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Seeking Local Government Financial Integrity Through Debt Ceilings, Tax Limitations, and Expenditure Limits: The New York City Fiscal Crisis, the Taxpayers' Revolt, and Beyond†

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The severe financial distress of many large American cities, highlighted by New York City's near bankruptcy and Cleveland's bond default, has generated considerable commentary in business, governmental, and scholarly circles, as well as in the popular press. In the welter of proposals and counterproposals for short-term and long-term "solutions," the legal devices originally intended to prevent fiscal mismanagement by cities—debt ceilings, tax limits, and expenditure limits—have received inadequate attention. Moreover, recent attempts to satisfy voter demands for tax relief have often focused upon a single fiscal control device while neglecting much needed reform of the overall local government financial management system.

This Article reappraises the efficacy of state constitutional debt ceilings and tax limitations, and statutory expenditure limitations, as controls on local government finance. First, the Article traces their general history; thereafter it considers the operation of constitutional tax and debt limitations in New York and local government expenditure limits in Arizona. In neither state have these limits restricted borrowing, taxing, or spending. Instead, they have spawned a series of municipal and legislative avoidance devices which have themselves produced adverse financial effects.

Having determined that the current mechanisms for control of municipal finance are insufficient, this Article next evaluates alternative approaches on the basis of informational, economic, and political principles. Tighter constitutional limits are contrasted with statutory, market, and political controls. Finally, the efficacy of electoral approval and administrative oversight mechanisms is considered.

Although this Article offers no easy solutions to the problems it addresses, it does sketch the outlines of a rational system of con-
straints and suggests factors to be considered by a state when revising its municipal fiscal control devices.

I. HISTORICAL BACKGROUND

A. DEBT CEILINGS

Constitutional debt ceilings were first imposed in the nineteenth century in reaction to unsuccessful entrepreneurial activities undertaken by states. During the early part of the last century, many states floated bonds backed by their general taxing power to finance substantial improvements in transportation and other commercial projects. After the economic panic of 1837, tax and project revenues were insufficient to meet the debt service and high fixed costs of these investments. As a result, several states defaulted or suspended payments on their obligations during the 1840s, and four actually repudiated portions of their debt. In an effort to avoid repetition of such disquieting financial experiences, restrictive limitations on state-incurred debt were incorporated not only into the constitutions of these states but also into those of states subsequently entering the union.

Local governments, generally unrestricted by these original limi-

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1. The first such project was the Erie Canal, financed by the State of New York. Its success induced other states to construct additional canals and highways. Mitchell, The Effectiveness of Debt Limits on State and Local Government Borrowing, 45 N.Y.U. INST. OF FINANCE Buss. 1 (1967).


3. See B. RATCHFORD, AMERICAN STATE DEBTS 98-120 (1941); Mitchell, supra note 1, at 11-12.

4. Bowmar, The Anachronism Called Debt Limitation, 52 IOWA L. REV. 863, 863-64 (1967); Morris, Evading Debt Limitations with Public Building Authorities: The Costly Subversion of State Constitutions, 68 YALE L.J. 234, 241 (1958); Nichols, supra note 2, at 406. In New York, there was strong reaction against the drastic, direct property tax that had to be imposed to prevent bankruptcy of the State government: Public indignation brought about the Constitutional Convention of 1846, by which amendments were adopted which were approved by the people, restricting legislative borrowing, making the State Comptroller an elective official independent of the Legislature, and prohibiting loans to individuals, associations and corporations. Conditions were somewhat, but not greatly relieved, and the Constitutional Convention of 1867 took further steps to correct continuing evils. Lounsberry, The Scope and Basis of the Local Finance Law, in N.Y. LOCAL FIN. LAW viii (McKinney 1968).
tations, financed much of the railroad boom of the mid-nineteenth century, thereby assuming the enterpreneurial role that the earlier restrictions had forced state governments to abandon. In competing for these new transportation facilities, the localities provided guarantees for railroad securities, made outright purchases of railroad stocks, and even offered gifts of land and rights of way to the railroads. Consequently, municipal credit, like state credit earlier in the century, soon became overextended. It has been estimated that fully thirteen to twenty percent of municipal bonds were in default during the 1873-1879 depression. In reaction, constitutional debt restrictions were extended to encompass local as well as state governments. Additional restrictions were imposed in the wake of a new wave of municipal defaults that coincided with the panic and depression of 1893.

Many of the early proponents of constitutional limitations sought a total prohibition of debt financing by state and local governments. For example, some delegates to the 1846 Wisconsin Constitution...
tional Convention, displaying a "horror of public debt,"\textsuperscript{11} proposed that "[n]o municipal corporation shall have power to contract debts . . . for any purpose whatever."\textsuperscript{12} Likewise, a faction of the California Convention of 1879 sought to impose a no-debt policy on local authorities.\textsuperscript{13} Although these extreme proposals advocating absolute preclusion of debt financing failed,\textsuperscript{14} the restrictions adopted in the mid-nineteenth century did generally establish very low debt ceilings,\textsuperscript{15} both at the state and local levels of government.\textsuperscript{16}

\begin{footnotesize}
\begin{enumerate}
    \item Limitations, 56 Iowa L. Rev. 646, 646 (1971). The following editorial comment appears to be representative of the views of the financial community at the time, and perhaps of the general public as well: "[A]s all experience shows that the use of public credit by local officials defies successful regulation, it follows that the primary error was in the original grant of the power to borrow money." Bradstreet's, May 22, 1880, at 4, col. 2, \textit{quoted in} Williams & Nehemkis, \textsuperscript{supra} note 6, at 180-81. Nor was the problem unique to the United States, as is revealed by the introductory sentence to Lord Avebury's treatise: "The portentous and rapidly growing increase of rates and municipal debts has roused the anxiety of all thoughtful citizens. . . . Though we pay so much, we are not paying our way. The local authorities [in Great Britain] are running head over heels in debt." \textit{LORD AVEBURY ON MUNICIPAL AND NATIONAL TRADING} 1-2 (1906), \textit{quoted in} J. Dillon, \textit{Commentaries on the Law of Municipal Corporations} 337 n.2 (6th ed. 1911).
    \item See \textit{2 California Constitutional Convention, Debates and Proceedings} 1068 (1881) (discussion of Jan. 18, 1879).
    \item The proposed amendment totally forbidding Wisconsin municipalities to incur debt, after being repeatedly amended, was finally rejected by the 1846 convention. Kiernan, \textsuperscript{supra} note 12, at 186. Instead of adopting a no-debt policy, the California Constitutional Convention of 1879 permitted local debt if it was approved by two-thirds of the qualified electors or could be repaid within 20 years from a sinking fund, supplied by annual taxation. \textit{See} Cal. Const. art. 11, § 18.
    \item \textit{See, e.g.,} sources cited in Morris, \textsuperscript{supra} note 4, at 241.
    \item In addition, constitutional provisions limiting the maturity periods of bonds were adopted. \textit{See} A. Heins, \textsuperscript{supra} note 2, at 31 (discussing the circumvention of Maryland's 15-year maturity limit through the use of revenue bonds). Also, the lending of municipal credit or donation of public money were prohibited during the same period. According to the Texas Supreme Court, the object of the prohibition of gifts or loans, added to the Texas Constitution in 1880, was to deprive municipalities of the power possessed by them under the constitution of 1889, in the exercise of which many counties and towns in the state assumed burdens not yet discharged, in anticipation of benefits never realized. The increase in population and values expected from railway connection in many instances never came; and the tax, not lightened from these sources, depressed values, prevented immigration, and became a curse to the localities which had invited it as a blessing.
    \item City of Cleburne v. Gulf, C. & S.F. Ry., 66 Tex. 457, 460, 1 S.W. 342, 342 (1886).
\end{enumerate}
\end{footnotesize}
The pattern for constitutional debt ceilings that prevails in most states today was established by these restrictions imposed in the early and mid-nineteenth century. Overall debt for any particular year was limited to a specified percentage of the value of the assessed real property within the state or locality. Debt ceilings were framed in this manner because funds for debt service were derived at the time almost entirely from property tax revenue. Moreover, real estate property owners were regarded as a class deserving special protection from excessive taxes.

