, 95 F.2d 774, 775 (4th Cir. 1938) (interpreting article 8, section 7 of the constitution of South Carolina); *Bremen v. Regions Bank*, 559 S.E.2d 440, 443 (Ga. 2002) (describing special limitations applicable to “temporary loans” contained in article IX, section V, paragraph V of the Georgia Constitution). Others provide the same by statute. *See* *Berkeley High Sch. Dist. of Alameda Cnty. v. Coit*, 59 P.2d 992, 996–97 (Cal. 1936) (upholding the legality of section 3719 of the California Code authorizing issuance of tax anticipation notes). For a discussion of the history of these rules, see Sterk & Goldman, *supra* note 33, at 1314–15.

72. *See* AMDURSKY & GILLETTE, *supra* note 19, at 180 (“Also excluded from debt are those obligations that are to be met out of current income and notes issued in anticipation of revenue to be collected during the current fiscal year, that is, tax or revenue anticipation notes.”).

73. *See* Christian Schneider, *The Exploding Use of Debt to Finance Government in Wisconsin*, WIS. POLY RES. INST., http://www.wpri.org/Reports/Volume_20/Vol20no9p1.html (last visited Apr. 24, 2011) (reporting on how Wisconsin debt exceeds tax revenue).

74. *See, e.g.*, *Pooled Money Inv. Bd. v. Unruh*, 200 Cal. Rptr. 500, 507 (Ct. App. 1984) (holding that the absence of definite repayment requirements or repayment date kept “short term notes” from being exempted from referendum requirement applicable to state debt); *Bundy v. Belin*, 461 A.2d 197, 207 (Pa. 1983) (refusing to lift a tax limitation standing in the way of generating tax revenues necessary to pay unpaid tax anticipation notes because “the last vestige of protection against run away [sic] spending by way of tax anticipation notes is the tax limitation”).

75. *See* AMDURSKY & GILLETTE, *supra* note 19, at 33–34 (describing New York cases requiring plaintiff to bear the “formidable” burden of proving the legislature intended to run a deficit in the year issued).

76. *See* Sterk & Goldman, *supra* note 33, at 1317 (suggesting that constitutional restrictions on tax exemptions are “first cousins” to debt limitations).

is to build desirable infrastructure. If a jurisdiction borrows money to build that infrastructure, however, the debt may be subject to the prevailing constitutional and statutory debt restrictions.⁷⁷ To circumvent this restriction, some jurisdictions opt to make businesses build their own facilities.⁷⁸ The government arranges to bear some of the cost of the improvements, however, by granting these businesses temporary property tax concessions, either by setting an artificially low value for their property or by offering a “tax holiday.”⁷⁹ The business can then use the cash it saves by not paying taxes to pay off the obligations it owes under the debt incurred to build the infrastructure.⁸⁰ As modern finance theory makes clear, all that counts is cash flow. From an economic perspective, the effect of both arrangements is the same: both involve the dedication of tax revenues to payment of the debt obligation. The government entering into a property tax concession arrangement imposes spending restrictions on future governments by limiting the amount of future tax revenues. The result would be the same if the government had not offered any tax concessions, collected higher tax revenues, and then used the increased tax revenues to pay off debt incurred to finance its infrastructure project. Both schemes leave future governments with the same amount of “free” tax revenues. Yet, restrictions on the amount of public debt do not also limit property tax concessions. Some state constitutions limit “permanent” tax exemptions in ways similar to the ways they limit governmental debt,⁸¹ but shorter-term exemptions are regularly used to attract investors to a jurisdiction.⁸²

77. See *supra* Part I.C.

78. For example, Daimler-Chrysler had to build its own plant in Toledo, Ohio. See Peter D. Enrich, *Business Tax Incentives: A Status Report*, 34 URB. LAW. 415, 427 (2002).

79. In order to attract Daimler-Chrysler, Toledo offered property tax breaks, which were then challenged by residents. *Id.* at 427. States and localities may offer concessions with respect to nonproperty taxes as well. *Cf. id.* at 416 (“Indeed, the 1990s witnessed the continuing proliferation of new forms of tax breaks and the expansion and enhancement of existing forms virtually nationwide.”).

80. *Cf. Sterk & Goldman, supra* note 33, at 1317 (“Long-term tax exemptions can be just as effective, if not more effective, [than debt] as a mechanism that enables legislatures to defer payment for current benefits.”).

81. See *id.* at 1317–21 (describing the development and history of “uniformity” and other constitutional restrictions on property tax exemptions).

82. See Enrich, *supra* note 78, at 417 (“Investment tax credits, job creation credits, and property tax abatement programs have become nearly universal . . .”).

Using tax concessions rather than public debt has other implications. Under most tax-concession arrangements, the land owner—and not the government—incurs debt and constructs improvements, albeit with funds made available by the government's reduction in its tax claim. Like other privatization arrangements, this may lead to an efficiency gain because the private party may be better at negotiating and overseeing the construction project.⁸³ But in a world in which debt limitations exist, it is often unclear whether such arrangements are expected or intended to generate efficiency gains or whether they are being used merely to avoid statutory or constitutional restrictions on the overall amount of, or procedural restrictions applicable to, government debt. Governments may not believe that they are inferior negotiators or builders, just inferior borrowers.

E. LEASES

Debt limitations also may be avoided when governments lease rather than purchase property. The variations of this technique range from simple long-term lease arrangements, to leases coupled with an option to purchase, to sale leaseback arrangements.⁸⁴ In the simplest variation of a lease agreement, a private investor builds a public facility, say a school building. The school district then enters into a long-term lease of the property at a rent sufficient to pay the private investor's costs and also allow the private investor to make a profit. From a legal perspective, the school district never becomes party to a debt contract. Yet, from an economic perspective, the rental payments required under the lease agreement are at least as burdensome as those that would have been due under the terms of a debt incurred to build the school.⁸⁵ Some state courts have examined these transactions and recharacterized them as debt arrangements subject to constitutional limitations;⁸⁶ but

83. See *supra* note 6 and accompanying text (recounting alleged efficiency benefits of privatization).

84. See *infra* note 89.

85. To provide the investor with a profit and the incentive to participate in the transaction, the rental payments must exceed the amounts due on the underlying mortgage.

86. *Montano v. Gabaldon*, 766 P.2d 1328, 1328 (N.M. 1989) (holding that a lease-purchase arrangement for jail qualified as debt); Sterk & Goldman, *supra* note 33, at 1332–33 (commenting favorably on courts treating lease agreements as debt). See generally AMDURSKY & GILLETTE, *supra* note 19, at 214–19 (discussing lease-purchase obligations and public building authorities).

in most states, courts uphold these transactions as long as the rental contract clearly provides that no rent will be due unless the state legislature “appropriates” the sum on an annual basis or describes the rental obligation as “morally,” rather than legally, binding,⁸⁷ despite the fact that the practical effect of these limiting contract terms is far from clear.⁸⁸

In sale-leaseback arrangements, the governmental owner of property sells it to another party while simultaneously executing a lease for continued use of the property.⁸⁹ In such transactions, the original governmental owner receives a lump sum up front, representing the fair market value of the asset, but becomes obligated to make a stream of rental payments over the term of the lease. For example, the State of Arizona recently sold investors \$735 million of state-owned buildings, including offices, arenas, and the chambers of the State Legislature, which it then leased back.⁹⁰ Like conventional leases,

87. See, e.g., *Jennings v. Kan. City*, 812 S.W.2d 724, 732 (Mo. Ct. App. 1991) (holding that the lease of school buildings did not constitute debt when the city has the right to terminate the lease by failing to appropriate annual funds); *St. Charles City-Cnty. Library Dist. v. St. Charles Library Bldg. Corp.*, 627 S.W.2d 64, 68 (Mo. Ct. App. 1981) (holding that the option to terminate a lease at the end of each year kept the lease of a library building from violating debt-limitation provisions); *Dieck v. Unified Sch. Dist. of Antigo*, 477 N.W.2d 613, 615 (Wis. 1991) (holding that the school district did not incur debt when it entered into a lease-purchase agreement with a “nonappropriation option”); see also GILLETTE & BAKER, *supra* note 50, at 636 (“Courts have shared the Wisconsin court’s view that the [nonappropriation] clause effectively removes any legal obligation to make payments over the full lease term, and hence takes the lease outside of the scope of constitutional debt.”); *Sterk & Goldman*, *supra* note 33, at 1332 (discussing *Bulman v. McCrane*, 312 A.2d 857 (N.J. 1973)).

88. There is reason to doubt that nonappropriation or “morally binding” rental agreements are any less binding as a practical matter than agreements phrased in more absolute terms. See Gillette, *supra* note 30, at 1257 (“These schemes technically allow the issuing locality to cease making payments should the project prove inappropriate, although the subsequent loss of creditworthiness means that payment is likely compelled as a practical matter.”); see also *Lonegan v. State*, 809 A.2d 91, 128 (N.J. 2002) (“A recently issued Research Report by Standard & Poor’s, one of the nation’s most prominent bond rating agencies, explains that general obligation bond and appropriations debt are virtually indistinguishable as credit risks and that appropriations debt, as a practical matter, must be paid by the State whose agency issued the debt in order for that State’s credit rating to be maintained.”). In 2008, New Jersey’s constitution was amended to impose a public referendum requirement on such “appropriation” debt. See N.J. CONST. art. VIII, § 2, para. 3.

89. See, e.g., Stephen R. Kruff, *Leveraged Aircraft Leases: The Lender’s Perspective*, 44 BUS. LAW. 737 (1989) (describing aircraft leaseback arrangements).

90. See Peter Carbonara, *Cash-Hungry States Are Putting Buildings on the Block*, N.Y. TIMES, May 5, 2010, at B8, available at 2010 WLNR 9265999.

leases that are part of sale-leaseback arrangements may include buyout provisions or run for the expected lifetime of the property, though either set of provisions risks losing the favorable federal tax treatment accorded such transactions.⁹¹ In addition, the leases executed in conjunction with these arrangements must meet the technical requirements needed to avoid the recharacterization of the arrangements as debt for state and federal tax law purposes.⁹² As an economic matter, sale-leasebacks allow governments to cash out equity that may have been created by past tax collections. Looking forward, such arrangements put future taxpayers in the position they would have been in had the government originally borrowed money to purchase or build the covered asset, instead of prepaying the expense through outright purchase.⁹³ In a sense, these transactions turn asset equity into a “rainy day fund” for the government. Certainly, the Arizona government was able to recoup the money it spent in earlier years on constructing its property through its sale-leaseback arrangement. Of course, once a local government makes use of a sale-leaseback arrangement as a source of funding it cannot do so again, because the property that was sold to make the arrangement no longer belongs to the government.

Sale-leasebacks have the potential to do more than merely place a jurisdiction in the same position it would have been in had it borrowed the money to construct (or purchase) the asset subject to the lease. Since the parties enter into the sale and

91. Asset owners are entitled to depreciation deductions, which are usually accelerated relative to economic depreciation. This acceleration generates time value of money gains for taxpayers with sufficient outside income against which the accelerated depreciated deductions can be applied. These tax benefits supply part of the economic rationale for the transaction, and increase the price the purchaser is willing to pay for the asset. However, if the alleged owner of the property retains too little risk of ownership, the Internal Revenue Service (IRS) can recharacterize such transactions as mere financing arrangements, insufficient to shift ownership of the assets (and their associated depreciation deductions) to the purchaser/lessor, thereby reducing the economic benefits of the transaction for the buyer and seller. *See* BORIS I. BITTKER ET AL., *FEDERAL INCOME TAXATION OF INDIVIDUALS* 14–17 (3d ed. 2002) (“[M]any tax shelter arrangements entailed transfers of legal ownership of property, such as a movie, while associated contracts effectively shifted the benefits and burdens of ownership to other persons. In such cases, the taxpayers holding legal title to the property have been denied depreciation deductions with respect to the property.”). In the Arizona transaction, the leases ran for twenty years, after which ownership reverts to the state. Carbonara, *supra* note 90.

92. *See* BITTKER ET AL., *supra* note 91, at 14–17.

93. This assertion assumes the sale and leaseback arrangements are effected at fair market value.

lease contemporaneously, the parties could structure such transactions to include an upfront sale/purchase price in excess of the asset's fair market value. The government could spend this excess as it pleased. Inflated rental payments would then compensate for the initial overpayment.⁹⁴ For example, suppose a state owned an office building that was worth \$1 million, with an annual fair rental value of \$100,000. The state could "sell" the building for \$2 million, while agreeing to "rent" it back for \$200,000. Essentially, both parties would pretend that the building was twice as valuable as it really was and act accordingly. Over the term of the lease, the \$100,000 of excess annual lease payments would compensate the purchaser for the initial \$1 million overpayment; over time, the parties would end up in the same place as if the original purchase had been effected for \$1 million. A transaction of this sort would leave later generations of ratepayers responsible for paying for more than the value of the benefits they receive through use of the asset covered by the lease, as they would be paying \$200,000 annually to rent a \$100,000 building. Thus far, though, jurisdictions do not seem to be borrowing additional money through sale-leaseback transactions. Instead, when that is the aim, they have turned to privatization transactions.⁹⁵

F. PRIVATIZATION

In a classic privatization transaction, a private enterprise assumes the responsibility of operating what had been a public function.⁹⁶ Instead of running a municipal waste operation, for example, a city may decide to let the job be handled by private haulers, with the waste deposited in a private landfill. The city may contract with the private enterprises on behalf of the residents, or may allow its residents to enter into contracts with

94. As demonstrated by the 1970's tax shelter industry, when desired, parties can set a greatly inflated sale price that is then offset by an equally inflated stream of rental payments. *See, e.g.*, *Estate of Franklin v. Comm'r*, 544 F.2d 1045, 1046 (9th Cir. 1976) (describing property purchased for approximately \$600,000 that was sold to shelter investors for \$1,224,000 shortly thereafter). Such overvaluation is grounds for loss of any associated tax benefits.

95. Privatization is a tool by which local governments "contract with private companies for the provision of services." Scott D. Maker, *Local Government, Privatization, and Antitrust Immunity*, 68 FLA. B.J. 38, 38 (1994).

96. *Id.* A decision to avoid providing a service that is sometimes provided by government, such as garbage collection or water provision, may be regarded as a *sub silentio* privatization. However, the term seems to be used only with respect to decisions to abandon activities the particular government previously carried out.

the providers directly. In all contexts, privatization decisions raise the question of the proper scope of government. This question is at the heart of the current debate over national health care,⁹⁷ but it is equally implicated in disputes over the use of school vouchers, charter schools, security services, and recreational facilities; and the answer turns, in part, on whether a public or private institution is best able to perform the function at the lowest cost.⁹⁸

That said, private parties are only interested in taking over those governmental activities that they believe can be carried out at a profit. With the exception, perhaps, of some nonprofit entities, they are not interested in engaging in money-losing activities. And in fact, many privatized (or potentially privatized) activities are either natural monopolies or confer great market power on their owners.⁹⁹ Governments need not—and in most cases should not—simply give private investors the excess value inherent in these monopoly markets. However, there are many ways for governments to extract this value from the investors. One option is rate regulation.¹⁰⁰ The government can require an investor to price the goods or services below their market-clearing price, to the benefit of current and future users of that good or service. Another option is for governments to tax the excess profits earned by the private investor, either

97. The current health care debate raises questions both about who should be responsible for financing health care (individuals or employers through private insurers or through the government, either by general revenues or by a government-run or government-subsidized insurance scheme) as well as who should provide that care (private enterprises or the government). At present, of course, we have a mix of financing schemes and providers. This mix may change with the implementation of the recently passed Patient Protection and Affordable Care Act., Pub. L. No. 111-138, 124 Stat. 119 (2010). However, the implementation of the new Act remains in doubt as the debate over health care reform continues to rage. *See, e.g.*, David M. Herszenhorn, *Senate Rejects Repeal of Health Care Law*, N.Y. TIMES, Feb. 3, 2011, at A20, available at 2011 WLNR 2136789.

98. Distributional issues can also be implicated, though if a private enterprise is truly more efficient at carrying out the activity, distributional concerns could be satisfied by providing government subsidies to allow needy individuals to take advantage of the privately provided service.

99. *See generally* C.D. FOSTER, *PRIVATIZATION, PUBLIC OWNERSHIP AND THE REGULATION OF NATURAL MONOPOLY* (1992) (describing the relationship between monopoly and privatization).

100. *See generally* Steven J. Horvitz, *Rate Regulation and Video Competition*, 674 PRAC. L. INST. 155 (2001) (discussing regulating cable TV rates); Claire A. Watkins, *Nuclear Power Rate Regulation After Eastern Enterprises: Are Ratepayers Being Taken for a Ride?*, 28 B.C. ENVTL. AFF. L. REV. 191 (2000) (discussing legal challenges to monopolistic nuclear power rates).

in the form of an explicit tax,¹⁰¹ or through some sort of fee-splitting arrangement, such as a yearly market access or rental fee payable to the government. For example, governments regularly charge concessionaires annual fees for the privilege of conducting their businesses on valuable state property, such as convention centers, state or national parks, beaches, airports, and the like.¹⁰² These fees need not merely cover the government's cost in providing the venue, but may be priced to reflect the value of the location. Patrons of these businesses certainly end up paying high prices for the goods purchased there, but if they are residents of the jurisdiction, they may receive a partial rebate in the form of lower taxes made possible by the revenues collected from these privatized operations.¹⁰³

The third option is for the government to collect the present value of the future, or expected, profits up front, in the form of a one-time sale, franchise, or commission fee. For example, in the early days of cable television, cities regularly extracted franchise fees from cable providers for the unique privilege of operating within their jurisdictions.¹⁰⁴ This option, unlike the others, leaves future residents paying higher fees while providing current residents additional cash (because they pay lower taxes) or additional governmental services (purchased with the cash the government received from the private enterprises). From a cash-flow perspective, the third option is identical to a conventional debt transaction: cash is received up front and then repaid through higher charges levied on future

101. Whether the government could levy an explicit tax would depend on the taxing powers granted to the jurisdiction. In theory, though, the government could tax away all profits in excess of a normal rate of return.

102. See *Four T's, Inc. v. Little Rock Mun. Airport Comm'n*, 108 F.3d 909, 911 (8th Cir. 1997) (ruling on an agreement allowing concession of rental automobiles at an airport).

103. For example, "[e]cotourism generates funds through concession fees that can be used to maintain protected areas and parks." Alexander O'Neill, Note, *What Globalization Means to Ecotourism*, 9 *IND. J. GLOBAL LEGAL STUD.* 501, 519 (2000). *But cf.* John Ziegler, Note, *The Dangers of Municipal Contracts*, 40 *PUB. CONT. L.J.* 571, 572 (2011) (describing a poorly managed concession contract that led to very high prices for taxpayers).

104. Before enactment of the 1984 Cable Act, "competition among rival companies for a de facto monopoly cable franchise" led to high franchise fees in some cases. See Robert W. Crandall et al., *Does Video Delivered over a Telephone Network Require a Cable Franchise?*, 59 *FED. COMM. L.J.* 251, 270 (2007). This competition all but ended when Congress passed a statute in 1984 limiting franchise fees to no more than five percent of the cable system's gross revenues. See *Cable Communications Act of 1984*, 47 U.S.C. § 542(b) (2006); Crandall et al., *supra*, at 270.

residents. The only change is in the terminology; in a debt arrangement, the funds are initially provided by the purchasers of bonds, who are then repaid with funds raised through taxes paid to the government; in the concession arrangement, the initial funds come from the concessionaires in the form of fees and are repaid when their customers pay higher prices for the goods and services those concessionaires provide.¹⁰⁵ The choice between regulating rates, splitting ongoing fees, and extracting an upfront concession fee implicates the temporal fairness question raised earlier.¹⁰⁶ Which set of ratepayers is entitled to the government's share of the return: those present at the time the concession agreement is entered into or those present as the agreement runs its course? On the one hand, it could be argued that those bearing the financial burden of the higher prices charged by the private operators should be entitled to an offset in the form of lower taxes. The net result might be close to the situation they would have been in had the government continued to provide the service at a nonmonopoly price. However, if privatization is in fact more efficient, it may be desirable to provide "governments" (which is to say current politicians) with some incentive to engage in privatization transactions. Providing their constituents—those present at the time the parties execute the agreement—with the government's share of the monopoly price in the form of lower taxes or higher benefits would provide such an incentive by making the politicians more popular. Providing too much of an incentive, however, risks encouraging unwise privatization of governmental functions, privatizations which provide little or no efficiency advantages while burdening future generations of taxpayers with higher out-of-pocket costs for the privatized service, or higher government taxes or fees or some combination of the two.

The prospect of unwise privatization, driven by governments' need for immediate cash, is hardly academic. In 2008,

105. There may be a distributional issue as well, since the group of feepaying residents may well be different from the group of taxpaying residents. It is hard to know in which direction this distributional issue cuts, however, since although it seems unfair to have feepaying residents pay unrelated governmental expenses of nonfeepaying residents, it is also unclear why the feepaying residents should be entitled to receive the good or service provided by the privatized entity (or for that matter, the government) at a price less than its fair market value. Why is one subsidy fair and the other not?

106. See *supra* text accompanying notes 23–29 (discussing the difficulty of determining who should pay for governmental services). As a legal matter, a jurisdiction may not have the unfettered right to choose between these alternatives, or it may regard the costs of ongoing rate regulation as untenable.

the City of Chicago “sold”¹⁰⁷ its parking meters to a private company, Chicago Parking Meters, LLC. Chicago Parking Meters, denominated the “Concessionaire” in its agreement with the City, leased Chicago’s parking meters for a seventy-five year period in return for a lump-sum payment of \$1.156 billion.¹⁰⁸ Few, if any, of the benefits of the agreement come from

107. See CHICAGO PARKING METER CONCESSION, *supra* note 5. Although the title of the Agreement (reprinted as “Exhibit B”) denominates it a “Concession and Lease Agreement,” section 2.6 of the agreement provides that the Agreement is intended for United States federal and state income Tax purposes to be a sale of the Metered Parking System and the Metered Parking System Assets to the Concessionaire and the grant to the Concessionaire of a right for and during the Term to collect and retain Metered Parking Revenues.

Id. at 50,563. A possible reason for the much-criticized length of the lease term may have been the need to qualify the agreement as a “sale” for tax purposes. The Concessionaire needs to “own” the assets covered by the agreement to become entitled to favorable depreciation deductions for tax purposes. See GAO REPORT, *supra* note 4, at 26–27 (describing how ninety-nine and seventy-five year lease terms of tollway agreements were required to prove “ownership” for tax purposes necessary to claim depreciation deductions over a fifteen-year period). The tax benefits provided by those depreciation deductions are an integral part of the economics of many privatization deals, such as Chicago’s 2005 sale of the Skyway, a toll bridge linking Chicago to Gary, Indiana, for \$1.8 billion. *Id.* at 21–26 (“[T]he availability of these [depreciation] deductions were important incentives to the private sector to enter into some of the highway public-private partnerships we reviewed.”); see also Jeffrey N. Buxbaum & Iris N. Ortiz, *Protecting the Public Interest: The Role of Long-Term Concession Agreements for Providing Transportation Infrastructure* 14 (USC Keston Inst., Research Paper No. 07-02, 2007), available at <http://www.camsys.com/pubs/Protecting%20the%20Public%20Interest-Report.pdf> (“The ability to depreciate the ‘value’ of the asset for tax purposes seems to be one of the driving factors behind the longer lease terms in the United States.”). Because the only physical assets involved in the parking meter deal were the parking meters themselves, with an expected useful life of about ten years, the beneficial tax results may have been obtainable with a shorter lease term. See OFFICE OF THE INSPECTOR GEN., CITY OF CHI., REPORT OF INSPECTOR GENERAL’S FINDINGS AND RECOMMENDATIONS: AN ANALYSIS OF THE LEASE OF THE CITY’S PARKING METERS 19 (2009) [hereinafter INSPECTOR GENERAL’S REPORT], available at <http://www.chicagoinspectorgeneral.org/pdf/IGO-CMPS-20090602.pdf> (“[T]he useful life of the parking meters is not likely to exceed 10 years. Thus, extending the length of the lease to 75 years was not necessary to allow the concessionaire to claim accelerated depreciation and thus increase the size of the upfront payment.”).

108. INSPECTOR GENERAL’S REPORT, *supra* note 107, at 1. Chicago has been a leader of the privatization movement. In addition to the parking meter deal, Chicago entered into long-term leases of its municipal parking garages and the Skyway. A fourth lease, of Midway Airport, was cancelled when the concessionaire failed to raise the capital necessary to make the agreed-upon upfront payment. *Id.* at 12. However, other cities have followed Chicago’s lead. Most deals have involved tollways or other transportation infrastructure, see *id.* at 10–12, but other cities have looked into leasing their parking meters and

privatization per se; indeed, under the agreement, the Chicago Police Department retains primary authority for enforcing the parking rules.¹⁰⁹ The agreement limits the private company's role to installing and maintaining new meters.¹¹⁰ The Concessionaire later contracted these tasks to a third party for a relatively small sum,¹¹¹ something the City of Chicago could have done.¹¹² In return, the Concessionaire became entitled to all of the parking meter revenues for seventy-five years. Obviously,

city-owned parking garages. Joe Smydo, *City Looks to Chicago for Privatized Parking Ideas*, PITT. POST-GAZETTE, Mar. 14, 2010, available at 2010 WLNR 5354050 (noting that Pittsburgh has paid attention to Chicago's transactions); Dumke, *supra* note 5 (noting that Pittsburgh, Los Angeles, and Las Vegas have followed Chicago's lead); Leonard Gilroy, *Setting the Record Straight on Chicago Parking Meter Privatization*, REASON FOUND. (Aug. 7, 2009), <http://reason.org/news/show/setting-the-record-straight-on-1> (noting that Chicago "is already serving as a model for Los Angeles, Indianapolis and other local governments contemplating similar deals").

109. See CHICAGO PARKING METER AGREEMENT, *supra* note 5, at 50,586. The Concessionaire does have the right to supplement the City's enforcement efforts. *Id.* at 50,566. According to a recent newspaper article, the company managing the parking meter system on behalf of the Concessionaire is taking advantage of that right, having hired "10 ticket writers and plan[ning] to add another five this year" despite compliance rates of about seventy-five percent. Dan Mihalopoulos & Mick Dumke, *Outrage Aside, Drivers Fuel High Parking Meter Profits*, N.Y. TIMES, July 30, 2010, at A17, available at 2010 WLNR 15156453.

110. The Concessionaire was a newly formed company, Chicago Parking Meters, LLC, created by Morgan Stanley on behalf of some of its investors. More than twenty-five percent of the new company is held by the "investment arms of the oil-rich Abu Dhabi government," another substantial chunk belongs to the German financial company Allianz, and the remainder is held by assorted partnerships. Dan Mihalopoulos, *Abu Dhabi Shares Profits from Parking Meters*, N.Y. TIMES, Dec. 6, 2009, at A45, available at 2009 WLNR 24590062. Chicago Parking Meters, LLC, in turn hired LAZ Parking to handle the actual operation of the parking meter system, including the replacement of coin-operated meters with electronic meters. The transition period did not go well, as even LAZ Parking "acknowledged that it did not have enough workers to deal with the turnover," Dan Mihalopoulos, *Company Piles Up Profits from City's Parking Meter Deal*, N.Y. TIMES, Nov. 20, 2009, at A29, available at 2009 WLNR 23426449, leading to a temporary moratorium on parking enforcement. However, after a few months, the profits started rolling in. *See id.*

111. To get an idea of the differential, one can look at the Agreement itself. Under the terms of the Agreement, the City retained some metered parking spaces, denominated Reserve Metered Parking Spaces. Section 7.1 of the Agreement provides that fifteen percent of the gross revenues from the Reserve Metered Parking Spaces will be paid to the Concessionaire for their "operation and management." CHICAGO PARKING METER CONCESSION, *supra* note 5, at 50,582. Operating costs for the parking meter system as a whole were estimated at approximately \$4 to \$5 million per year. INSPECTOR GENERAL'S REPORT, *supra* note 107, at 16.

112. See *infra* text accompanying notes 116–21.

the vast majority of this return will be attributable neither to the Concessionaire's investment in nor its servicing of those machines, but to the upfront cash payment accompanying the execution of the contract. From an economic perspective, the City of Chicago sold seventy-five years' worth of parking meter revenues for the upfront payment of \$1.156 billion.¹¹³

Proponents of the parking meter transaction claimed that the City could not have raised equivalent revenues from its parking system in the absence of the privatization arrangement because of political constraints on raising parking fees; essentially, they argued that a private business party can be more ruthless in setting prices than governments (or at least the Chicago government) could be.¹¹⁴ Though this argument might be convincing in some contexts, it is less than plausible in this context since the city council could not enter into the contract without first passing legislation authorizing the rate increases.¹¹⁵ If it could raise parking rates for purposes of entering into the contract, surely it could have raised parking rates for other revenue-raising purposes.

Further, some of the projected revenue is attributable to the replacement of the City's existing parking meters with new "pay-and-display" meters. It is unclear how much of that additional revenue should be attributed to the privatization agreement given that that modernization could have been effected without the privatization agreement or with a radically different agreement. The cost of purchasing and installing the new meters was estimated at \$50 million.¹¹⁶ Assuming the City wished to pay off that \$50 million loan with parking meter proceeds, it could have done so with a much shorter "lease"

113. See INSPECTOR GENERAL'S REPORT, *supra* note 107, at 18.

114. See William Blair & Co., *Chicago Metered Parking System Transaction Summary and Valuation Analysis*, CITY OF CHI., 4 (June 30, 2009), http://www.cityofchicago.org/content/dam/city/depts/rev/supp_info/ParkingMeter/ValueAnalysisByWilliamBlair.pdf [hereinafter Blair, *Valuation Analysis*] (describing the assumption of annual parking rate increases of three percent as "probably aggressive given the fact that the rates on 75% City meters [sic] had not increased in over 20 years" despite a "rate of inflation average [of] approximately 3.2% per year"). For a more complete discussion of the argument and its application to the Chicago parking meter deal, see *infra* note 129.

115. See Authorization for Execution of Concession and Lease Agreement and Amendment of Titles 2, 3, 9 and 10 of Municipal Code of Chicago in Connection with Chicago Metered Parking System, 12-4-08 Coun. J. 50506, § 10 (2008) (codified as amended at Chicago, Ill., Mun. Code tit. 9, ch. 64, § 205 (2008 & Supp. 2010)).