Courts and commentators have agreed that the principal purpose of the nineteenth century constitutional debt ceilings was to limit the capacity of local officials to incur long-term financial commitments in order to protect the interests of taxpayers, especially those of future generations, and, to a lesser extent, bondholders. Creditor protection was of lesser concern, since it can be, and has been, provided by other means. Since current taxpayers actually
pay less when their government borrows money to pay for a project rather than pays for it from general revenues, the real beneficiaries of debt ceilings were the taxpayers of the future, who would not have to pay inordinate debt service on capital projects producing no tangible benefits for them. As the New York Court of Appeals recognized, "[t]he mischief to be prevented was the creation of an excessive debt, the carrying charges of which would fall upon current revenues, and the principal upon posterity." 24

Contemporary economists label this concept "intergenerational equity." This principle requires each generation of taxpayers to pay, through debt service or otherwise, for its "stream of use" of government structures and services. 25 Thus, one generation should not be permitted to enjoy a low tax level by borrowing to finance the cost of a structure that will not provide benefits for the next generation, which will have to bear the burden of financing. 26 At the same time,

interest and amortization from first revenues of local government should latter fail to make annual appropriation). See generally Fordham, Methods of Enforcing Satisfaction of Obligations of Public Corporations, 33 COLUM. L. REV. 28 (1933); note 251 infra.


26. Another way of measuring intergenerational equity in public finance is to determine what effect money borrowed by government has upon capital formation in the economy, and thus upon the income of future generations. The "classical model" proceeds on two assumptions: that one dollar of tax or loan by the public sector reduces private expenditures by one dollar and that taxation falls largely on consumption, while public debt falls largely on savings or investment.

Although this analysis is a "reasonable first approximation," it must be modified slightly, especially when applied to state and local finance. R. Musgrave & P. Musgrave, supra note 25, at 491, 587-89. In the first place, taxation probably causes a sharper reduction in private expenditure than the classical model suggests, and some forms of taxation, such as the retained earning tax and (to a lesser extent) the personal income tax, tend to reduce private investment as well as consumption. Id. at 475-80, 492, 587-89. These taxes are now available to many local governments. See notes 140, 216-17, infra and accompanying text. Second, to the extent that state and local bonds are held by outside investors, the reduction in capital formation predicted by the classical model does not occur, because local residents in the present generation do not have to reduce either savings or consumption in order to provide debt financing for their governments. See R. Musgrave & P. Musgrave, supra note 25, at 589-90. While it is difficult to obtain sufficient data with respect to the holders of all state and local debt, bonds issued by states and larger cities appear to be held by investors throughout the country. On the other hand, states that tax their residents' income but provide an exemption for interest earned on their own bonds and those of their localities may have (depending on how steep their income tax rates are) a slightly higher relative proportion of in-state investors, thus conforming more closely to the classical model. Even in these states, however, purchasers of local government debt can obtain this benefit without being residents of the issuing locality.
the present generation should not have to pay the full cost of government structures that will also benefit the next generation; both should share debt service, maintenance costs, and depreciation in proportion to the benefit each receives.\textsuperscript{27}

B. Tax Limitations

The most common limitation on local government taxing power is restriction of the real estate tax rate. Local government tax limits initially appeared in state statutes in the 1870s and 1880s.\textsuperscript{28} Alabama in 1875 and New York in 1884\textsuperscript{29} became the first states to constitutionalize these local government real estate tax limits.\textsuperscript{30} Although the principal concern characterizing this era was the limitation of local government debt powers,\textsuperscript{31} some saw tax limits as an adjunct remedy necessary to prevent an increase in taxes to pay for capital projects previously financed by public debt.\textsuperscript{32} Early property tax limits, like the debt ceilings, were thus aimed at reducing the growth of public expenditures. Since nearly all local government revenues were derived from the property tax at that time,\textsuperscript{33} a property tax rate limit was believed to be the most effective means for controlling current expenditures.\textsuperscript{34} In addition, the limits were aimed at the narrower

\textsuperscript{27} None of this is to deny the intergenerational inequity of taxing future generations of state and local residents to pay interest on bonds whose benefits they do not enjoy, whether the investors reside inside or outside the jurisdiction.

\textsuperscript{28} Id. at 589. Hence, the no-debt policies proposed in the nineteenth century, see notes 10-16 supra and accompanying text, would also violate intergenerational equity.

\textsuperscript{29} The earliest tax limits applied only to the classes of local government (counties, municipalities, or school districts) specified in the limiting statutes. U.S. Advisory Commission on Intergovernmental Relations, State Constitutional and Statutory Restrictions on Local Taxing Powers 28 (1962) [hereinafter cited as ACIR, Local Taxing]. The first states to adopt statutes imposing property tax rate limits on all taxing districts in the state were Rhode Island in 1870 and Nevada in 1895. Id.

\textsuperscript{30} Id. The 1884 New York provision directly restricting the real estate taxation imposed by most local governments was preceded by a provision in the 1846 Constitution giving power to the State Legislature "to provide for the organization of cities and incorporated villages, and to restrict their powers of taxation." N.Y. Const., art. VIII, § 9 (1846, amended 1884).

\textsuperscript{31} See notes 8-20 supra and accompanying text.

\textsuperscript{32} ACIR, Local Taxing, supra note 28, at 34; U.S. Advisory Commission on Intergovernmental Relations, State Limitations on Local Taxes and Expenditures 11 (1977) [hereinafter cited as ACIR, Tax and Expenditure Limits].

\textsuperscript{33} See note 19 supra and accompanying text.

\textsuperscript{34} ACIR, Local Taxing, supra note 28, at 34-35. By the turn of the century, an additional motive for constitutional tax limitations had emerged: the encouragement
interest of protecting property owners from an undue rise in their tax burden in the wake of the panic of 1870 and the depression that followed.

The next group of constitutional tax limitations emerged during the depression of the 1930s. As individual income and property values declined, tax delinquency rose. Property owners and real estate groups pressured state legislatures and the electorate to lower assessments and impose new or tighter tax limitations. They successfully persuaded three states to adopt new overall constitutional limitations and two more to reduce the rate permitted by pre-existing constitutional limits. Unlike earlier tax limits, which were intended to prevent a rise in taxes, the primary purpose of tax restrictions imposed in the 1930s was to force reductions in then current tax levels.

Beginning in 1970, several states have employed a slightly different approach to the restriction of property taxes—the levy limit. Unlike earlier limits, which restricted the tax rate that could be applied to assessed (or full) real property values, levy limits establish the maximum revenue that a jurisdiction's property tax can generate in a particular year. Levy limits, which have uniformly been statutory rather than constitutional, generally allow the total real estate

of uniform tax valuations. See generally id. at 35.

35. Property owners were, at that time, considered a special group deserving protection from excessive tax levels. See note 20 supra and accompanying text.

36. ACIR, Tax and Expenditure Limits, supra note 32, at 11.


38. ACIR, Local Taxing, supra note 28, at 36-37.

39. In the 1930s, Michigan, West Virginia, and New Mexico imposed constitutional tax limits for the first time, and Ohio and Oklahoma lowered the limits already in their constitutions. Id. at 30. Limits on taxes to be raised for specific functions were also adopted by several states during this period. ACIR, Tax and Expenditure Limits, supra note 32, at 12.

40. ACIR, Local Taxing, supra note 28, at 37.


42. The property tax levy equals property tax rate multiplied by property tax base (generally assessed value). The earlier limits operated by restricting the tax rate component of this equation. The levy limits adopted in the early 1970s were aimed directly at limiting the tax levy, the overall total of the equation. When assessments rise substantially, therefore, the rate must be lowered to stay within the levy limit. ACIR, Tax and Expenditure Limits, supra note 32, at 12-14. It should be noted that the property tax levy is greater than the actual collection of property tax revenue, because the former includes uncollected property taxes as well. Id. at 15 n.3.
tax levy to rise by only a specified percentage each year. The principal purpose of levy limits has been to provide property tax relief, primarily for home owners faced with rising assessments caused by inflation. These limits can generally be exceeded by referendum or by approval of a state agency. State-mandated cost increases often are excluded from the levy limits.

The Jarvis-Gann initiative (Proposition 13), adopted by California voters in June, 1978, was the first of a new wave of constitutional and statutory property tax rate limits that have swept the country. This development was referred to in the popular press as "the tax revolt of 1978." In November of that year, voters in seven states considered proposals for new limits on real estate taxes. Al-
though there were overtones of distrust of government and concern about state and local government expansion, the principal purpose and effect of these new limits, like those imposed in the 1930s and early 1970s, was property tax relief.

C. Expenditure Limits

A third method of regulating local government finance has been direct restriction on the level of spending. The first such expenditure lid was imposed by statute on Arizona counties and municipalities in 1921. Subject to certain exclusions, it prohibits local budgets from rising more than ten percent over those of the prior year. New Jersey adopted a similar spending limit in 1976, which restricted local government budget increases to five percent per year. Although subsequent attempts to impose local government expenditure limits have generally been unsuccessful, several state government spending

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1. But proposed constitutional amendments similar to Proposition 13 failed in Oregon and Michigan (Tisch Amendment). See also Emshwiller, Tax-Cut Advocates Fight One Another Instead of City Hall, Wall St. J., Aug. 31, 1978, at 1, col. 4. For a good analysis of the salient features of all the above proposals and the final vote count, see J. Shannon, Slowing Down Public Sector Growth—Hard Questions for Policymakers, app. A-7 (Dec. 12, 1978) (outline of remarks to Utah Chapter American Society for Public Administration) (on file with author).


53. See note 165 infra and accompanying text.

54. For the wording of the current Arizona expenditure limit law, see text accompanying note 167 infra.

55. "Beginning with the tax year 1977 municipalities, other than those having a municipal purposes tax levy of $0.10 or less per $100.00 and counties shall be prohibited from increasing their final appropriations by more than 5% over the previous year except within the provisions set forth hereunder." N.J. STAT. ANN. § 40A:4-45.2 (West Supp. 1979). A limit on state government expenditures was imposed at the same time. Rather than the flat percentage lid placed upon local government budget increases, the state spending limit requires an elaborate formula calculation. See id. § 52:9H-6 to -13. These spending limits were imposed as a concession to the voters, coinciding with the adoption of New Jersey's first state income tax. Perry & Hyatt, While California Votes on Taxes, Other States Mull Spending Limits, Wall St. J., June 6, 1978, at 1, col. 1.

56. In November, 1978, Nebraska voters defeated a proposed constitutional amendment to limit local government budget increases to five percent per year, with additional increases based upon population growth. See Neb. Initiative No. 302 (on file with author). At the same time, local government spending limits were defeated in Colorado and Oregon. See J. Shannon, supra note 50, app. A-7, at 4.
lids have been adopted.

Spending limits strike more directly at government expansion than do either the traditional tax limits or the more recent levy limits. Their advocates contend that expenditure limits restrict the capacity of local officials to expand budgets in response to interest group and union pressures and that this will eventually result in a lower level for all taxes.

II. DEBT CEILINGS AND TAX LIMITATIONS IN NEW YORK

A. THE FINANCIAL AND POLITICAL DILEMMA

The principal legal restraints on New York City finance are the debt ceiling and the tax limitation imposed by the Constitution of the State of New York. Under the state constitution, New York City may not borrow in excess of ten percent of the five-year average full value of real property within its boundaries. Nor may it impose real estate taxes in excess of 2.5 percent of the five-year “average full valuation of taxable real estate” within its boundaries. Moreover, the New York State Legislature, pursuant to power granted by the state constitution, has lowered the municipal tax limit in the past.
It has often been argued that these limitations place the City on the horns of a financial and political dilemma. On the one hand, New York State has required the City to exercise substantial responsibility for a vast array of public services not generally financed by other American municipalities: mass transit, higher education, health care, and courts. Moreover, New York requires its local governments to make higher contributions to welfare programs than do other states. Congress and federal administrators, in turn, have also skewed City spending priorities through the use of categorical grants-in-aid for systems to the New York City Transit Authority—a substantially independent agency. This statute was upheld by the New York Court of Appeals. See Salzman v. Impellitteri, 305 N.Y. 414, 113 N.E.2d 543 (1953) (per curiam). For discussions of the Salzman case and the detriment to home rule occasioned by conditioning local taxation power on the transfer of functions, see Macchiarola, Local Government Home Rule and the Judiciary, 48 J. Urb. L. 335, 343 (1971); Richland, Constitutional City Home Rule in New York: II, 55 Colum. L. Rev. 598, 617-619 (1955).


Other metropolitan areas use school districts, county governments, and specialized districts as well as the central city government to provide the services that the City of New York provides by itself. Indeed, a report to Congress concluded, If one compares the New York employment and spending patterns with those of all the local governments providing services to the residents of other large cities, New York appears to be less extraordinary . . . . [I]ts expenditure on the services commonly provided by municipalities is not out of line with those of other large cities.