116. See INSPECTOR GENERAL'S REPORT, *supra* note 107, at 15.

term, or even a lease term running until the \$50 million and some stated interest amount was repaid. Essentially, the City used a \$50 million upgrade of its parking meter system as camouflage for a much larger loan.

Economically, then, the parking meter transaction is best described as a loan transaction: the City of Chicago borrowed \$1.156 billion,¹¹⁷ but rather than pay interest on the debt at a set rate, it agreed to pay a contingent rate of interest both measured and secured by seventy-five years of parking meter revenues.¹¹⁸ When characterized this way, the transaction is a variant of special funds indebtedness, the type of indebtedness that in some jurisdictions, including Illinois,¹¹⁹ escapes constitutional restrictions on debt.¹²⁰ Further, it is the more questionable variant of special-funds indebtedness, because most of the parking meter revenues that will be used to pay back the debt are not revenues that will exist only because the Concession Agreement was entered into or to compensate for the costs of running the parking meter system. The City of Chicago could have generated most of the revenue alienated under the contract by raising parking meter rates and replaced its parking meters with pay-and-display meters, without entering into a \$1.156 billion contract.¹²¹

Thus, the agreement exchanges future public revenues for present public funds, just like debt. And just like many debt arrangements, the parking meter deal will leave future ratepayers decidedly worse off. The City's expenses going forward will not change (except for the relatively modest cost of installing and servicing the parking meters), but it and its ratepayers will have to come up with a new source of revenue to fund those ongoing expenses. Future ratepayers will be doubly disfavored relative to current residents: they will have to pay higher taxes

117. Actually, the debt incurred by Chicago was about \$50 million larger than the \$1.156 billion payment received by the City because the Concessionaire bore the cost of purchasing and installing the new parking meters. See Blair, *Valuation Analysis*, *supra* note 114, at 4.

118. See GAO REPORT, *supra* note 4, at 20 (listing "avoid[ing] the legislative or administrative limits that governed the amount of outstanding debt these states were allowed to have" as an "advantage[]" for the states" of using highway public-private partnership agreements).

119. See *People ex rel. City of Salem v. McMackin*, 291 N.E.2d 807, 816 (Ill. 1972) ("In each of these cases we have held that when the obligation is to be paid solely from the income derived from the property purchased by the use of the bonds, no municipal indebtedness is incurred.")

120. See *supra* notes 55–59 and accompanying text.

121. See INSPECTOR GENERAL'S REPORT, *supra* note 107, at 16–17.

to maintain the same level of services, even as their disposable income is reduced by the extra parking fees mandated by the agreement.

In some respects, Chicago's sale/lease of its parking meter revenues is no different from its sale or lease of any other piece of valuable governmental property that could be retained and rented out. It is hardly unusual for governments to dispose of unwanted or surplus property ranging from old police cars to unwanted office buildings, rather than keeping the property and trying to use it to generate income.¹²² Generally, the sort of privatization that motivates government to sell used vehicles rather than trying to engage in proprietary endeavors is lauded; the accepted wisdom is that governments will be worse at selling used cars at the retail level or renting them out than would the private sector. It would seem foolish to say that governments should be forbidden from ever disposing of property once acquired, even though the sums received from such sales could be traced to past tax contributions, and the future income foregone to future taxable years. Perhaps this is because most of these sales are recurring situations and in these recurring sale situations, the government's current expenditures on replacement cars and office buildings and schools likely exceed the amounts they receive from the sale of the older models. Such current acquisitions compensate future taxpayers for the losses they suffer from the alienation of the old property. They are not really being left worse off. Perhaps this is because the property being disposed of is viewed as truly surplus, not something of continuing financial interest to the city or its inhabitants. Perhaps the prospect of politicians spending the capital accumulated by former generations is sufficiently common to be beyond objection. Perhaps the sums involved are relatively trivial in the context of the entire governmental budget.

These arguments, however, cannot be made to support the City of Chicago's parking meter deal. The politicians disposed of future revenues belonging to future residents (residents, it is worth noting, who will receive little if any recompense in the form of improved parking), not past, built-up capital which in some sense belonged to current (or past) residents. The use of

122. See, e.g., *Illinois Opens Online Bidding for Surplus Property*, CHI. DEFENDER ONLINE (Aug. 16, 2010), <http://www.chicagodefender.com/article-8510-illinois-opens-online-bidding-for-surplus-property.html> (discussing the wide variety of city and state property auctioned to the public by the State of Illinois).

the disposed-of property will not change, it will continue to be used by the same individuals for the same purpose, and there is no sense in which the parking spaces are surplus. Further, these politicians, for the most part, used the revenues alienated from future years to pay current expenses, which, in an ideal world, would have been paid out of the pockets (and taxes) of current residents,¹²³ and not to purchase replacement assets that would benefit future residents. Moreover, the sum involved is huge.

Most importantly, the possibilities for extension of the concept to other portions of the state and local revenue bases are obvious. The former mayor of Chicago was eyeing the public water system.¹²⁴ But every fee-based, or potentially fee-based, government service may be the target of a similar privatization arrangement. Governments can apply the arguments that were made to support parking meter privatization—that private businesses can carry out (some portion) of the activities as well as government, and that selling the right to engage in the activity for an upfront fee removes the government’s risk that fees will fail to grow over time due to government timidity about raising rates or declines in interest in the activity¹²⁵—to hunting fees, vehicle registration programs, sewage treatment facilities, and fire protection, for example, in order to collect the present value of these future fees in advance. Further, the smaller the operational responsibilities devolved on the private investor relative to the revenue expected from the activity, the

123. The City planned to put \$400 million of the \$1.156 billion in a “long-term reserve/revenue replacement fund,” \$100 million in a “human infrastructure fund,” \$325 million “in a mid-term budget relief fund to help balance our budgets through 2012,” and \$320 million “in a budget stabilization fund that may be used to help bridge the period until the nation’s economy begins to grow again,” while using \$150 million “to balance the 2009 budget.” *Chicago Parking Meter Facts*, CITY CHI., http://www.cityofchicago.org/content/dam/city/depts/rev/supp_info/ParkingMeter/ParkinMeterBrochure.pdf (last visited Apr. 24, 2011). Splitting the numbers up this way makes it only slightly harder to discern that of the \$1.156 billion received, the City expected to spend fully \$795 million within three or four years of entering into the contract. In fact, the City spent almost \$400 million from the parking meter deal in 2009, and expects to spend another \$600 million in 2010. See Dan Mihalopoulos & Hal Dardick, *Daley Steers Clear of More Layoffs, Taxes*, CHI. TRIB., Oct. 22, 2009, at A1, available at 2009 WLNR 20922022.

124. See Mihalopoulos & Dardick, *supra* note 123, at A1 (“[Mayor Daley] did not discount the possibility of privatizing the city’s water system, an approach that Milwaukee officials recently considered.”).

125. See Blair, *Valuation Analysis*, *supra* note 114, at 4–5 (calling rate and utilization “challenges and risks” that the transaction “shifted . . . to the concessionaire” under the agreement).

larger the upfront payment to the government, and the larger the net burden placed on future ratepayers.¹²⁶ The arguments made in favor of the parking meter transaction—that it raised more money for the City than it would have been able to raise had it kept the meters because it transferred the risk that future revenues will fall¹²⁷ and that the City never would have been able to raise parking rates to the levels called for under the agreement¹²⁸—apply not only to other types of fees but also to taxes such as real estate turnover taxes, sales taxes, and the like.¹²⁹ In short, the rationale would stretch to cover the sale of any portion (or indeed the entirety) of a jurisdiction's future tax revenues.¹³⁰

The history of constitutional and statutory limitations of governmental debt is one of avoidance and noncompliance,

126. Cf. GAO REPORT, *supra* note 4, at 34 (cautioning that public receipt of greater present-day benefits from public-private partnerships are more likely to burden future taxpayers).

127. See Blair, *Valuation Analysis*, *supra* note 114, at 10 (“The City will also benefit from a risk transfer, as the investment returns on the revenue replacement fund will be less volatile and more certain than the cash flow produced by the System.”). As the recent recession has amply demonstrated, tax revenues can fall rather than increase.

128. See *id.* at 4 (outlining “two significant challenges to increasing parking meter rates,” one of which was the City’s failure to increase rates in the past).

129. The “risk” alluded to in the Blair report is the risk that parking revenues will fall as parking rates rise as a result of “the reaction of parkers . . . during the initial five years of rate increases.” *Id.* at 5. Similar risks of avoidance (or evasion) arise when any fee or tax rises. See INSPECTOR GENERAL’S REPORT, *supra* note 107, at 4 (“Specifically, the City has argued that (a) it would have been impossible for the City to have both kept the parking-meter system and raised the rates to the same extent as the lease, because there was not sufficient political will to do so . . .”). Somehow, the mayor and city council found the “political will” to approve a contract that mandated exactly those rate hikes, and have stood fast against all attempts to undo or change the hikes. See *id.* at 5 (“In brief, the ‘impossibility argument’ is disproven by (among other things) the fact that the City did in fact raise the rates when it approved the lease, and the fact that other cities have kept their parking-meter systems and passed large rate increases.”).

130. See *supra* text accompanying note 11 (discussing the practice of “tax farming”). The IRS experimented with outsourcing its debt collection activities beginning in 2006, though it paid its contractors a percentage of collections rather than accepting an up-front fee. See David Cay Johnston, *IRS Enlists Outside Help in Collecting Delinquent Taxes*, N.Y. TIMES, Aug. 21, 2006, at A12 (announcing award of contracts); Press Release, Internal Revenue Serv., IRS Selects Three Firms to Take Part in Delinquent Tax Collection Effort (Mar. 9, 2006), available at <http://www.irs.gov/newsroom/article/0,,id=155069,00.html> (same). The program was terminated in 2009 after the IRS determined it was more efficient to use in-house workers. See Stephen Ohlemacher, *IRS Collecting Own Debts*, SEATTLE TIMES, Mar. 7, 2009, at A4.

aided and abetted by courts and state legislatures.¹³¹ The current absence of controls on privatization fits that pattern, and may be seen as innocuous for that reason. However, as Part III of this Article argues, privatization is a uniquely dangerous technique for avoiding debt limitations because the problems it creates extend beyond merely creating excessive debt.

III. THE COLLATERAL DAMAGE OF PRIVATIZATION

As detailed above, although most state constitutions limit the ability of state and local governments to incur debt, a number of devices have evolved to help these governments undercut the limitations. Governments do not always take advantage of these avoidance devices.¹³² Referenda on debt issuances remain a staple of political life, for example, and, in most cases, politicians adhere to the outcomes of those referenda.¹³³ Some suspect that politicians use these escape mechanisms strategically, to finance those projects that do not have the support of the public but that the politicians are nonetheless interested in pursuing.¹³⁴ Even independent of this agency problem,¹³⁵ though, are the extra costs involved in taking advantage of these mechanisms. All of them involve some additional costs (although those costs must be compared to the costs of holding

131. *See supra* Part II.A–E.

132. They may take advantage of them more than most people realize, however. *See* BRIFFAULT & REYNOLDS, *supra* note 17, at 709 (“In recent decades, however, nonguaranteed debt [that is exempt from debt limitations] has become the principal form of state and local borrowing. In 2000, 73% of state long-term debt outstanding consisted of nonguaranteed debt. . . . 59% of municipal and township long-term debt . . . consisted of nonguaranteed debt.”); Gillette, *Democracy and Debt*, *supra* note 42, at 379 (“In a recent New Jersey case challenging the state’s use of alternative financing mechanisms, one of the judges noted that the state had outstanding \$3.5 billion of general obligation debt that typically requires a bond election, while it had outstanding \$10.8 billion of a different form of debt that required none.” (citing *Lonegan v. State*, 809 A.2d 91, 128–29 (N.J. 2002))).

133. But not always. *See* Gillette, *Democracy and Debt*, *supra* note 42, at 375–76 (“Nevertheless, in recent years, there have been multiple instances in which the local electorate has rejected proposed bond issues, only to have local officials finance the same project through an alternative mechanism not subject to the bond election requirement.”).

134. *See id.*

135. Whether to construe politicians’ pursuit of personal agendas as an agency problem depends on one’s view of what underlies that personal agenda: Is it a desire for personal or political gain, or a sincere belief that the electorate is deceived about its self interest and would be made better off if the politicians’ wishes prevailed? Only the first is an agency problem; the second is arguably what politicians are elected to do.

a referendum), but privatization has more than the others. In particular, privatization deals raise serious pricing issues.¹³⁶ Further, privatization restricts future government decision-making more than some of the other debt avoidance devices. Additionally, it is particularly nontransparent, leading to a loss of political control over its misuse.

A. CASH PRICING

In traditional municipal debt transactions, pricing is relatively simple and relatively free from opportunities for corruption.¹³⁷ From a financing perspective, the only issue is the appropriate interest rate given the length of the financing contract and the riskiness of the debtor. Even if the debt is initially sold to an intermediary, an investment bank, for example, for resale to investors, the accuracy of the price at which it was sold to the intermediary can be determined by checking it against the price the intermediary received on resale; discrepancies can be identified and punished, either under the securities laws or by the debtor's decision to use another intermediary in future transactions.¹³⁸ Additionally, when debt is divided into small chunks and sold on relatively large, established, and open public markets, price collusion is hard to sus-

136. See GAO REPORT, *supra* note 4, at 33 (cautioning that in exchanging future revenues for immediate cash, "the public sector may give up more than it receives in a concession payment").

137. No market is free from abuse possibilities. In 2004, municipal bond dealers engaged in refinancings of municipal debt were found to have cheated the federal government by inflating the cost of Treasury bills being sold to municipal governments. See Press Release, Sec. & Exch. Comm'n, SEC Settles with Ten Brokerage Firms as Part of Global Resolution of Yield Burning Claims (Apr. 6, 2000), available at <http://www.sec.gov/news/press/2000-45.txt>; *Issue Brief: Yield Burning*, GOV'T FIN. OFFICERS ASS'N (Jan. 2008), <http://gfoa.org/downloads/yieldburning.pdf>. More recently, federal agencies have been investigating allegations that financial intermediaries colluded to set unreasonably high fees for underwriting municipal bonds or derivatives based on the bonds, sometimes paying kickbacks to public officials to direct the deals (and the fees) their way. See Mary Williams Walsh, *Nationwide Inquiry on Bids for Municipal Bonds*, N.Y. TIMES, Jan. 9, 2009, at A1, available at 2009 WLNR 441316. For a description of an earlier incarnation of this scheme and attempts to combat it, see generally Jon B. Jordan, *The Regulation of "Pay to Play" and the Influence of Political Contributions in the Municipal Securities Industry*, 1999 COLUM. BUS. L. REV. 489. All of these scandals involve alleged malfeasance by intermediaries rather than mispricing of the underlying securities. There is no reason to believe that the intermediaries involved in putting together privatization deals are more or less corrupt than those involved in the municipal bond market; indeed, they may be the same institutions and people.