67. The federal grant-in-aid program requires states to provide matching funds on the basis of a per-capita income formula. New York State was required to pay the maximum of 50% for welfare programs. The state, in turn, required New York City to pay one-half of its costs. Temporary Commission on City Finances, The City in Transition: Prospects and Policies for New York 45 (1978) [hereinafter cited as Temporary Commission]; City of New York, Official Statement of Aug. 25, 1978, at 61 (relating to sale of $105,995,000 general obligation serial bonds) [hereinafter cited as Official Statement]. Thus, New York City must pay up to 25% of its welfare costs and 50% of the costs of the state home relief programs. See Congressional Budget Office Study, supra note 66, at 13; Shalala & Bellamy, A State Saves a City: The New York Case, 1976 Duke L.J. 1119, 1121. The average monthly benefit is $118 per person, with 85% of the City’s caseload receiving support from AFDC and the remainder receiving state/local assistance in the form of home relief and veterans’ assistance. Official Statement, supra, at 61.
social services that are accompanied by high matching fund and detailed reporting requirements. In addition, the federal judiciary has prohibited imposing residency requirements for the receipt of local welfare benefits. All of these services, mandated by state and federal law, must be financed by a single city government that is subject to tax limitations more severe than those applied to other local governments in New York State.

It is by no means contended that the outside forces of intergovernmental structure and demographic changes are the sole causes

68. The Temporary Commission on City Finances summarized the federal involvement as follows:

[D]uring the Kennedy and Johnson administrations, Federal grants grew rapidly, achieving Depression-level proportions in state and local budgets. The Great Society programs did not change the form of federal involvement [financial aid and transfer payments but not administration], but they did change its volume and purpose. Most of the grants awarded during the 1960s were categorical grants in the areas of health, education, social services, and environmental protection; they were awarded to states with no requirement that states pass the funds on to localities. In almost all cases, the grants required matching funds from the state government (or locality if the state chose to pass on the funds), could be used only for narrowly defined purposes, and carried with them complex administrative and reporting regulations. By 1969, the height of the surge in Federal grant programs, Federal grants-in-aid provided over one-fifth of all revenues available to state and local governments.

TEMPORARY COMMISSION, supra note 67, at 47. See generally note 67 supra.


70. See Macchiarola, Local Finances Under the New York State Constitution with an Emphasis on New York City, 35 FORDHAM L. REV. 263, 263, 282 (1965). It was long ago noted that “[n]o adequate reason has ever been given for fixing the City’s tax limit [of 2.5 percent] far below the combined city-county-school district limits of the other cities in the State, which range between 4 and 6 per cent of full value.” STATE OF NEW YORK TEMPORARY COMMISSION OF THE REVISION AND SIMPLIFICATION OF THE CONSTITUTION, STAFF REPORT No. 31, at 103 (1959) [hereinafter cited as STAFF REPORT No. 31], quoted in Macchiarola, supra, at 284. See also STATE OF NEW YORK TEMPORARY COMMISSION ON THE REVISION AND SIMPLIFICATION OF THE CONSTITUTION, STAFF REPORT No. 11 (1958) [hereinafter cited as STAFF REPORT No. 11]. But see C. HARRIS, CONSTITUTIONAL RESTRICTIONS ON PROPERTY TAXING AND BORROWING POWERS IN NEW YORK VIII-4 to VIII-6 (1967) (because of New York City’s broad borrowing powers, its effective tax rate is higher than other cities; raising tax limit even higher would have detrimental effect on economy).

71. One recent report describes the association between intergovernmental and demographic factors:

The intergovernmental system also has contributed to the socioeconomic transformation of New York City by providing incentives for money-providers to leave the city (high taxes) and incentives for service-demanders to remain or enter the city (high social service benefits). This, in turn, not only caused further increases in Federal and State aid but also put even greater pressure on the City’s limited tax base, a pressure that other major
of the New York City financial crisis. Some financial difficulties have also been self-inflicted, through overextension of City government and internal mismanagement, especially in the labor relations field. The point is simply that the New York constitutional tax and debt limitations have been ineffective tools for preventing local and state officials from expanding the size and scope of local government and may even have contributed to some of the inefficiencies in finance and management. For example, long before the City's financial crisis, at least one state report observed that the City's tax limit has continued to restrict the City's financial operations forcing it to continue to finance all of its capital improvements by borrowing and thus to accumulate a large debt requiring inordinately large appropriations for debt service. . . . The tax limit also forced the City to

U.S. cities felt to a lesser extent because their state governments typically assumed a larger share of all nonfederal program costs than New York. TEMPORARY COMMISSION, supra note 67, at 59.

72. For example, the City University system long provided free tuition for any city resident with a high school diploma and paid its teaching staff one of the highest rates in the nation. Schnepper, New York City: A Short Term Solution, a Long Term Plan, in New York City Financial Crisis: Hearings on S. 1883, S. 1862, S. 2372, S. 2514, and S. 2523 Before the Senate Comm. on Banking, Housing, and Urban Affairs, 94th Cong., 1st Sess. 218, 224 (1975) [hereinafter cited as Senate Comm. Hearings]. Many commentators feel the City should be relieved of this huge financial responsibility. See, e.g., id.; Berger & Macchiarola, New York City's Budget—Looking into the Future, N.Y.CITY PERSPECTIVE, Nov. 1974, at 1. Some financial relief was provided in September 1976, when the City University system revised its open admissions policy and imposed tuition for the first time. Official Statement, supra note 67, at 61.

More generally, the Dean of the New York University Graduate School of Public Administration has concluded that the present financial crisis requires the City to shed some of its functions entirely, reducing its role to the provision of those services that the city can effectively administer and finance, instead of attempting selective reductions in service standards or in the rate of increase of employee salaries. . . . All of this is to argue that if New York City seems ungovernable, it is not because of the city's great size, but because the city's government is too big in the sense that it does too many things.


73. See generally New York City—What Lies Ahead?, 12 COLUM. J.L. & Soc. PROS. 587-619 (1976) (symposium). For a comparison of labor negotiations under Mayor Wagner and under Mayor Lindsay, see M. Gelfand, Decentralization—London and New York, 76-86 (Trinity Term, 1974) (M. Phil. thesis, Oxford Univ.). The debt limitations may, however, have had at least an indirect adverse effect on labor relations as well. See notes 113-15 infra and accompanying text.
resort to various makeshifts in its financings and to impose some uneconomic non-property tax levies.\textsuperscript{74}

B. Evasion of the Debt Ceiling

New York City, with the assistance of the New York Legislature, has readily evaded the debt ceiling and increased its level of outstanding debt above the ten percent limit set by the State Constitution. One technique, not properly characterized as evasion but having the same practical effect, has been resort to special constitutional and statutory exemptions. For example, the legislature is empowered by the New York Constitution to exempt local government indebtedness incurred for the construction of sewage disposal facilities,\textsuperscript{75} water supply facilities,\textsuperscript{76} or housing.\textsuperscript{77} In addition to these general exemptions that apply to all municipalities in the state, special constitutional provisions applicable only to New York City debt have exempted $150 million for hospital bonds, $500 million for school construction, and the debt incurred for acquisition of the transit system.\textsuperscript{78} The New York Legislature has also approved numerous statutory exclusions, primarily to finance various aspects of subway system expansion.\textsuperscript{79}

The two principal means of direct evasion have been legislative creation of special purpose authorities\textsuperscript{80} and the City's misuse of tax anticipation and revenue anticipation notes.\textsuperscript{81}

\textsuperscript{74} Staff Report No. 31, supra note 70, at 103, quoted in Macchiarola, supra note 70, at 284. For a 1978 update, see Temporary Commission, supra note 67, at 59.

\textsuperscript{75} N.Y. Const. art. VIII, § 5(E).

\textsuperscript{76} Id. art. VIII, § 2.

\textsuperscript{77} Id. art. XVIII, § 4. This provision, by authorizing the legislature to permit the City to incur debt up to two percent of the average assessed valuation of its real property for housing construction, allows the City to borrow up to $781,667,936 outside of the general 10% debt ceiling. As of July 1, 1978, $571,194,350 of this additional debt-incurring capacity had been used by the City. Official Statement, supra note 67, at 86.

\textsuperscript{78} See N.Y. Constr. art. VIII, §§ 7, 7a. For further discussion of these constitutional exemptions, see Macchiarola, supra note 70, at 270-73.

\textsuperscript{79} For a description of some of these statutory exclusions, see Saltzman v. Impellitteri, 305 N.Y. 414, 113 N.E.2d 543 (1953) (per curiam); Macchiarola, supra note 65, at 343; W. Farr, Urban Government 250-51 (1974) (unpublished manuscript on file with author).

\textsuperscript{80} Debt incurred by special purpose authorities is exempt from the general 10% debt ceiling imposed by N.Y. Constr. art. VIII, § 4, because it is financed through revenue bonds, see notes 87-91 infra and accompanying text, and serviced by user charges and grants from other levels of government.

\textsuperscript{81} Such short-term borrowing can be serviced by property taxes that do not count against the general 2.5 percent tax limit imposed by N.Y. Const. art. VIII, § 10. See notes 63-65 supra and accompanying text. See generally S. SATO & A. VAN ALSTYNE, STATE AND LOCAL GOVERNMENT LAW 12-13 (1970).
1. Special Purpose Authorities

New York City is by no means unique in employing special districts to circumvent its constitutional debt ceiling. Just as financial responsibility for capital investment was shifted from constitutionally restricted state governments to unrestricted municipalities during the 1860s and 1870s, it was later shifted to special districts and authorities once constitutional debt limitations restricted the ability of municipalities to finance the twentieth century demand for capital development. This shift was facilitated by state court rulings, beginning at the turn of the century, that special district borrowing was not subject to the municipal debt ceiling, even when a special district and a city had overlapping boundaries. Among the first such semi-autonomous bodies were school districts. Later, other statutory authorities—public corporations exempted from state and municipal debt limits—were developed to build and operate revenue-producing assets, such as bridges and toll roads, that tended to serve a limited, fee-paying clientele.

Today, special districts and authorities finance, construct, and operate a broad range of programs and facilities. Their costs are financed by revenue bonds, which nearly always pay a greater rate of interest than general obligation bonds. Empirical studies have found interest rate differentials of between 0.25 and 1.25 percent for comparable revenue and general obligation bonds. This is because

82. See notes 5-9 supra and accompanying text.
84. See, e.g., Campbell v. City of Indianapolis, 155 Ind. 186, 57 N.E. 920 (1900); Ex parte City of Newport, 141 Ky. 329, 132 S.W. 580 (1910); Robertson v. Zimmerman, 268 N.Y. 52, 196 N.E. 740 (1935). See also Wein v. City of New York, 36 N.Y.2d 610, 331 N.E.2d 514 (1975), and cases cited therein.
85. Mitchell, supra note 1, at 18. New York City today does not share in this particular form of debt limitation avoidance, since it is one of the few cities that still finance their own school system. See note 66 supra and accompanying text.
86. See Mitchell, supra note 1, at 19.
87. See generally Quirk & Wein, A Short Constitutional History of Entities Commonly Known as Authorities, 56 Cornell L. Rev. 521, 587 n.387 (1971); Virtue, supra note 19, at 295-96.
88. Quirk & Wein, supra note 87, at 569 n.286. In the present economic climate there may be a few special authorities, with bonds backed by a strong revenue-producing asset, that pay the same or lower interest rates as cities facing financial crises.
89. See, e.g., ACIR, Restrictions on Debt, supra note 83, at 55-56 (local bonds
the risk to investors is generally greater with revenue bonds, since debt service on revenue bonds is derived from user charges and grants by other levels of government,\textsuperscript{40} rather than from the real estate taxes that back general obligation bonds issued by general purpose local governments.\textsuperscript{41}

While there may be certain economic advantages in separately incorporating agencies to operate collateral services or structures that can be financed by revenue bonds and user charges,\textsuperscript{42} commentators agree that special districts and authorities have principally been employed to increase capital expenditure without exceeding state and municipal debt limits.\textsuperscript{43} In this avoidance process municipalities

\begin{itemize}
\item for water supply and sewer systems—0.5-0.6\% differential); A. Heins, supra note 2, at 45-50 (state government general obligation and revenue bonds); O'Donnell, The Tax Cost of Constitutional Debt Limitation in Indiana, 15 Nat'l Tax J. 406, 410 (1962) (school building corporation bonds); Tyler, Revenue Bond Financing: Advantages and Disadvantages, 32 Municipal Finance 76, 78-79 (1959). See also Mitchell, supra note 1, at 28-31 (discussing these and other studies on interest differentials). The financing costs added by these higher interest rates can total many millions of dollars over the life of the revenue bond. Id. at 31.
\item 90. For example, the New York City Transit Authority regularly receives funds from the City's capital budget, and sometimes from its operating budget. See J. Rappaport, Public Benefit Corporations in New York City 5 n.5 (1975) (report prepared for the State Charter Revision Commission for New York City).
\item 91. The Council of State Governments has described authority financing as follows:
\begin{quote}
Public authorities are authorized to issue their own revenue bonds, which ordinarily do not constitute debt within the meaning of constitutional debt limitations . . . . They lack the power to levy taxes, but are empowered to collect fees or other charges for the use of their facilities, devoting the resulting revenue to payment of operational expenses and to interest and principal of their debt.
\end{quote}
\item 92. When a project produces insufficient external economies for the general population of taxpayers, it may be desirable to impose the burden of maintenance upon its users and shift the risk of project failure to its bondholders, even if such an approach requires paying the latter a higher interest rate to compensate for the higher risk. See generally A. Heins, supra note 2, at 56-60; Mitchell, supra note 1, at 23-24. Moreover, special authorities have the additional advantage of overcoming jurisdictional barriers, so as to provide public services, especially transportation or sewerage, on a regional or interstate basis. See, e.g., J. Rappaport, supra note 90, at 1; Brooks, The Metropolis, Home Rule, and the Special District, 11 Hastings L. J. 110, 126 (1959).
\item 93. See, e.g., J. Bolleins, Special District Governments in the United States 7-9 (2d ed. 1961); Mitchell, supra note 1, at 22-24; Quirk & Wein, supra note 87, at 585-96; Virtue, supra note 19, at 289-94; note 83 supra. Mitchell's elaborate empirical study ranks all states in the continental United States in terms of degrees of restrictiveness for public borrowing and then compares this ranking to the overall amount of
\end{itemize}
have received substantial assistance from both the federal and state
governments. There has been a massive expansion in special author-
ity revenue bond debt financing since World War II.