138. See *supra* note 137 (discussing exposure of yield-burning schemes).

tain because of the financial incentives for individual market participants to cheat an attempted cartel.¹³⁹

The story is similar for somewhat less traditional municipal debt transactions such as special-funds debt, whether the debt is backed by proceeds from contracts with private enterprises (i.e., industrial revenue bonds) or fees generated by public projects such as tollways, airports, or power facilities.¹⁴⁰ Mechanically, the procedures for issuing such debt remain the same. Ultimately, the price of the debt is set in a relatively thick public market.¹⁴¹ Public investors must weigh the riskiness of the underlying project. Indeed, the market check provided by investors who investigate the creditworthiness of a project before making their investment is typically identified as one of the benefits of using special funds rather than full faith and credit debt.¹⁴² When knowledgeable investors refuse to buy

139. See George J. Stigler, *A Theory of Oligarchy*, 72 J. POL. ECON. 44, 44 (1964) (positing that secret price cutting by cartel members may undermine attempts at price collusion).

140. The move toward the use of special funds (rather than general obligation) debt has been criticized for some of the same reasons this Article argues against debt masquerading as privatization: the added costs of complexity and the restraints on future policymaking. See RICHARD BRIFFAULT, *BALANCING ACTS: THE REALITY BEHIND STATE BALANCED BUDGET REQUIREMENTS* 45–47 (1996).

141. Of course, markets are only as good as the underlying information on which they are based, and criticism has long been leveled at the rating agencies providing information to the bond markets. See, e.g., John Patrick Hunt, *Credit Rating Agencies and the “Worldwide Credit Crisis”: The Limits of Reputation, the Insufficiency of Reform, and a Proposal for Improvement*, 2009 COLUM. BUS. L. REV. 109, 114 (criticizing rating agencies’ rating of novel financial instruments); Joel Seligman, *The Municipal Disclosure Debate*, 9 DEL. J. CORP. L. 647, 658 (1984) (“One critic went so far as to argue that in light of the number of municipal bonds and the number of rating analysts, the average bond rating should take only twenty seconds.”); Francis A. Bottini, Jr., Comment, *An Examination of the Current Status of Rating Agencies and Proposals for Limited Oversight of Such Agencies*, 30 SAN DIEGO L. REV. 579, 579 (1993) (“An analysis of the current market for ratings of both financial securities and insurance companies reveals significant problems with rating agencies, such as lethargy in changing ratings, political influence, unsolicited ratings, and inaccurate ratings.”). Some believe that the current municipal bond market is overvalued. See Page Perry LLC, *Risks Grow in the Municipal Bond Markets*, INVESTMENT FRAUD LAW. BLOG (June 17, 2010), http://www.investmentfraudlawyerblog.com/2010/06/risks_grow_in_the_municipal_bo.html (noting controversy over current safety of municipal bond investments). However, despite the market’s problems, large numbers of investors routinely invest significant amounts of money in municipal bonds, indicating their belief that the prices set in the market are reasonably accurate.

142. Investors are supposed to serve as a check on profligate or unwise investments by refusing to purchase bonds in projects that are unlikely to gen-

bonds, other investors also become suspicious that they will not be paid in accordance with their terms or are otherwise undesirable and also stay away from them; in the absence of buyers, the sale of the bonds will fail to raise enough money to undertake undesirable projects. However, even sophisticated bond buyers care only about downside risks: Will the project generate enough cash to pay off the debt in accordance with its terms? They have no share in, and therefore no interest in analyzing, the extent of potential gains above that minimum return.

By contrast, one of the most contentious issues in many privatization deals is the ultimate contract price.¹⁴³ Price becomes an issue precisely because the privatization deals are more complex and the privatization markets less thick and less transparent than the regular municipal bond market.¹⁴⁴ These characteristics of privatization markets provide room for misbehavior and mistakes. Further, suspicion abounds.¹⁴⁵ The absence of clarity and transparency makes for the appearance, if not the reality, of improper behavior.

Privatization deals are more complex than municipal bond deals because investors are interested not just in downside

erate the cash flow necessary to pay them off. See Gillette, *supra* note 30, at 1259–60 (explaining the disciplining function of the market for municipal debt).

143. *E.g.*, *infra* note 145.

144. *Cf.* Ellen Dannin, *To Market, To Market: Legislating on Privatization and Subcontracting*, 60 MD. L. REV. 249, 268–69 (2001) (discussing the difficulty of pricing privatization deals given the unique circumstances of each).

145. The economics behind Chicago's parking meter deal remain controversial. The report issued by the City's inspector general concluded that the investors grossly underpaid the City. See INSPECTOR GENERAL'S REPORT, *supra* note 107, at 3 (arguing that "the parking-meter lease was a dubious financial deal for the City"); Mihalopoulos, *supra* note 110 at A29. The designer of the deal disagreed. See Blair, *Valuation Analysis*, *supra* note 114, at 2 ("Our analysis confirms that by properly projecting System revenues and by applying a discount rate that appropriately reflects the relative risks of the System, the conclusion that the City received full and fair value for the Concession of the System is clearly supported and affirmed."). Suspicions have been raised about Blair's independence and objectivity. See Connie Wilson, *Chicago Residents Outraged over Mayor's Sale of Chicago Parking Meters and Lots*, ASSOCIATED CONTENT, June 21, 2009, available at http://www.associatedcontent.com/article/1866529/chicago_residents_outraged_over_mayors_sale (noting the substantial fee William Blair received for effectuating the deal, his contributions to the mayor's wife's favorite charity, and other personal linkages); see also Ben Joravsky & Mick Dumke, *FAIL, Part Two: One BILLION Dollars! New Evidence Suggests Chicago Leased Out Its Parking Meters for a Fraction of What They're Worth*, CHI. READER (May 21, 2009), <http://www.chicagoreader.com/chicago/one-billion-dollars/Content?oid=1123046>.

risks, but also upside possibilities.¹⁴⁶ When an activity is privatized, the buyers become entitled to all of the revenue generated by the privatized activity; their interest is not capped as it is under most debt deals. From a risk perspective, the difference between the two types of transactions is the same as the difference between selling and buying stocks rather than bonds. This is not just a question of whether an equity cushion exists; it is also a question of variance. More specifically, the range of projected revenue streams may be large, leading to substantially different value estimates.¹⁴⁷ For example, the amount of revenue generated from a tollway depends on its usage, which, in turn, depends on the state of the economy, the development (or not) of transportation alternatives, and regional development patterns.¹⁴⁸ High gasoline prices or health concerns may en-

146. See GAO REPORT, *supra* note 4, at 26 (“[P]rivate investment groups . . . have recently demonstrated an increasing interest in investing in public infrastructure. They see the sector as representing long-term assets with stable, potentially high yield returns.”).

147. While Blair defended the sale price of \$1.156 billion for Chicago’s parking meters, see Blair, *Valuation Analysis*, *supra* note 114, at 1, the Inspector General thought that the City “was paid, conservatively, \$974 million less for this 75-year lease than the City would have received from 75 years of parking-meter revenue,” INSPECTOR GENERAL’S REPORT, *supra* note 107, at 2. Several years earlier, when Chicago leased its interest in the Skyway, linking Chicago to the Indiana Tollway, the winning bid was \$1.82 billion, more than double the second-highest bid and substantially above Chicago’s prebid estimate of its value. See Craig L. Johnson et al., *Toll Road Privatization Transactions: The Chicago Skyway and Indiana Toll Road*, CARL VINSON INST. GOV’T, 3–4 (Sept. 2007), <http://www.cviog.uga.edu/services/research/abfm/johnson.pdf> (reporting bids of \$505 million, \$700.5 million, and \$1.82 billion). Though most rejoiced at the high price, some believed that even the winning Skyway bid was too low. See *id.* at 10 (“[F]rom a longer-term financial perspective, it is difficult to know whether the Skyway privatization was a good deal for the City.”); see also INSPECTOR GENERAL’S REPORT, *supra* note 107, at 9 (“[S]ome criticized the deal as raising toll rates too aggressively and arguing that the City did not receive a large enough payment.”). Nor are discordant valuations limited to transactions involving Chicago. The winning bid for the Indiana Toll Road was \$3.8 billion. While the consulting firm hired by the state deemed its value to be slightly under \$2 billion, a study performed by an economics professor on behalf of opponents of the concession estimated the value at about \$11 billion. See GAO REPORT, *supra* note 4, at 33. The point is not (necessarily) that the governments granting concessions received too little, but simply that the valuation issues are extremely difficult, leading to widely disparate estimates of a “fair” price for these transactions. See *id.* at 33 (explaining how “toll rate assumptions can influence asset valuations and, therefore expected concession payments”). In turn, this makes it difficult to enforce (either as a criminal or political matter) ethical and competency norms.

148. See GAO REPORT, *supra* note 4, at 34 (“[U]nforeseen circumstances can dramatically alter the relative value of future revenues compared with the market value of the [tollway] facility.”).

courage transportation substitutes, reducing parking meter usage. Different people reasonably may disagree over the likelihood of particular risks occurring, leading to differing valuation estimates.¹⁴⁹

Further, because many of the risks inherent in privatization deals may be allocated through negotiated contractual terms, the amount of risk accepted by investors varies from contract to contract. For example, the contractual parties may split positive returns through a profit-sharing arrangement triggered when revenues exceed a preset floor amount.¹⁵⁰ Similarly, parties may share negative returns through a mirror image of such an arrangement, where some portion of the agreed upon compensation is forfeited if revenues derived from the property covered by contract fall below a certain level. Contracts may provide that its signatories are forbidden from engaging in activities likely to encourage drops in demand—or from engaging in activities that will artificially discourage such demand reduction.¹⁵¹ For example, a tollway privatization agreement may provide that the government may not construct a competing roadway within a twenty mile radius of the road that is being privatized. Indeed, parties may manipulate contract terms so that a transaction denominated as a sale economically replicates a conventional debt transaction by narrowly limiting the investor's upside returns and downside losses to a range consistent with the returns offered by conventional debt. Presumably, however, doing so would risk the agreement's recharacterization as a debt for tax purposes, undermining some of the deal's tax benefits. Even worse, it may be recharacterized for state law purposes, making it subject to any applicable constitutional and statutory debt limitations.

Although negotiating risk allocations offers advantages to the contracting parties, the variation across contracts¹⁵² in risk

149. See Buxbaum & Ortiz, *supra* note 107, at 4 (“The experts disagree on the true costs and benefits of these deals. . . . [M]uch of the information promoting long-term concessions comes from those who will benefit directly—the construction companies, toll operators, bankers, attorneys, and their consultants. Similarly, opposition comes from those with a vested interest . . .”).

150. See Pagano, *supra* note 4, at 383 (describing Florida's requirement that all concession agreements contain a revenue sharing component); Buxbaum & Ortiz, *supra* note 107, at 40.

151. See CHICAGO PARKING METER CONCESSION, *supra* note 5, at 50,573 (limiting the right of the City to construct competing off-street parking lots); Buxbaum & Ortiz, *supra* note 107, at 42 (describing noncompete clauses in tollway deals).

152. It is worth noting that later parking meter leases were configured

allocations makes it harder to discern the fair market value of what parties are giving up or the adequacy of what parties are receiving in return under any particular contract. The more risk variations there are, the fewer in number the similar transactions, and the less trustworthy any market comparables. The harder it is for outside observers to penetrate the pricing decisions, to determine if they are fair to the locality, the harder it is to tell if the localities' agents, the politicians and bureaucrats, have done a good or bad job of negotiating the contract. Political checks cannot work in the absence of information about the right price for privatization deals; without such information, citizens do not know whether they should be lauding or punishing the politicians responsible for such deals.

This lack of pricing transparency is accentuated by the fact that the privatization market is much thinner than the market for publicly traded stocks and bonds. Stocks and bonds represent relatively small chunks of larger enterprises. The value of these small chunks is low enough to appeal to large numbers of independent investors who serve as checks against mispricing.¹⁵³ Privatization deals are much more similar in size to sales of entire businesses. Because of the scale of these transactions, relatively few potential buyers exist for any particular deal. This leaves opportunities for collusion or simple underpricing at the expense of the selling entity. In Chicago's parking meter deal, for example, only two bidders vied for the project.¹⁵⁴ Although one can certainly claim that there was a fair public auction of the Chicago parking meter system in that anyone could have entered the auction, the paucity of bidders can also be regarded as a symptom of a defective market, one susceptible to control by insiders or other elites and simply too thin to be trustworthy.¹⁵⁵ Even in the absence of a history of

quite differently than Chicago's. See Darrell Preston, *Morgan Stanley Chicago Parking Makes Cities Redo Deals*, BLOOMBERG.COM, Nov. 15, 2010, <http://www.bloomberg.com/news/print/2010-11-15/morgan-stanley-chicago-parking-windfall-makes-cities-redo-deals.html> (comparing Indianapolis, which "would rather take less money up front in favor of more total fees" and "exit clauses that let the city end the lease," to "Los Angeles, which may get a larger initial payment by giving up control over rates").

153. See *supra* note 142 and accompanying text.

154. See INSPECTOR GENERAL'S REPORT, *supra* note 107, at 13 (describing how ten bidders responded to the RFQ for the parking meter deal, of which eight were qualified, but only two made actual bids).

155. Again, this does not mean that the governments entering into these deals necessarily lose out; they may benefit from the "winner's curse," which suggests that the highest bid in an auction is likely to be too high. See

corruption and sweetheart deals (that is, involving some city other than Chicago), suspicions of malfeasance are likely to arise under these circumstances; moreover, they would be difficult to disprove. Other privatization auctions also involved relatively few bidders.¹⁵⁶

RICHARD H. THALER, *THE WINNER'S CURSE: PARADOXES AND ANOMALIES OF ECONOMIC LIFE* 50–51 (1992) (explaining the winner's curse). There is, however, no way of knowing when, or if, the winner's curse will occur, though it is less likely to occur when there are few bidders. See Clayton P. Gillette, *Business Incentives, Interstate Competition, and the Commerce Clause*, 82 MINN. L. REV. 447, 455–56 (1997) (detailing circumstances making the winner's curse less likely). *But see* PHINEAS BAXANDALL ET AL., U.S. PUB. INTEREST RESEARCH GRP. EDUC. FUND, *PRIVATE ROADS, PUBLIC COSTS* 23 (2009), available at <http://cdn.publicinterestnetwork.org/assets/rXyTdCxiacJTXJi3Cm-W1w/Private-Roads-Public-Costs-Updated.pdf> (noting that one investor had to write down the value of its tollway investments in late 2008). The underlying question is what purpose is served by putting future ratepayers at the mercy of this sort of valuation lottery.