As in other states with constitutional limits on governmental
borrowing, New York State and its localities have made substantial
use of special authorities and districts. In the 1938 New York Consti-
tution, an attempt was made to end this abuse by imposing severe
restrictions on the formation and operation of special authorities. Yet, this method of financing has continued, particularly for services
provided within the boundaries of New York City. The Transit Con-
struction Fund, for example, was established in 1972 to finance capital
improvements in the transit system. Within two years, scheduled
expansions were estimated to exceed $2 billion, to be provided by
federal, state, and city funds. A more complicated arrangement is
employed for the construction of higher education facilities by the

general obligation and “non-guaranteed” (revenue bond) debt in each state. The process is then repeated in terms of degrees of restrictiveness for local governments. Mitchell, supra note 1, at 21, 50-52.

94. Particularly during the depression of the 1930s, the federal government of-
fered financing for employment-producing construction projects to cities that had
already accumulated debt close to their constitutional ceilings. State legislatures, in
turn, created special purpose districts and authorities with power to incur debt outside
the limitations their constitutions imposed upon general purpose state and local gov-
ernments. See J. RAPPAPORT, supra note 90, at 1; Quirk & Wein, supra note 87, at 567
(upholding statutory creation of Sewer Authority for City of Buffalo, which was too
near its debt limit to provide adequate facilities).

95. Mitchell, supra note 1, at 17-22, 26-27. In particular, the 1968 to 1978 period
was very active, with revenue bonds moving from 42% of new issues to 60% by the end
103 [hereinafter cited as Illusory Lightening].

96. The state legislature may not impose liability for special authority debt on
the states or local governments. N.Y. Const. art. X, § 5. Moreover, the state constitu-
tion prohibits, with some exceptions, the gift or loan of state credit, id. art. VII, § 8,
or of local government credit, id. art. VIII, § 1, and tax exemptions are repealable. Id.
art. XVI, § 1. As two astute commentators have noted:

It is probably fair to say that the authority system cannot survive under such
restraints. . . . It may be asked, why, in light of the constitutional re-
strictions, is there outstanding in New York today some $5.5 billion of author-
ity debt [two and one-half times the outstanding State debt]? The answer
is simple—the constitution has been ignored.

Quirk & Wein, supra note 87, at 579 n.347.

is administered by the New York City Director of the Budget and two mayoral appoint-
ees. Id. §§ 1225-b, -e.

98. A. SCHICK, CENTRAL BUDGET ISSUES UNDER THE NEW YORK CITY CHARTER 54
(1974) (report prepared for the State Charter Revision Commission for New York City);
W. Farr, supra note 79, at 252.
State Dormitory Authority, which receives annual rental payments from the City University Construction Fund (CUCF) to cover debt service, overhead, and administration. The City of New York, in turn, is responsible for one-half of these rental payments. As a result, although $27.9 million in annual rental payments to the CUCF are reflected in the City's current Expense Budget, $564.7 million of outstanding Dormitory Authority debt for facilities leased to the City are not charged against its debt limit. Thus, by using these two legislatively created authorities to finance construction, the City has incurred no "debt" within the meaning of the New York Constitution. It has, however, substantially expanded its capital investments and assumed liability, through continuing lease payments, for debt service on those investments. The City has similar long-term lease arrangements with the Urban Development Corporation for community facilities and housing.


101. Id. at § 6279. The state pays the remainder. Id. While the City is technically liable only to the extent of its funds actually available for lease payments, should it fail to make a payment, that amount would be deducted from state aid to the City and transferred directly to the Dormitory Authority. See Official Statement, supra note 67, at 97-98.

102. Office of Management and Budget, City of New York, Adopted Budget—Fiscal Year 1979, at 84E (1978) [hereinafter cited as 1979 City Budget]. This represents an increase over the fiscal 1978 appropriation, which was $23 million. Id.


104. Lease payments to the City University Construction Fund (CUCF) will be made from the Expense Budget in fiscal 1979, see note 102 supra and accompanying text, but the City is also authorized to borrow to meet these annual payments. A. Schick, supra note 98, at 55. While the City has exercised this power to capitalize in the past, see 1979 City Budget, supra note 102, at 20C-21C (reflecting $6.66 million of prior authorization in the capital budget for earlier CUCF projects), it does not plan to continue the practice in the future. See id. (no planned appropriation for these or other CUCF projects in the projected Capital Budgets for fiscal years 1979 through 1982).

105. This is not an uncommon arrangement. The long-term leasing of property from statutory authorities or from private parties has been employed by cities in several other states to avoid constitutional debt limitations. See Magnusson, Lease-Financing by Municipal Corporations as a Way Around Debt Limitations, 25 Geo. Wash. L. Rev. 377, 389 (1957), Mitchell, supra note 1, at 21; Nichols, supra note 2, at 411-14.

106. Approximately $64.1 million of Urban Development Corporation debt relates to facilities leased to the City for 40 years, none of which is counted against the
In addition to avoidance of the City’s debt limitation, the semi-autonomous operation of special authorities may lead to a reduction in both City revenue and political accountability. Revenue is lost because the City does not receive the charges imposed by special authorities upon their users. In this respect, an authority operates more like a private corporation than like a City agency. Unlike private corporations, however, special authorities are exempt from City real estate and income taxes. While the City has been able to negotiate payments “in lieu of taxes” with several authorities, “monies received do not always bear a relationship to the current assessed valuation” of property owned or income produced by the authorities. Moreover, some public authorities receive direct subsidies
Thus, many profitable enterprises are conducted by special authorities with no provision for transfers to the City; yet the City is required to underwrite the deficits produced by other authorities.

Perhaps more significant, though less visible, than the tax loss suffered by the City or the direct subsidies it pays to special authorities is the dispersion of political authority created by their semi-autonomous operations. The difficulty of coordinating planning, housing, and transportation policy among a multiplicity of special and general purpose local governments within the same geographic area has long been a staple of public administration literature. This political dispersion also has significant economic implications. In addition to increasing the cost of debt financing, the authority system may have contributed to high municipal employee wage rates in New York City. As the Temporary Commission on City Finances

million, and Urban Development Corporation properties, assessed at $160 million, were removed in fiscal 1978. Nevertheless, the City estimates that $250 million of publicly owned properties remain on the tax rolls. Official Statement, supra note 67, at 50, 52. Including such exempt property on the tax rolls was an additional means of avoiding constitutional debt and tax limits. See notes 135-37 infra and accompanying text.

110. The principal recipients of subsidies are the New York City Transit Authority and the New York City Housing Authority. The City is required to pay the Transit Authority $51 million plus interest on the latter's anticipation notes, in ten equal annual installments from 1972 to 1981. N.Y. Pub. Auth. Law § 1207(2) (McKinney 1970 & Supp. 1978). If these payments are not made, the State Comptroller is instructed to deduct the payments from state aid apportioned to the City. Id. The City also has an agreement with the Transit Authority to pay for new subway cars at an additional $5.1 million per year until November 1, 1987. Official Statement, supra note 67, at 102. See generally N.Y. Pub. Auth. Law § 1207-k (McKinney 1970). The City's fiscal 1979 Capital Budget contains a total of $474.5 million for the Transit Authority. Although federal, state, and Triborough Bridge and Tunnel Authority grants supply the majority of these capital funds, $65.3 million is derived from the City's own revenue. 1979 City Budget, supra note 102, at iiC, 113C.