156. See Buxbaum & Ortiz, *supra* note 107, at 14, 16 (noting that five proposers were selected to submit detailed bids for the Chicago Skyway concession and four bids were submitted for the Indiana Toll Road). There has been considerable discussion about the growth of competition and consequent drop in investor yields. See Yvette Shields, *Illinois Holds Hearing on Leasing Toll Road*, BOND BUYER, June 1, 2006, at 1, 53 (“[A] widening pool of potential bidders could help increase competition and prices. While initially some bidders sought high rates of return on their investment in the area of 12%, those figures have dropped in some cases to 7% to 9%”); Emily Thornton, *Roads to Riches: Why Investors Are Clamoring to Take over America's Highways, Bridges, and Airports—And Why the Public Should Be Nervous*, BUS. WK., May 7, 2007, at 50, 52, available at http://www.businessweek.com/magazine/content/07_19/b4033001.htm (“Now a slew of Wall Street firms . . . [are] piling into infrastructure Rob Collins, head of infrastructure mergers and acquisitions at Morgan Stanley, estimates that 30 funds are being raised around the world”). Despite this discussion, there has been little indication of efficacious competition in actual deals. In Spain, a leader in the privatization of tollways, “two private companies dominate the industry—accounting for 70% of the country's tolled traffic.” Jessica Hurtado, *For Whom the Road Tolls: A Two-Year Moratorium on Highway Privatization in Texas*, 41 TEX. TECH L. REV. 653, 657 (2009). Projected rates of return from privatization projects in the United States remain high. See Blair, *Valuation Analysis*, *supra* note 114, at 7–8 (justifying the pricing of the Chicago deal at ten to fourteen percent rate of return). It is worth noting that in concluding that the contract price fell within these parameters, Blair assumed that the investor would have to replace the parking meters several times over the course of the lease, at substantial expense. See *id.* at 6. Whether these expenditures actually will be necessary, or whether technological advances during the term of the contract will make them unnecessary, is far from clear; it is plausible that parking fees may be paid through cell phone transfers in the not very distant future, eliminating the need for expensive meters. See *Parking Fee Paid via Mobile Phone*, ECOMMERCE J. (Aug. 15, 2008, 4:46 AM), http://ecommercejournal.com/news/parking_fee_paid_via_mobile_phone (describing a pilot program in England).

Pricing problems are not unique to the privatization context.¹⁵⁷ Defense contracting provides a close parallel. When the federal government wants to build a new fighter jet or other weapons system, great concern is always expressed about the small number of potential bidders, the opportunities for collusive bidding, and the quality of the final product.¹⁵⁸ The federal government sometimes goes to great lengths to ensure the continued existence of multiple competitors due to fears about the pricing power of a contractor with a de facto monopoly.¹⁵⁹ The use of cutting-edge—and sometimes even beyond cutting-edge—technology reduces the utility of market checks on pricing because often there is only one possible provider of the technology. Over time, the federal government has experimented with a number of defense contract formulations—from cost-plus contracting, where the government promises to reimburse the purveyors' costs with a guaranteed profit margin, to flat-price contracts, where the government sets the price in advance, to incentive pricing, where the government reduces

The investors will reap an even higher rate of return if future meter expenditures are avoided or reduced.

157. Indeed, one might worry that forcing governments to use conventional debt rather than privatization agreements will simply shift losses from corruption or incompetence to other contractual arrangements, such as service, construction, or purchase contracts entered into contemporaneously with the privatization agreements. However, those opportunities for misbehavior would exist—and likely be exploited to the extent possible—independently of any advantages gained under a debt or privatization contract. One can at least hope that reducing the number of opportunities for misbehavior will reduce its extent.

158. See HOUSE ARMED SERVS. COMM. PANEL ON DEF. ACQUISITION REFORM, FINDINGS AND RECOMMENDATIONS 9 (2010), available at http://www.ndia.org/Advocacy/LegislativeandFederalIssuesUpdate/Documents/March2010/Defense_Acquisition_Reform_Panel_Final_Report_3-23-2010.pdf (“The length and scope of weapon system programs has accelerated defense industry’s consolidation around a handful of aerospace firms that now control large amounts of production capacity The Panel is concerned that the end result of this process is the gradual erosion of competition and innovation in the defense industrial base.”).

159. See *Joint Strike Fighter: Strong Risk Management Essential as Program Enters Most Challenging Phase, Testimony Before the Subcomm. on Air and Land Forces of the H. Comm. on Armed Servs.*, 111th Cong. 5 (2009) (statement of Michael Sullivan, Director, Acquisition and Sourcing Management), available at <http://www.gao.gov/new.items/d09711t.pdf> (defending continuing development of an alternate engine for the Joint Strike Fighter program because “[r]esults from past competitions provide evidence of potential financial and nonfinancial savings”); Nathan Hodge, *Navy Weighs Ship’s Design, Along with Its Own Future*, WALL ST. J., July 11, 2010, at A2 (noting that the Navy will order ten warships from one shipyard and five from a competing shipyard).

payments when costs exceed a certain level—only to find that there is no perfect structural solution.¹⁶⁰

Accordingly, it seems odd at best, and perverse at worst, for cities and states to do the opposite: to reduce the fairly robust price competition in two preexisting markets—debt markets¹⁶¹ and the markets for providing services—by bundling transactions into packages very few organizations are interested in bidding on, and for which the pricing is less transparent. Although such arrangements reduce “risk” by monetizing what is otherwise an uncertain income stream, the associated pricing problems create substantial, offsetting risks of underpayment and outright corruption. In the absence of pricing transparency, the political system is poorly placed to police against these risks, and no other effective controls exist.

Pricing problems, and the difficulties of policing prices, are not the only problems associated with the use of privatization deals as a way of borrowing money. A second problem is that the terms of these deals often lock the affected jurisdiction into questionable long-term policies. These lock-ins, as described in the next section, are necessary to safeguard the huge upfront investments made by the private buyers, investments equaling the present value of future taxes foregone. But they are hardly benign.

B. NONCASH CONTRACTUAL TERMS

Private investors are not altruists; they enter into privatization deals to make money. And because that money must come from the revenues derived from the privatized enterprise, those profits depend on the success of the enterprise they are purchasing (leasing). The government can, and often must, commit itself to increase the chances of that success in the sales (lease) contract. Its reason for doing so is straightforward: decreasing the riskiness of the enterprise increases the price

160. See *Defense Acquisitions: Managing Risk to Achieve Better Outcomes, Testimony Before the Subcomm. on Def. of the H. Comm. on Appropriations*, 111th Cong. 5–7 (2010) (statements of Paul Francis, Managing Director, Acquisition and Sourcing Management; Michael Golden, Managing Associate General Counsel, Acquisition and Sourcing Management; William Woods, Director, Acquisition and Sourcing Management), available at <http://www.gao.gov/new.items/d10374t.pdf> (describing types of contracts used by the Defense Department and objections to them); Daniel Michaels & August Cole, *Defense Contractors Resist Fixed-Price Jobs*, WALL ST. J., Dec. 14, 2009, at B3 (same).

161. For a discussion of the market for municipal debt, see *supra* notes 137–45 and accompanying text.

the investors will pay for it up front. Investors will not pay much for an enterprise that may be taxed or regulated out of existence in short order, nor for one that is likely to face competition sponsored by its contractual partner. Privatization deals often include analogues to the “covenants not to compete” found in wholly private business purchase agreements. However, the terms of a privatization deal’s noncompetition clause tends to last for a longer period of time and is often more restrictive than those found in private contracts.

For example, tollway and bridge deals often limit the selling jurisdiction’s ability to build competing tollways, roads, or bridges for the term of the lease, while containing covenants about the level of tolls allowed to be charged.¹⁶² Although some of the leases provide exceptions to the no-competition clause if certain usage criteria are exceeded, others do not.¹⁶³ Contracts may instead protect against the consequences of unforeseen increases or changes in demand, such as huge traffic jams and delays, by specifying performance criteria.¹⁶⁴ Of course, predicting the performance criteria that will be important over the next seventy-five years is impossible. This is one of the difficulties with such a long contractual term.

The Chicago parking contract similarly protects the private investor against loss not only by providing scheduled rate increases over the term of the contract but also by guaranteeing the number of parking spaces and their hours of operation.¹⁶⁵ Further, Chicago must compensate the investors for any loss of parking demand attributable to the City’s (or for that matter, “the County of Cook or the State of Illinois (or any subdivision

162. See GAO REPORT, *supra* note 4, at 45–47 (noting that “fully restrictive noncompete clauses” are avoided and describing existing clauses); Buxbaum & Ortiz, *supra* note 107, at 10–11 (describing provisions). Some of these provisions require an offending state to compensate the private investors for amounts lost as a result of the competing roads. See *id.* at 46 (Texas and Indiana).

163. See GAO REPORT, *supra* note 4, at 36 (explaining the change in contractual terms in agreements entered into after the California DOT was forced to buy out concessionaires to deal with congestion problems).

164. See *id.* at 42–43 (describing provisions in Indiana, Texas, and Toronto concessions).

165. See CHICAGO PARKING METER CONCESSION, *supra* note 5, at 50,590. If they fall below the standard set in the contract, the City must provide the investors with monetary compensation for lost revenues. See *id.* at 50,621. When streets are closed to parking on account of weather or street fairs, the City must pay the parking operator revenues equivalent to the meter revenues that would have been generated had the streets remained open. See *id.* at 50,589.

or agency of any of the foregoing”)¹⁶⁶ actions,¹⁶⁷ though the scope of that responsibility is unclear.¹⁶⁸ The contractual language is drafted broadly enough that it might give pause to politicians thinking about expanding public transportation or rezoning plans that might draw commercial traffic away from areas where the Concessionaire has parking meter rights.

This sort of revenue protection makes financial sense whether one views the privatization deal as the functional equivalent of debt or the purchase of an ongoing business. Purchasers often obtain covenants not to compete in connection with their initial purchase agreement, and forbid the transfer of assets without payment of adequate compensation.¹⁶⁹ Creditors want to get their money back, with interest, and often include protective covenants in debt agreements. And generally speaking, creditors do not forgive debt just because the debtor views repayment as inconvenient. However, the funds necessary to repay conventional government debt can come from a variety of revenue sources. An indebted municipality can choose to raise additional funds from any tax it is authorized to levy—be it a property tax, a sales tax, a transactions tax, or in some jurisdictions, an income tax.

By borrowing money in the form of a privatization agreement, localities lose that flexibility. They have to repay their constructive debt through parking or toll revenues, even if in the intervening years, the government decides it would prefer to raise revenues from a different tax or fee base. A government

166. *Id.* at 50,618–19.

167. *See id.* The City also has to compensate the investors if it builds new indoor parking garages or increases parking taxes. *See id.* at 50,573–74, 50,589–90.

168. Covered government actions include all those “Reserved Powers” specifically described in section 7.3 of the Agreement as “Reserved Powers” that the City may undertake but only with notification to the Concessionaire, and with stated compensation rights. *See id.* at 50,584. In addition, the contract provides that other “Adverse Actions” by the City or other governmental entities which will have “a material adverse effect on the fair market value of the Concessionaire Interest” entitles the Concessionaire to “AA Compensation” or to elect termination followed by payment of its “Concession Value.” *See id.* at 50,618–19. Whether an “Adverse Action” would include, for example, an expansion of the City’s public transportation system or a change in zoning regulations opening new areas of the City to commercial development (and perhaps decreasing the use of parking meters in older commercial areas) is unclear.

169. *See Gillian Lester & Elizabeth Ryan, Choice of Law and Employee Restrictive Covenants: An American Perspective*, 31 COMP. LAB. L. & POL’Y J. 389, 393 n.21 (2010) (discussing “covenants not to compete . . . connected to the purchase and sale of a business or its assets”).

might legitimately decide, for example, that street parking should be subsidized with heavier property or income taxes, or, alternatively, it might decide to encourage public transportation by imposing almost punitive taxes on street parking. There is no reason to think that such intrusions in public policy decisions are, on the whole, beneficial. Indeed, the longer the term of such privatization agreements, the less likely it is that these policy constraints will be beneficial simply because the officials drafting the agreement will know less about future conditions and problems. It is worth noting that most covenants not to compete are, as a matter of law, extremely time limited.¹⁷⁰

Chicago (and other governments) could, in theory, buy out its contractual partner if it wanted to finance this implicit debt from sources other than parking meter revenues.¹⁷¹ That is, it could borrow money from another source, pay off its contractual partner, and then use whatever funds it so desired to repay the new debt. However, buying one's way out of a privatization agreement is likely to be much more complex than refinancing a debt. A city cannot simply repay an amortized portion of the initial purchase price, perhaps with an interest-rate adjustment calculated with reference to market-established discount rates.¹⁷² Instead, investors may be entitled to receive the present value of their interest in the privatized function.¹⁷³ That is the standard measure of contract damages, and it applies in many government contract situations.¹⁷⁴ In the case of

170. See Douglas G. Baird, *Discharge, Waiver, and the Behavioral Undercurrents of Debtor-Creditor Law*, 73 U. CHI. L. REV. 17, 30 (2006) ("Covenants not to compete are suspect under nonbankruptcy law. They must be reasonable, and they can last only for a limited period of time . . ."); Lester & Ryan, *supra* note 169, at 390 ("There is a strong imperative that the [covenant not to compete] be no greater in terms of duration, geographic scope, and limitation on vocational activities than is reasonably necessary to protect the interests of the employer.").

171. Indeed, one of the first U.S. tollway privatizations was undone this way. See GAO REPORT, *supra* note 4, at 36 (describing California's buyback of SR-91 express lanes to allow improvement of adjacent public lanes).

172. See, e.g., CHICAGO PARKING METER CONCESSION, *supra* note 5, at 50,637 (establishing the City's responsibility to pay "the Metered Parking System Concession Value as of the date of" the buyout).

173. See, e.g., *id.*

174. Privatization agreements generally require governmental entities to make them whole for any interference with contractual rights. See GAO REPORT, *supra* note 4, at 46 (describing "compensation clauses"). Under the terms of the Chicago parking meter lease, the Concessionaire would be entitled to such an amount in the event Chicago attempted to terminate the agreement for its "convenience" as this would constitute a breach of the agreement. See CHICAGO PARKING METER CONCESSION, *supra* note 5, at

the Chicago parking meter agreement, this would mean an amount calculated with reference to then-current projections of parking demand and other variables.¹⁷⁵ The contract specifies that third-party appraisers determine this value.¹⁷⁶ In practice, the process of determining value is likely to be an expensive and fraught procedure given the pricing problems described above, thus posing a significant barrier to the use of the buyout provision.

The underlying contract terms are not the only impediment to buyouts. Arranging a substitute debt transaction is neither a trivial nor cheap transaction.¹⁷⁷ These costs discour-

50,637 (providing that the City may not terminate “this Agreement for convenience”). Damages under a contract which could be terminated for “convenience” would be limited to reliance damages. *See* Daniel R. Fischel & Alan O. Sykes, *Governmental Liability for Breach of Contract*, 1 AM. L. & ECON. REV. 313, 354 (1999) (“The effect of ‘termination for convenience’ is to reduce the government’s liability to the contractor relative to what the government would owe if the termination were treated as a breach (which would entitle the contractor to expectation damages).”); Gillian Hadfield, *Of Sovereignty and Contract: Damages for Breach of Contract by Government*, 8 S. CAL. INTERDISC. L.J. 467, 492 (1999) (discussing the measure of damages for breach of federal procurement contracts). Even calculating reliance damages for a contract such as the Chicago parking meter lease would be difficult. Given the absence of a stated principal amount, interest rate, or amortization schedule, it would be far from obvious how much of the initial payment received by the City would remain to be recouped through damages and how much would have already been recouped through the parking fees received prior to the contract’s termination.

175. Among those variables are governmental policies which increase the value of the parking spaces. Suppose, for example, that Chicago decides to transform more formerly “free” parking spaces to metered spaces. By eliminating cheaper parking alternatives, this policy change likely would increase the demand for, and the value of, spaces covered by the Concession Agreement. Interestingly, some foreign privatization deals contain clauses allowing interim renegotiation “if it is in the public interest to do so.” GAO REPORT, *supra* note 4, at 47; *see also* Pagano, *supra* note 4, at 384 (arguing for “require[d] . . . renegotiation at intervals throughout the term of the contract”). Chicago’s parking meter agreement, however, provides that the City “may only terminate this Agreement in accordance with the express terms hereof and shall not, in any event, have the right to terminate this Agreement for convenience.” CHICAGO PARKING METER CONCESSION, *supra* note 5, at 50,637. The “express terms” of the Agreement allow termination only if the Concessionaire defaults on one or more of its contractual responsibilities. *See id.* at 50,626–29.

176. *See* CHICAGO PARKING METER CONCESSION, *supra* note 5, at 50,622 (describing the computation of compensation required in the event of a “Reserved Powers Adverse Action”).

177. *See* U.S. TREASURY DEPT., TREASURY ANALYSIS OF BUILD AMERICA BONDS AND ISSUER NET BORROWING COSTS 9 (2010), available at <http://www.treasury.gov/resourcecenter/economicpolicy/Documents/4%202%2010%20BABS%20Savings%20Report%20FINAL.pdf> (“[T]he weighted average of the underwriting fees for tax-exempt bonds issued in 2009 and early 2010 was

age governments from changing course in midstream and switching from privatization debt to conventional debt. Further, when the actual cost of a privatization agreement is enormous, jurisdictions may be loathe to admit the exact size of the hole they dug for their constituents, as would be required should they convert the deal into conventional debt.¹⁷⁸ It is generally easier to carry on with the original deal, for better or for worse.

The incentives for stasis are particularly troubling given the term of these privatization deals. The term of the average U.S. privatization agreement is twice the length of those in European privatization agreements.¹⁷⁹ Tollway deals in the United States last for ninety years; similar deals in Europe last thirty or forty years.¹⁸⁰ The Chicago parking meter deal runs for seventy-five years.¹⁸¹ Generally speaking, because of both uncertainty and the time value of money, lengthening the term

\$6.19 per \$1,000.”); Eddie Baeb, *Bond Advisers Irk Wall Street, Curb Fees on Public Finance*, BLOOMBERG.COM, June 30, 2005, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aXuOdXOe6Jt4&refer=canada> (noting that “[u]nderwriting fees range from \$5.53 to \$6.45 per \$1,000 of bonds,” but providing examples where “independent advisors” negotiated substantially lower prices). Underwriting fees are only part of the cost of issuing debt; financial advisors, attorneys, and credit agency rating fees also can be substantial. See Gillette, *Democracy and Debt*, *supra* note 42, at 400–01 (“Bond lawyers, financial advisors, and underwriters earn significant fees for putting together and marketing transactions involving municipal obligations The pursuit of such business has apparently been so lucrative that the Municipal Securities Rulemaking Board intervened in 1994 to promulgate a rule against political contributions to municipal officials by ‘municipal finance professionals’ on the grounds that such contributions had become a primary means of attracting municipal underwriting business.”). Large as these sums are, they are considerably lower than the fees reaped in privatization deals. See Jenny Anderson, *Turning Asphalt to Gold: Australian Bank Pursues Toll Roads and Other Public Works*, N.Y. TIMES, Jan. 20, 2006, at C-1, *available at* 2006 WLNR 1081037 (“The potential for fees in these public infrastructure deals is astounding, even by Wall Street’s obsessive and excessive fee standards. Bankers can make advisory fees on the sale of the often-large assets. Then, once packaged into funds, the assets earn Macquarie management fees (1 to 1.5 percent) as well as incentive fees: 20 percent on profits above a certain threshold In essence, its deals are like leveraged buyouts: it provides the equity, borrows the debt and rakes in rich fees.”). Of course, in many jurisdictions and for some types of debt, the cost of a successful referendum must be added to bond issuance costs.

178. They would, at the very least, be required to determine the principal amount of the outstanding debt as well as the rate of interest payable on that principal.

179. See Buxbaum & Ortiz, *supra* note 107, at 10 (“In other countries, the typical length of concession agreements is 30 to 40 years.”).

180. *Id.*

181. INSPECTOR GENERAL’S REPORT, *supra* note 107, at 1.

of these contracts adds little economic value to the deal. For example, only seven percent of the sales price in the Chicago parking meter contract was attributable to years thirty-seven through seventy-five of the agreement.¹⁸² What the additional years may sometimes add is tax value—federal income tax value—which increases the value of the deal to the investors and thus the price they are willing to pay participating governments. Investors may claim generous depreciation deductions¹⁸³ only with respect to property that they own; deductions with respect to leased property must be claimed by the lessor.¹⁸⁴ If these privatization deals were classified as leases for tax purposes, the lessor would be a government that is not subject to federal income tax, and for whom the generous depreciation deductions therefore would provide no benefit. However, the IRS is willing to treat lessees/concessionaires as owners for tax purposes when the term of the lease exceeds the design life of the asset at the time of the transaction.¹⁸⁵ In many situations, twenty or thirty years would not meet this standard,

182. See INSPECTOR GENERAL'S REPORT, *supra* note 107, at 6 ("93% of the lease payment was to pay the City for the value of the first 50% of the 75-year period (37 years).").

183. Much of the purchase price can be depreciated over the fifteen-year period specified in § 197 of the Internal Revenue Code, rather than over the longer lease term. See GAO REPORT, *supra* note 4, at 27 n.18 (describing the effect of § 197 on tollway leases); Memorandum from Subcomm. on Highways and Transit Staff to Members of the Subcomm. on Highways and Transit 7 (Feb. 12, 2007), available at <http://books.google.com/> (search "Memorandum to Members of the Subcommittee on Highways and Transit Re Hearing on Public-Private Partnerships: Innovative Financing and Protecting the Public Interest") (explaining that the portion of the upfront payment in a tollway lease allocated "to the right to impose and collect tolls" is amortized over fifteen years). The portion of the payment allocable to the right to collect parking meter revenues in the parking meter lease is analogous to the right to impose and collect tolls.

184. See BITTKER ET AL., *supra* note 91, ¶ 14.06 ("Lessors are entitled to depreciation deductions . . . because, as owners, they bear the burdens of exhaustion, wear and tear, and obsolescence.").

185. See Rev. Rul. 55-541, 1955-2 C.B. 19 (holding that the lease transfers "equitable ownership" when lessee "will enjoy all of the benefits of ownership for substantially the entire useful life of the property"); Pagano, *supra* note 4, at 374 ("The long terms of the agreements arise in part from the economic benefit that the toll road company gets by claiming accelerated depreciation for tax purposes."); Memorandum from Subcomm. on Highways and Transit Staff, *supra* note 183, at 7 (explaining the tax consequences of extended term agreements). *But see* INSPECTOR GENERAL'S REPORT, *supra* note 107, at 19 (arguing that a shorter lease period would have been sufficient).

while seventy-five or ninety years would.¹⁸⁶ Accordingly, by lengthening the terms of the contracts, the parties may gain access to a valuable tax benefit—a benefit that they can split between themselves by adjusting the stated purchase price. In sum, these privatization deals are not only a method of circumventing debt limitations, many of these deals are also tax shelters in that they shift the economic benefits of accelerated depreciation from a tax-indifferent party (state and local governments are not subject to the federal income tax) to a taxable party (the private investor).¹⁸⁷ Unfortunately, one price some jurisdiction must pay to access the shelter is a contract with a term that lasts generations.

Given the favorable federal income tax treatment of municipal debt, it may be difficult to justify looking askance at this collusion between investors and local governments in the pursuit of tax benefits.¹⁸⁸ The benefits investors obtain from accelerated depreciation are certainly no greater, and are most likely less, than those they would have obtained had they invested

186. See Pagano, *supra* note 4, at 374 (“In order for the concessionaire to qualify as an owner eligible to deduct depreciation, the lease term must exceed the useful life of the asset.”). Tax considerations mandate long lease terms in tollway privatization contracts; however, the parking meter contract could have run for a shorter period without imperiling the tax benefits delivered to investors. See INSPECTOR GENERAL’S REPORT, *supra* note 107, at 5 (“While there are arguments in favor of longer leases (like 75 years) in certain situations—namely, the unavailability of favorable tax-depreciation status . . .—they simply do not apply here.”).

187. Though it is tempting to blame these transactions on the oddities of the Internal Revenue Code, and suggest that the Code be amended to shut them down, this is easier said than done. Not only will it be difficult to come up with a tax rule that punishes (makes undesirable) only these transactions, tax considerations are not the sole driver of long lease terms. See *supra* note 186 (noting the length of Chicago’s parking meter transaction cannot be attributed to tax considerations).

188. Section 103 of the Internal Revenue Code excludes interest received from certain bonds issued by state and local governments from income for tax purposes. See 26 U.S.C. § 103 (2006). Investors in such bonds pass some or all of the benefits of exclusion to the issuing government by accepting a lower rate of interest on these bonds. Essentially, then, § 103 is a complicated (and most would argue inefficient) method by which the federal government subsidizes government borrowers. See, e.g., Calvin H. Johnson, *A Thermometer for the Tax System: The Overall Health of the Tax System as Measured by Implicit Tax*, 56 SMU L. REV. 13, 17 (2003) (“Indeed, the § 103 exemption probably does considerably more harm than good overall.”); Stanley A. Koppelman, *Tax Arbitrage and the Interest Deduction*, 61 S. CAL. L. REV. 1143, 1177 (1988) (“The differential between taxable and tax-exempt bond rates has not approached the highest marginal tax rate.”).

in more traditional governmental debt obligations.¹⁸⁹ That said, since the Internal Revenue Code already gives favorable treatment to municipal debt, it is hard to understand why municipalities need another path to obtain favorable tax treatment, particularly a path that may induce yet additional distortions in government policy.

These distortions are all the more troubling because they are all too often invisible to the voting public at the time that the public might be able to exercise some political control, before the deals have been enacted. As the next section shows, attaching the privatization label to these transactions all too often leads observers to miss the fact that they are a form of debt.

C. TRANSACTIONAL TRANSPARENCY

The public does not seem to appreciate the economic similarity between modern privatization agreements, debt, and the advance sale of tax revenues.¹⁹⁰ Politicians seem to be in no hurry to enlighten the public. Former Mayor Daley, for example, touted Chicago's use of proceeds from privatizing the Skyway (a toll road connecting the City to the Indiana Toll Road) to "pay off nearly \$1 billion in long term debt,"¹⁹¹ obscuring the reality that the preexisting debt was being refinanced. Of course, if the mayor had admitted that the Skyway deal merely refinanced the underlying debt—by substituting future tollway fees paid directly to the new "owners" for fees paid to the Skyway Authority, which would use the proceeds to pay bondholders—he might have had to explain why it made sense to pay an implicit interest rate of ten percent on the new debt¹⁹² when

189. Accelerated depreciation generates time value of money gains while § 103 provides a complete exclusion from income. 26 U.S.C. § 103(a). In both cases, however, because access to the favorable tax treatment is mediated by another party, it is unclear how much of the tax benefit goes to that other party as opposed to remaining with the investor.

190. It is worth noting that the designer of the parking meter transaction did recognize the equivalency of the two types of transactions. In a report written to defend the parking meter deal, William Blair asserted (without proffering any evidence) that the City would have had to pay interest in the ten to fourteen percent range if it decided to raise the \$1 billion obtained through the parking meter deal by issuing parking meter-based revenue bonds. See Blair, *Valuation Analysis*, *supra* note 114, at 8–9.

191. See Richard M. Daley, *How We'll Weather the Storm*, CHI. TRIB., Nov. 11, 2009, at C-21.

192. This was the discount rate used by the City and the purchaser in valuing the Skyway's future cash flows. See Greg Hinz, *City Council Giddy over Skyway Lease*, CRAIN'S CHI. BUS. (Oct. 27, 2004), <http://www.chicagobusiness.com/article/20041027/NEWS02/200014397>.

the preexisting Skyway and city debt being defeased bore coupon interest rates of between 4.5 and six percent.¹⁹³ Newspaper coverage of these transactions has also been misleading, generally describing the upfront payments as “windfalls”¹⁹⁴ and the portion of the payments not immediately spent as reserves.¹⁹⁵ In the Chicago parking meter example, the money contained in these “reserves” will have to be paid back to the Concessionaires in the future in the form of higher fees; they represent unspent loan principal rather than what is typically thought of as a reserve or a “financial cushion.”¹⁹⁶ And like the decision to use privatization to defease lower interest bonds, the decision to borrow more money than necessary to cover immediate needs was questionable. Looked at in isolation, maintaining “reserves” would have cost Chicago money; the implicit interest rate of ten to fourteen percent payable on the reserves significantly exceeded the investment return Chicago expected to earn from them.¹⁹⁷

The explanation given for maintaining these reserves, that their existence buttresses Chicago’s credit rating and thus re-

193. See CITY OF CHIC., COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE YEAR ENDED DECEMBER 31, 2008, at 81, 127–28, available at http://www.cityofchicago.org/dam/city/depts/fin/supp_info/CAFR/2008/CAFR2008.pdf (listing bonds “defeased” with proceeds from the Skyway deal); U.S. DEPT. OF TRANSP., INNOVATION WAVE: AN UPDATE ON THE BURGEONING PRIVATE SECTOR ROLE IN U.S. HIGHWAY AND TRANSIT INFRASTRUCTURE 11 (2008), available at http://www.ncppp.org/councilinstitutes/dotpppreport_20080718.pdf (describing the \$465 million in Skyway revenue bonds redeemed out of proceeds of the Skyway transaction).

194. See, e.g., Hal Dardick, *Property-Tax Rebates Unclaimed; Small Refunds Were Part of Deal on Parking Meters*, CHI. TRIB., May 23, 2010, at C-7; Fran Spielman, *Daley 2009—Flubs and Fiascos: Privatizing Parking Meters, Failing to Win Olympic Bid Leave the Mayor Reeling*, CHI. SUN-TIMES, Dec. 27, 2009, at A-16; David Zahniser & Phil Willon, *Risks Are Seen in L.A.’s Plan to Privatize Garages: A Rushed Bidding Process Could Lead to Undervalued Leases of Parking Structures*, L.A. TIMES, Feb. 8, 2010, at AA-1.

195. See Mihalopoulos & Dardick, *supra* note 123, at C-1.

196. See *Chicago Parking Meter Facts*, *supra* note 123 (describing reserves created by Skyway and parking meter transactions as “a financial cushion most cities don’t have”).