The City has also guaranteed $136 million of debt issued by the New York City Housing Authority. This amount is chargeable against its constitutional debt ceiling. Official Statement, supra note 67, at 97-98. In addition, the City has guaranteed repayment of $468.3 million of Housing Authority debt to the State of New York, id. at 98, besides providing substantial subsidies to cover Housing Authority operating expenses and debt service. Id. at 100.


112. See text accompanying notes 87-91 supra.
found, "[e]ach independent agency operating under the State system . . . could formulate its own bargaining position with respect to its employees without regard for the overall labor policy of the City." In contrast to this lack of coordination among public employers, public employee unions relied on a "pattern bargaining" strategy so that a contract negotiated with one body, whether an authority or a City agency, became a model for other unions in their later negotiations with the City. Thus, the labor relations policy of the City government has been heavily influenced by actions of public authority officials who have no direct political accountability to City voters and who, in some cases, are not even appointed by the mayor.

113. Temporary Commission, supra note 67, at 77. Statutory authorities may choose to be within either the New York state labor relations system, regulated by the Public Employees' Fair Employment Act (Taylor Law), N.Y. Civ. Serv. Law, §§ 200-214 (McKinney 1973), or the New York City system, regulated by the New York City Collective Bargaining Law, N.Y. City Charter ch. 54 (Williams 1976 & Supp. 1978). See N.Y. City Administrative Code § 1173-4.0(c) (Williams 1978). The principal differences are in the composition of the independent administrative board and the scope of bargaining permitted. Administrative determinations in the state system are rendered by a three-member Public Employment Relations Board appointed by the Governor, N.Y. Civ. Serv. Law § 205(1) (McKinney 1973), while comparable determinations for the City system are made by the Board of Collective Bargaining (composed of two "labor" members appointed by the Municipal Labor Committee, two "city" members appointed by the mayor, and three "impartial" members selected by the labor and city appointees), and the Board of Certification (composed of the three "impartial" members of the Board of Collective Bargaining), N.Y. City Charter §§ 1171-1172 (Williams 1972). The Taylor Law also permits collective bargaining on a much broader range of subjects. Compare N.Y. Civ. Serv. Law § 203 (McKinney 1973) with Exec. Order No. 52 (Mayor of City of New York), Sept. 29, 1976 (quoted and discussed in Note, The Taylor Law, the OCB and the Public Employee, 35 Brooklyn L. Rev. 214, 224-28 (1969)).

114. For example, the settlement between the Transit Authority and the Transport Workers Union, Local 100, in the spring of 1974—providing for a two-year contract with a 14 percent rate increase plus a cost-of-living formula—has provided the basis for most settlements between the City of New York and its civil service unions in 1974.

R. Horton, Reforming the Municipal Labor Relations Progress in New York City 18 (1975) (report prepared for the State Charter Revision Commission for New York City). Although all subway lines (237 miles) and bus routes (934 miles) operated by the New York City Transportation Authority are within the city limits, city government has little practical control over the Transit Authority's labor or other policies. See J. Rappaport, supra note 90, at 27-29, app. A at vi; note 115 infra.

115. For example, all eleven members of the Metropolitan Transportation Authority—who, sitting ex officio, comprise the Board of Directors of the New York City Transit Authority—are appointed by the Governor, although three must be nominated by the Mayor. See N.Y. Pub. Auth. Law §§ 1201, 1263 (McKinney 1970 & Supp. 1978). Similarly, the three-member Board of the Battery Park City Authority is entirely
2. Tax Anticipation and Revenue Anticipation Notes

A unique borrowing abuse involved the City's misuse of tax anticipation notes (TANs)\textsuperscript{118} and revenue anticipation notes (RANs).\textsuperscript{117} The purpose of these short-term borrowing devices was to bridge the temporary cash flow gap between expenditures, which must be made on a daily basis, and revenues (taxes and intergovernmental aid), which are received only on a quarterly or yearly basis.\textsuperscript{118} If repaid within the permissible statutory period,\textsuperscript{119} TANs and RANs are excluded from the New York Constitution's article VIII debt limit.\textsuperscript{120} City officials abused these exempted short-term debt instruments by borrowing "in increasing amounts against accrued, but actually uncollectable, tax revenues."\textsuperscript{121} Some "anticipated" real estate tax revenue was uncollectable because tax exempt properties were, and con-
continue to be, carried on the City's tax rolls. Moreover, although the tax delinquency rate for privately-owned property was seven percent, non-paying landowners were retained on the records used in formulating estimates of "anticipated" real estate taxes. These two devices, in violation of standard accounting procedures, resulted in an overestimate of the income likely from current taxes, thus enabling the City to issue more TANs than could be repaid from revenue actually received. Similarly, the city issued substantial amounts of RANs against overstated estimates of "anticipated" federal and state aid. These unsupported TANs and RANs had to be refinanced, becoming gradual accretions to the City's permanent debt, unregulated by the constitutional debt ceiling.

As a result of the ad hoc exemptions, the refinancing of short-term excluded debt, and the availability of federal and state capital funds, only fifty-eight percent of the City's fiscal 1979 Capital Budget is covered by the ten percent debt ceiling. The same pattern prevails when total outstanding debt is considered. The City currently has $6,827.9 million of outstanding long-term debt and $4,236.2 million of outstanding short-term debt, but only $6,231 million is

122. See note 109 supra.
125. Id. ch. 2, at 18-23. The amount of outstanding RANs grew from $420 million on June 30, 1970 to $2.56 billion on June 30, 1975. Id. ch. 2, at 22. The State Comptroller reported "the city had included as accounts receivable substantial amounts that were not collectible or where the likelihood of collection was extremely remote." Office of the New York State Comptroller, Prior Year Accounts Receivable, Managerial Summary 3 (July 3, 1975) (quoted in SEC Staff Report, supra note 124, ch. 2, at 19).
126. See Shalala & Bellamy, supra note 67, at 1124-25 & n.21. According to the Municipal Assistance Corporation: "Once on the treadmill, the city had to continue borrowing, in order to pay off previous debts and to finance new deficits. To market this growing debt, both higher interest rates and shorter maturities were required." MAC Report, supra note 66, at 7.
127. The 1979 Capital Budget authorizes $1,511 million of new construction. Of this, only $875.6 million is covered by the general debt limit. See 1979 City Budget, supra note 102, at iiC. Constitutionally exempt financing (housing, sewage disposal and water supply facilities), see notes 75-77 supra and accompanying text, accounts for $116.5 million; the remaining $519.6 million is supplied primarily by federal grants. See 1979 City Budget, supra note 102, at iiC. This is by no means a new development. One governmental study reported that "barely half of the capital improvements proposed by the City Planning Commission for 1973-74 [were] covered by the constitutional debt limit." A. Schick, supra note 98, at 55.
charged against the City’s general debt ceiling. In overall terms, this means that New York City’s current outstanding debt is not ten percent of the full value of taxable real property, as mandated by the art. VIII, § 4 general debt ceiling, but rather is 13.8 percent.