197. See Blair, *Valuation Analysis*, *supra* note 114, at 7–8 (using a discount rate of ten to fourteen percent to value parking meter concession); Mick Dumke, *Fact-Checking Mayor Daley’s Budget Address*, CHI. READER (Oct. 21, 2009, 2:53 PM), <http://www.chicagoreader.com/TheBlog/archives/2009/10/21/fact-checking-mayor-daleys-budget-address> (questioning the ability of the City to earn even its projected five percent return on reserve funds). As discussed *infra* notes 222–23, almost all of the “reserve” funds were spent within two years, so that the return issue is academic.

duces the cost of newly issued public debt,¹⁹⁸ suggests that even rating agencies might not understand the similarity between these deals and debt. Ordinarily, an enterprise does not improve its fiscal solvency by assuming more debt, even if the enterprise invests rather than spends the debt proceeds, because the accession to cash is counterbalanced by the repayment obligation. Perhaps the ratings increase resulted from the belief that the contractual prices were unjustifiably high, that the City was on the right side of the winner's curse. The most likely justification for the improvement in the City's credit ratings, though, is one that highlights the myopic nature of bond ratings: although the transactions may not substantially change the City's overall financial position (at least for the better), the maintenance of a reserve makes it less likely that the City will default on bonds maturing in the near future. It can use the reserve to pay off the early debt, thereby shifting the risk of non-payment to later bondholders; those defaults would fall outside the time horizon covered by the current ratings. As later events showed, retention of the favorable bond rating depended on continued maintenance of the reserve.¹⁹⁹

The public's failure to recognize the equivalence between the privatization transactions and governmental debt, like its uncertainty as to the adequacy of the price received by the government in these transactions, reduces the political feedback required to ensure that the government neither overborrows nor overspends. If the public does not understand how these transactions mortgage future tax revenues, and instead views the cash received in these transactions as windfalls or gain, the public may be more accepting of political decisions to engage in the transactions in the first instance and to spend the transac-

198. The City trumpeted the rating increase as a benefit of its Skyway and parking meter privatization deals. See *Chicago Parking Meter Facts*, *supra* note 123. Chicago's bond rating went up after its Skyway and parking meter deals went through. See Leonard Gilroy, *supra* note 108 (noting that the deals "prompted all three major credit rating firms to raise the city's bond rating").

199. See Tim Jones, *Chicago Mayor Candidate Wants Bond Rating Protected*, BLOOMBERG.COM, Nov. 10, 2010, <http://www.bloomberg.com/news/2010-11-10/chicago-mayor-candidate-calls-for-protecting-parking-meter-fund.html> (noting that both Standard & Poor's and Fitch downgraded Chicago's credit rating due to its "heavy reliance on nonrecurring revenues to bridge its 2011 budget gap, including the use of most of its remaining reserves from the sale of its parking meters"); Yvette Shields, *Chicago to Tap Stimulus Programs*, BOND BUYER, July 30, 2010, http://www.bondbuyer.com/issues/119_255/chicago-council-budget-2010-1005876-1.html ("Chicago's reliance on reserves from its parking meter lease to erase a good chunk of its \$520 million 2010 deficit raised concerns among some [and some worried continuation could] drive a downgrade.").

tional proceeds on current needs or desires. Or it may not. The public might be as shortsighted as politicians, as eager to spend as much as creditors are willing to give them now and worry about the consequences later—or leave their children or grandchildren to worry about the consequences. It is impossible to predict with any certainty whether the general public would approve of these transactions if they fully understood them. The point, though, is that the power to approve or disapprove means nothing when that understanding is lacking. Casting loans in the form of privatization transactions reduces the likelihood that the public understands what their politicians are doing on their behalf.

In sum, it is questionable whether the potential gains from privatization are worth their cost, or whether, given the inherent difficulties and opportunities for abuse in such deals, attempts should be made to discourage them and, instead, to try to force local governments to borrow using conventional debt formats. Of course, even if the answer to that question is “yes,” the question remains whether it is possible to achieve that end.

IV. REINING IN SMOKE-AND-MIRROR ACCOUNTING AND LIMITING DEAD-HAND CONTROL

The last time the temptation to provide municipal government services without accompanying taxation led to fiscal disaster, the response was to limit municipalities’ ability to incur debt.²⁰⁰ However, over time, municipalities (like states) have developed a plethora of mechanisms to achieve the fiscal aims of debt without, as a technical matter, incurring any debt at all.²⁰¹ Few courts faced with such transactions have been willing to extend the definition of debt to bring these analogous transactions within the scope of existing limitations.²⁰² The results of those debt avoidance techniques are not always pretty, and they are getting less pretty all the time. The question is what, if anything, can be done.

200. See *supra* notes 33–42 and accompanying text.

201. See *supra* Part II.

202. See Richard Briffault, *Foreword: The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 RUTGERS L.J. 907, 940 (2003) (“Indeed, the debt provisions are often treated as little more than technical shoals to be navigated by clever lawyering rather than as embodiments of substantively valuable principles.”); *id.* at 948 (explaining that “courts are complicit in the widespread evasion of constitutional restrictions [on debt]”); Gillette, *supra* note 30, at 1256 (“A century and a half of judicial construction of these clauses has dramatically reduced the significance of debt limitations.”).

One possibility, floated by some analysts, is to simply get rid of the various limitations on state and local government debt.²⁰³ Another possibility is to try to prohibit certain, particularly objectionable, types of transactions. A third option is to achieve the same result by eliminating the financial and political advantages of engaging in the most troubling transactions. This final Part discusses each of these options in detail.

A. ELIMINATING DEBT RESTRICTIONS

The simplest option (in terms of explanation, though not necessarily in terms of implementation) is for states to eliminate their restrictions on governmental debt. This option would require states to amend their constitutions and statutes so as to get rid of debt caps, legislative supermajority, and referenda requirements; states would then police all debt transactions through the regular political (and market) process. If one concludes that the debt restrictions are doing more harm than good by encouraging the use of evermore harmful alternatives to debt without significantly holding down the overall amount of debt-like transactions, throwing in the towel and eliminating the restrictions might encourage politicians to move toward the use of less harmful, conventional debt transactions. As a result, some of the pricing issues and distortions in public policy might disappear. As noted above, several commentators have made precisely this suggestion.²⁰⁴

The unanswered question is how many of these destructive transactions would go away if debt restrictions were removed. Although the transactional forms, including privatization, may have been developed to avoid running afoul of debt limitations, it can be hard to put a genie back into the bottle. Now that jurisdictions are familiar with the privatization mechanism, they may continue to enter into them because they lack transparency; such transactions may be more politically acceptable than

203. See Briffault, *supra* note 202, at 949 (“[A] constitutional debt limit seems attractive in theory but it has proven extremely difficult to operationalize in practice.”); Gillette, *supra* note 30, at 1259 (“[T]he relevant inquiry is whether debt limitations that seem haphazard and that are systematically, but expensively, evaded add anything to admittedly imperfect market based constraints, or whether they simply further distort local financing decisions. My tentative conclusion here . . . is that even flawed market constraints on local officials may be better suited than legal constraints to balance the objectives . . .”).

204. See *supra* notes 6–7.

deciding to issue additional public debt.²⁰⁵ Moreover, nondebt debt may be useful in avoiding budgetary controls other than debt limitations. It is worth noting that Chicago, one of the leaders of privatization, is not subject to a debt limitation.²⁰⁶ Although its politicians are bound by a balanced-budget requirement,²⁰⁷ it appears that, as in many jurisdictions, borrowed funds may be used to reach the necessary balance.²⁰⁸ Thus, Chicago's leadership in privatization transactions seems to stem more from the political appeal of hiding debt in the form of privatization transactions than from legal restrictions on its use of debt.

Simply removing one of the spurs for engaging in privatization agreements, then, may not be enough. Legal changes that operate more directly on faux privatization agreements may be preferable, or a necessary supplement, to eliminating debt restrictions.

205. See *supra* notes 192–99 and accompanying text (explaining that the public is led to believe that the privatization deals create windfalls, making them more politically palatable than taking on debt).

206. The Illinois Constitution allows the state legislature to restrict local government debt. See ILL. CONST. art. VII, § 6(j)–(k) (granting the state legislature the power to limit debt incurred by home-rule counties and municipalities); *id.* art. VII, § 7 (nonhome-rule counties and municipalities have the right “to incur debt except as limited by law and except that debt payable from ad valorem property tax receipts shall mature within 40 years from the time it is incurred”). Thus far, however, the legislature has restricted only the debt-issuance powers of nonhome-rule local governments. See Local Government Debt Limitation Act, 50 ILL. COMP. STAT. 405/1 *et seq.* (2010). Chicago has home rule. See ILL. CONST. art. VII, § 6(a) (“A County which has . . . a population of more than 25,000 are home rule units.”).

207. See 65 ILL. COMP. STAT. 5/8-2-2 (2010) (“Prior to November 15 of each year, the mayor . . . shall submit to the corporate authorities the executive budget [which] shall provide the basis upon which the annual appropriation ordinance is prepared and enacted. . . . All of these estimates shall be so segregated and classified as to funds and in such other manner as to give effect to the requirements of law . . . to the end that no expenditure shall be authorized or made for any purpose in excess of funds lawfully available therefor.”); see also *id.* 5/8-2-6(d) (limiting appropriations to “the aggregate amount available in that fund or for that purpose as shown by the estimates of the available assets thereof at the beginning of the fiscal year for which appropriations are made and of taxes and other current revenue set forth in the budget document”).

208. The statute requires the mayor only to state the source of funds for planned expenditures; like many balanced-budget requirements, it does not appear to rule out the use of debt as a source of such funds. See *id.* 5/8-2-2; see also BRIFFAULT, *supra* note 140, at 9–10 (giving examples of similarly lax rules in other states).

B. DIRECT ATTACKS ON PRIVATIZATION/SALES OF TAX REVENUES

If there is a role for direct attacks on privatization transactions, the question becomes what form the attack should take. Two quite different approaches to this problem are possible. One option is to identify the particularly troubling transactions, subsets of general privatization transactions, and limit or forbid those transactions. A second option would be to identify the harmful effects of the transactions, and limit or forbid all transactions that give rise to those effects. The remaining question is which of these approaches is most likely to generate the desired result without undercutting the possibility of achieving privatization gains.

1. Limiting Particular Transactions

The biggest challenge with trying to control the problem of overcommitting (or overcontrolling) future generations by limiting particular transactions is coming up with an adequate definition of the transactions (or transactional terms) that should be limited. In this age of financial engineering, most transactions can be cast in several different forms; all that matters is the cash flow. This is precisely the reason earlier attempts to control excessive municipal debt failed to achieve their intended purpose.²⁰⁹ Governments were able to recast financing arrangements as tax concessions, sale-leasebacks, leases, or sales—all of which fall outside the literal description of the transactions subject to legal limitations.²¹⁰ Some of these transactions did not exist when jurisdictions first established the original limitations; others may have existed but lawmakers did not realize how they could be used to circumvent debt limitations and thus did not draft the rules to encompass them.

The same combination of ignorance and lack of imagination would likely doom any attempt to limit functional substitutes for debt transactions such as sales of future tax revenues. Given the amount of money at stake, investment bankers and attorneys would likely dream up new variations on old themes. Were the state to forbid the sale or lease of tax revenue

209. *See supra* notes 40–49 and accompanying text (explaining that with new debt-limiting restrictions placed on municipalities, municipalities entered deals that fell outside the restrictions but contained similar debt-like consequences).

210. *See supra* Part II (describing the myriad of ways governments worked around debt restrictions).

streams, localities could find a way to recast their transactions to fall outside the literal definition of the statutory ban. They might, for example, sell derivatives, giving purchasers rights to sums based on the amount of taxes collected at a certain point in time. Alternatively, localities might sell, instead of tax revenues, property subject to an irrevocable tax concession—or simply sell the tax concessions. Just as in some states parents can prepay in-state college tuitions for their children, localities might allow property owners to prepay ten or twenty years of property tax obligations in the form of an up-front flat fee; once having paid the fee, the property owners would be held harmless in the event of subsequent increases in either assessed value for property tax purposes or increases in property tax rates. Given courts' demonstrated reluctance to interfere with past techniques used to avoid state constitutional debt limitations,²¹¹ they may well reject attempts to look through these new techniques in order to create a penumbra of protection against forbidden tax sales. The potential to rearrange and recast economically similar transactions so that they fall outside the definition of any statutorily disfavored transaction could also undermine any attempt to subject specific transactions to special procedural protections, such as a referendum requirement.

Perhaps broader drafting to include a wider variety of transactions within the proscribed category would solve (or at least reduce the problems posed by) recharacterization opportunities. However, broader drafting would create a problem of its own, namely it could delegitimize too many transactions. Virtually every contractual arrangement entered into by a municipality has some impact on the entity's future financial freedom. For example, employment contracts (other than contracts at the will of either party) obligate employers to pay compensation in future years, yet it is probably unnecessary to treat the costs of these contracts as a debt or a tax sale or subject these contracts to special procedural limitations. Moreover, it is possible to view most rental agreements, even short-term rental agreements, as creating a municipal debt, since normally a government cannot renege on such contracts without paying damages. It is hard to conceive a government functioning if every contractual relationship had to be scrutinized on these grounds.

211. See BRIFFAULT, *supra* note 140, at 49 (giving examples of state courts that "have effectively read debt limits out of their constitutions").

Focusing on objectionable contract terms might be more profitable than focusing on types of transactions. If there are certain terms that routinely occur in debt substitution transactions, and if those terms are causally related to the transaction's shift of tax revenues from one period to another, then it may be possible to restrict the offensive transactions by restricting the objectionable terms. But what terms would these be?

One term that has received some adverse comment is the length of contractual obligations. Chicago's parking meter lease agreement runs for seventy-five years, a term that struck many as unduly long.²¹² As noted earlier, the duration of state tollway privatization arrangements exceeds the duration of similar arrangements entered into by foreign governmental agencies.²¹³ There is a general tendency in law to disparage overly long obligations, a tendency at least as old as the rule against perpetuities. However attractive length initially seems as an aggravating factor, closer inspection reveals that it is a less than compelling object of regulation.

In the first place, it would be very difficult to identify a proper or nonsuspicious length for municipal contracts. A short time period would serve some purposes, but it would undercut other valuable goals. It all depends on context. If a state law restricted contract terms to five-year periods, a city could sell, at the most, five years of tax revenues, or the right to collect parking meter fees or the like for, at the most, a five-year period. Given the limitations on the length of the contract, the financial effects of such contracts would be felt largely within the political lifetime of the politicians responsible for entering into the contract. Robbing Peter to pay Paul accomplishes very little when Peter and Paul are the same individual. Politicians might stay in office for a few more years, but the majority of them would still be around for the public to vilify, disgrace, or simply throw out of office when the bill comes due.

212. See Robert C. Longworth, *Privatizing—Yes or No?*, MIDWESTERNER (Sept. 29, 2010), <http://globalmidwest.typepad.com/global-midwest/2010/09/privatizing-yes-or-no.html> (arguing that almost all deals privatizing the delivery of transportation infrastructure are too long). To put the parking meter lease into perspective, the contract's length is only slightly longer than the history of the automobile. Ford's Model T went into production in 1909, nearly one hundred years before the seventy-five year contract was signed. See WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1451 (1976).

213. See *supra* notes 179–82 and accompanying text.

Unfortunately, it is impossible to set a term that is short enough to force politicians to internalize costs without diminishing opportunities for some types of beneficial privatization. It may be efficient for a contract to tie the compensation of a contractor, who is rebuilding a tollway or other highway infrastructure project, to usage of the road through a lease arrangement. Such arrangements might provide effective inducements to efficient scheduling of repairs and encourage quality workmanship. However, no one would want the private contractor to think only in terms of a five- or ten-year time horizon for fear that it would use cheaper materials or substandard construction techniques that would last for only that period of time. A longer-term contract may be necessary to ensure that the private actor has the incentive to do its part of the bargain in the way that most benefits the public.

Similarly, if the benefit of privatization is that it diffuses political opposition to necessary but unpopular actions, the shorter the contract term, the less the political insulation it provides. One reason given for Chicago's privatization of its parking meters was the mayor's desire to avoid constant battles over raising parking rates; the result of that battle, according to the City, was that such rates (prior to privatization) had long failed to keep pace with inflation, thus denying the City what seemed like an appropriate source of revenue.²¹⁴ The City touted the deal—like the tollway deal that preceded it²¹⁵—as a device that allowed city politicians to commit to a policy they believed was correct, but unpopular with the public: raising parking fees to keep up with inflation.²¹⁶

214. See INSPECTOR GENERAL'S REPORT, *supra* note 107, at 4 ("The City has also argued that it would make no sense to calculate the value of the parking-meter system to the City under the terms of the lease, because . . . it would have been impossible for the City to have both kept the parking-meter system and raised the rates to the same extent as the lease, because there was not sufficient political will to do so . . ."); Blair, *Valuation Analysis*, *supra* note 114, at 4 (describing the assumption that the City would increase parking rates at annual rate of three percent as "aggressive given the fact that the rates on 75% [of] City meters had not increased in over 20 years [despite] . . . the rate of inflation average [of] approximately 3.2% per year").

215. See *supra* notes 148–52 and accompanying text.

216. See Joravsky & Dumke, *supra* note 145 (describing the history of attempted rate increases and suggesting the aborted attempt to raise meter rates was "a maneuver by the city to boost the value of the meters while persuading aldermen it would be better to let a private company raise the rates and take the heat"). The alderman may have thought the lease was a good way to raise parking meter rates, but this does not mean, of course, that the decision to enter into this seventy-five year long contract was anything close to the

In addition, a fixed term limit could interfere with a number of normal contractual arrangements. Academic tenure, for example, would likely be impossible. Outright sales of property might be questioned, since the effect of a sale lasts forever. Short-term contracts with renewal clauses might be thrown into question, since those contracts might—or might not—circumvent any term-limit requirement.

Indeed, the length of the contractual relationship is only part of the problem with Chicago's parking contract and similar deals. The underlying issue stems from the temporal mismatch between the costs and benefits of the contractual arrangement. In sale-leaseback agreements, advance sales of tax revenues, and variations of these two arrangements, such as the Chicago parking contract, the distinguishing feature is the large upfront payment the selling government receives upon entry into the contract—the upfront payment that future taxpayers must repay in the form of reduced future revenues without any offset in the form of valuable government services. The amount of this obscured debt can be substantial.

The City of Chicago, for example, received \$1.156 billion when it entered into the parking contract.²¹⁷ All of that money was an advance payment for the fees the other party expected to receive over the next seventy-five years—fees in excess of the amounts the Concessionaire will likely spend on providing parking services. In the absence of the contract, future residents of Chicago, as opposed to those residing in Chicago at the date the contract was entered into, would have benefited from the fees covered by the contract either in the form of additional city revenues, if city authorities raised parking fees, or in the form of lower parking rates. The contract leaves current Chicagoans with revenue and future Chicagoans paying higher parking fees. Those higher fees, of course, go to a private party, not the City's treasury. The minor improvement of the parking meter system provided a smokescreen for the sale of what would have been future, unrestricted city revenues. Although Chicago's mayor at the time pledged not to spend the entirety of the funds received under the contract, and to instead hold a substantial amount in reserve to offset the effects of the associated

most desirable way of raising parking rates. One person's counterproductive political grandstanding may be another person's desirable political check; perhaps parking fees should not increase in tandem with the inflation rate in the absence of a political check.

217. See *supra* note 108 and accompanying text.

future revenue losses,²¹⁸ the pledge was not legally—or, as it turns out, politically—binding. The City spent much of the “reserve” to fund the fiscal 2010 budget deficit, and it is likely that all the money will be gone in a few years.²¹⁹ Thereafter, Chicagoans will have to find other sources of money to fund a government whose size was bloated by parking meter revenues. Future ratepayers are likely to find themselves paying more in taxes and parking fees while receiving less in the way of government services, compared to those who reside in Chicago in the years immediately following the receipt of the parking meter revenues.

It makes no sense to prevent governments from entering into transactions under which they receive cash payouts. That said, identifying payouts as a critical component of what makes these agreements troubling also suggests another approach that might work, an approach that focuses on the hidden borrowing itself. The next section describes this approach.

2. Limiting Harmful Effects

There is nothing inherently wrong with governments borrowing money. There also is nothing inherently wrong with governments privatizing some of their activities. However, when governments merge the two activities into one, whether through an abusive sale-leaseback arrangement or a privatization deal generating a large up-front cash payment, something is clearly lost. That something is transparency, a transparency that helps voters evaluate and control the actions of their governing agents. The method described below will restore some transparency to these transactions, and thus some accountability for the politicians that engage in them. Such transparency should not interfere with justifiable privatization arrange-

218. According to the material put out by the City of Chicago explaining the parking meter lease transaction, \$325 million would be used to defray shortfalls in the 2010–2012 budgets and \$400 million would be placed in a “long-term reserve.” See *Chicago Parking Meter Facts*, *supra* note 123.

219. According to the City’s own press releases, the 2010 budget takes “\$270 million . . . from the parking meter long-term reserve” and “advance[s] the \$100 million 2012 parking Meter [sic] mid-term reserve.” Press Release, Peter Scales, Mayor Daley Presents 2010 Budget Proposal (Oct. 21, 2009), available at http://www.cityofchicago.org/city/en/depts/obm/provdrs/city_budg/news/2009/oct/mayor_daley_presents2010budgetproposal.html. For how this corresponds to the original projections, see Fran Spielman, *Bye-Bye to Almost \$1 Billion; 2010’s \$6.1 Billion Budget Has Property Tax Relief, No Tax Hikes, but It’s Eating up Huge Chunk of Parking Meter Windfall*, CHI. SUN-TIMES, Dec. 3, 2009, at 14.

ments, but may well deter those that would be undertaken only as a means of obtaining unregulated financing.

The underlying scheme is quite simple. State statutes should require that governments place in escrow funds sufficient to generate an income stream equal to the net taxes or fees alienated, or rental obligations created, under any contractual relationship in which the government receives large, up-front cash transfers.²²⁰ Importantly, this net amount should be determined within the four corners of that contractual relationship. A government should not be able to claim that its use of revenues generated from the deal on some other governmental expense (say, in the case of the parking meter arrangement, on schools) will confer future, offsetting benefits on future generations of ratepayers. These statutes would then require that the escrowed funds, and the income generated through investment of the escrowed amounts, be paid to the government over the lifetime of the contract on approximately the same schedule as the government would have received fees or taxes had the parties never entered into the contract.

Such a requirement would still leave governments with an incentive to enter into profitable privatization deals, as they could spend as they please any amounts received in excess of accelerated revenue. The governmental officials who implemented the privatization plan could also spend the gains generated from lowering the cost of performance or increasing revenue. At the same time, they would be dissuaded from entering into transactions where the sole benefit stems from accelerating the receipt of fee or tax revenue because the officials would not benefit from the acceleration. The requirement here is to compensate future taxpayers for their losses, not to interfere with efficient privatization deals.

The aim of the rule is to keep governments from disguising debt as "gains" from a sale or lease contract. This may prevent governments from incurring some debt or it may force governments to get explicit permission from the electorate to obtain access to some funds. Such a change may be unpleasant for the

220. It will be necessary to define "large, up-front cash transfers" somewhat broadly. Although the current transactions involve single up-front payments, any statutory or constitutional restriction limited to such transactions could be easily avoided by breaking the payment into two parts paid in successive years. The definition of "large, up-front cash transfers" would probably require some sort of present-value test (i.e., a comparison of the value of the payouts made in the early years of an arrangement to the value of those made in later years).

officials involved in the transactions and for their constituents, but there would be a point to the unpleasantness: it would force both officials and their constituents to recognize, and to some extent internalize, the costs of their choices. This should lead to better decisions about the nature and extent of governmental services and tax burdens.

The new rule would not hold future ratepayers entirely harmless from privatization deals, since future ratepayers necessarily lose the opportunity to enter into similar privatization deals. One cannot privatize parking meters or tollways or sewage systems twice. But in the absence of a theory entitling either current or future ratepayers to any windfall profits provided by such deals (i.e., those engendered by transferring ownership to a more efficient private operator),²²¹ it is hard to criticize the scheme on this account. Another objection is that enabling such deals now forecloses the possibility of better deals in the future. But knowledge is always imperfect, and it is equally possible that an earlier deal is better than any that would become available to a later set of ratepayers. As long as any transaction is priced and structured fairly (hardly a given in this context),²²² one cannot worry too much about how, with the benefit of hindsight, a jurisdiction might have constructed the transaction differently.

The more substantial problem is that often it will be far from easy for the parties to determine the amount that should be set aside for the benefit of future ratepayers. The difficulties stem from two different sources. First, setting an appropriate discount rate will be a contentious process, especially if the contract term runs for very long periods of time. Very few (if any) bonds or other financial instruments currently run for seventy-five-year terms,²²³ all but eliminating the financial markets as a source of information about appropriate discount rates. The second task may be even harder: determining the amount for-

221. On the one hand, one wants to encourage public officials to find such efficient operators (if they exist). *See supra* notes 6–8 and accompanying text. On the other hand, providing incentives to the first group of officials arbitrarily rewards them in part for being earlier in time; later officials might have made the same or an even better deal if the earlier privatization deal had not already been struck. The earlier deal deprives the later officials of their chance to shine.

222. *See supra* notes 145–54 and accompanying text.

223. Some states place limits on the time state or municipal debt may be outstanding. *See, e.g.*, ILL. CONST. art. VII, § 6(d) (home-rule units of local governments do not have the power to incur debt payable out of property tax receipts that mature more than “40 years from the time it is incurred”); *id.* § 7 (same for nonhome-rule units of local government).

gone by future ratepayers requires offsetting future revenue estimates against estimates of the future cost savings (if any) from entering into the contract. Estimates are always susceptible to manipulation. Future revenues may be underestimated to make a transaction look more attractive. Clever officials may try to undercut the intent of the regime by systematically failing to exploit a revenue source for several years to make the case that profits from its later sale should redound to the benefit of earlier, rather than later, groups of ratepayers. To prevent this type of abuse, it may be necessary to calculate future revenues based on the fees that the terms of the privatization agreement allow investors to charge. This would have the effect of denying politicians most of the gains associated with taking the unpopular step of raising rates. However, such a bright line rule is probably wise given the difficulties of drawing a line between situations in which politicians would not have been able to raise rates in the absence of a privatization deal and those situations in which they would have been able to raise rates without such a deal. Whether or not undertaken in the context of a privatization agreement, politicians can still attempt to minimize the political fallout of future rate increases by setting fees in the form of a formula, rather than as set amounts. The Chicago parking meter lease, for example, allows the Concessionaire to increase parking meter rates in line with increases in the consumer price index in the later years of the agreement.²²⁴ Federal taxes and benefit payments also are tied to inflation indexes.²²⁵ Determining the amount of future offsetting costs will also be difficult.

This new rule requires addressing another problem: identifying the transactions subject to the escrow requirement. At the very least, a *de minimis* rule would be necessary since it would not make sense to make every sale or sale-like transaction subject to the regime. The cost of paperwork alone would eliminate any possible benefits of, for example, requiring a government to escrow some portion of the proceeds generated through the sale of obsolete buses, cars, or even most government-owned build-

224. See CHICAGO PARKING METER CONCESSION, *supra* note 5, at 50,547 (defining "Regular Rate Adjustment").

225. The statutes setting federal income tax brackets, social security payments, and legislative salaries all contain automatic inflation adjustments, for example. See, e.g., 2 U.S.C. § 31-31(2)(a) (2006) (providing inflation adjustment for congressional salaries); 26 U.S.C. § 1(f) (2006) (providing inflation adjustment for tax-rate tables); 42 U.S.C. § 415 (2006) (providing cost-of-living adjustment for social security benefits).

ings.²²⁶ That said, this rule would require drawing some difficult lines. Suppose, for example, a government enters into a mining lease of some sort. If it receives a cash lump sum rather than periodic royalties, should that lump sum be subject to the escrow requirement? If the sums involved are significant enough, the answer is surely “yes,” though that answer raises another question: Over what period of time should the revenues be allocated under the escrow? There is no easy answer to this question. Given the exhaustible nature of most natural resources, it is unclear whether (as a matter of theory) the receipts should be spread over the years the mine is in operation, or all future years since the current generation has no particular claim to the resources being exploited. Most likely, rules would have to be developed to cover these difficult, but common situations. Though such rules undoubtedly would be arbitrary at the edges, the alternative would encourage jurisdictions to structure natural resource extraction agreements for lump sums rather than royalty arrangements.

The fact that enforcement issues will inevitably afflict the regime should not, however, blind one to its merits. Any enforceable set aside is better than none, both in terms of intergenerational fairness and as a check on socially useless privatization deals. And none is what we currently have.

CONCLUSION

Governments, like all large entities, suffer from agency problems, and privatization deals often occur amid suspicions, if not outright accusations, of favoritism, self-dealing, and simple incompetence. There are a number of reasons for these suspicions, not least being that the market for many of these transactions is too thin for many to believe that competition adequately polices the price negotiations, while the absence of a market check also makes it harder to impose political checks. This lack of accountability probably cannot be solved, which makes it all the more important that privatization transactions be limited to those justifiable on grounds other than that they serve as a convenient mechanism for evading legal and political restrictions on debt. To put it another way, one of the problems with incurring debt through privatization transactions is that it

226. Alternatively, one might have a rule that a jurisdiction can receive an amount equal to its actual cash purchase price for an asset without becoming subject to the escrow regime. This would take care of many small-sales transactions.

turns a transaction for which there are sufficient market checks to minimize opportunities for corruption and incompetence—conventional debt—into one with almost unlimited opportunities for both. Further, the price that is exacted is not paid entirely in cash. These deals typically restrict future government decisionmaking in ways that could be counterproductive while minimizing opportunities for public oversight. The situation cries out for rules that would operate to minimize the occurrence of these transactions, discouraging their use solely for political optics. This Article proposes one such rule.

Even if it is theoretically possible to reduce the number of questionable transactions, as a practical matter, reform may be unlikely. At the very least, state legislatures would have to adopt the legal changes suggested in this Article. Further, they might have to be incorporated into state constitutions. Yet, in the area of debt financing, state legislators and officials are subject to the same perverse incentives as local politicians.²²⁷ They too often prefer to postpone the day of fiscal reckoning, and forcing local governments to be honest about their fiscal status may increase political pressure on state as well as local officials.²²⁸ Hard-pressed localities often turn to state entities to compensate for funding shortfalls; and state officials risk becoming a lightning rod for public discontent when they fail to provide such aid. Further, corrective legislation can be overridden by majority vote, so the stability of statutory reforms is questionable. But as an initial matter, these political impediments are secondary to the question of whether it is possible to craft a legally effective corrective to debt-avoidance techniques, one with more bite than the debt limitation restrictions governments adopted after the last municipal debt crisis. This Article suggests one such corrective mechanism.

227. Indeed, some state governments have resorted to similar devices to avoid debt limitations applicable to them. *See, e.g.*, Carbonara, *supra* note 90 (describing the sale and leaseback of the Arizona state capitol building and comparable transactions in California and Connecticut).

228. For example, constitutional limitations on state debt tended to result in the “devolution” of the debt burden to local governmental entities rather than decrease overall levels of debt. *See* Kiewiet & Szakaly, *supra* note 39, at 85 (concluding that an empirical study shows “strong indications of devolution”).