C. AVOIDANCE OF THE TAX LIMITATION

As noted above, the New York Constitution establishes a general real estate tax limit for New York City of 2.5 percent of the average full valuation of taxable real property. Real estate taxation at this level would have produced only $1.3 to $1.7 billion per year for the City during the 1973 through 1977 period, or between eleven and seventeen percent of the City’s actual Expense Budget liability. To

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128. Official Statement, supra note 67, at 78, 86. Thus, only 56.3% of the City’s total outstanding debt is covered by the constitutional ceiling. Another way of measuring the extent of New York City borrowing is to add the long-term debt of the City and the long-term debt of the Municipal Assistance Corporation (which currently holds all short-term City debt). The total is $11,934.3 million, compared to only $6,231 million covered by the City’s general debt ceiling. Id. at 92.

Since all figures here and in the text are for outstanding debt, they do not include $550.6 million in bonds and notes held in City sinking funds. Id. at 87-88, 92. For figures on gross long and short-term debt, see Moody’s, supra note 123, at 2514-16.

129. Full valuation of New York City taxable real estate is $86,646.9 million for the 1979 fiscal year. Official Statement, supra note 67, at 50. When total long-term City and Municipal Assistance Corporation debt is taken as the base, see note 128 supra, the ratio of debt to full value of taxable real property becomes 13.8%. Official Statement, supra note 67, at 93. This debt ratio, however, does not include the massive borrowings authorized by the statutory authorities that operate in New York City. See notes 102-06 supra and accompanying text.

130. See notes 63-65 supra and accompanying text.

131. The following table summarizes New York City’s potential annual tax yields for fiscal years 1973-1977 and their relation to the Expense Budget:

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>[column 1]</th>
<th>[column 2]</th>
<th>Ratio of column 1 to column 2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Taxation at 2.5% of full value</td>
<td>Expense Budget (billions)</td>
<td>(percentage)</td>
</tr>
<tr>
<td>1973</td>
<td>1.49</td>
<td>9.40</td>
<td>16</td>
</tr>
<tr>
<td>1974</td>
<td>1.68</td>
<td>10.16</td>
<td>17</td>
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<tr>
<td>1975</td>
<td>1.34</td>
<td>11.10</td>
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<tr>
<td>1976</td>
<td>1.56</td>
<td>13.63</td>
<td>11</td>
</tr>
<tr>
<td>1977</td>
<td>1.70</td>
<td>13.58</td>
<td>13</td>
</tr>
</tbody>
</table>

The figures in column 1 are taken from Official Statement, supra note 67, at 48. The Figures in column 2 for fiscal 1973 through fiscal 1975 are taken from Moody’s, supra note 123, at 2511, while the column 2 figures for fiscal 1976 and fiscal 1977 are from Official Statement, supra note 67, at 14.
enable the Expense Budget to rise to its current level, the City has
undercut, or avoided by various devices, the general 2.5 percent tax
limitation. The result has been an average City tax levy of 3.68 per-
cent of full valuation for the years 1972 through 1979.132

One of the most important deviations from the 2.5 percent limit
is authorized by the New York Constitution itself, which exempts real
estate taxes imposed by local governments for debt service.133 This
provision has consistently been invoked to justify increased taxes for
debt service on the City's massive short and long-term borrowing.
During fiscal years 1972 through 1979, the debt service levy consti-
tuted an incredible 46.8 percent of the City's total real estate tax
levy.134

The overall level of real estate taxes has also been increased by
including in the computation of "full value of taxable real estate"
certain property that cannot realistically be taxed. Despite the re-
moval of a substantial amount of exempt real property from the tax
rolls during the last two fiscal years,135 an estimated $568 million of
publicly-owned property remains.136 Although this property is not
held for a "public use" and thus is technically subject to the property
tax, the City, as it freely admits, "is unable to collect taxes from
itself."137 Insofar as such property is included in the calculation of

132. This figure is an average derived from the annual levy rates contained in
Official Statement, supra note 67, at 49.

133. [T]he amount to be raised by tax on real estate in any fiscal year,
in addition to providing for the interest on and the principal of all indebted-
ness, shall not exceed an amount equal to the following percentages of the
average full valuation of taxable real estate of such county, city, village or
school district, less the amount to be raised by tax on real estate in such year
for the payment of the interest on and redemption of certificates or other
evidence of indebtedness . . . .

N.Y. Const. art. VIII, § 10 (emphasis added). Furthermore, the legislature may not
restrict the power of local governments to impose debt service levies. Id. at § 12.

Historically, the debt service levy has been computed as the amount necessary to
pay principal and interest on the City's long-term debt and interest on its short-term
debt for the immediate fiscal year. Official Statement, supra note 67, at 47.

134. This figure is an average derived from the annual figures contained in Offi-
cial Statement, supra note 67, at 48. The highest percentages were during the crisis
years of 1975 and 1976: 58.6% and 54.0% respectively. The lowest percentage in recent
years was 34.5% in 1970. See id.

135. See generally note 109 supra.

136. This figure represents the estimated full value of publicly-owned property
currently on the tax rolls. It was calculated by multiplying the City's own estimate of
the property's assessed value, $250 million, see Official Statement, supra note 67, at
50, 52, by the full value/assessed value ratio of 2.27. That ratio was derived from 1979
estimates of assessed and full values of the taxable real estate within the City. See id.
at 50.

137. Official Statement, supra note 67, at 50.
constitutionally permissible tax revenue, the rate of taxation to be applied to privately-owned property is permitted to exceed the levels contemplated by the constitutional limitation.

A third means of undercutting the principal purpose of the New York tax limitation (to restrict the burden imposed on landowners), while staying within its structure, has been to increase property valuations. Even though the same rate is applied, both the burden on the taxpayer and the revenue of the local government are increased.

Moreover, the limit has been side-stepped by the adoption of corporate and personal income, sales, and user taxes. Though many of these taxes, such as the sales tax, draw upon a wider population than just New York City landowners, their primary effect is to increase the residential homeowners' burden. Others, such as commer-

138. See Macchiarola, supra note 70, at 268-70 (describing early criticisms of this potential evasion).

139. This form of evasion can be prevented either by freezing assessments while maintaining tax rates, see, e.g., CAL. CONSTR. ART XIII A, §§ 1, 2, or by automatically readjusting tax rates after reassessments are conducted. See ACIR, TAX AND EXPENDITURE LIMITS, supra note 32, at 14 (levy limits). See also Shannon & Weisert, After Jarvis: Tough Questions for Fiscal Policymakers, INTERGOVERNMENTAL PERSPECTIVE, Summer 1978, at 11 (describing the Florida procedure).

140. The City imposes a vast array of taxes, including resident and non-resident personal income taxes, business income taxes (general and special corporations, off-track betting, and utility), a retail sales tax, special sales taxes (stock and bond transfers, real property and mortgage, and gasoline), and special use taxes (motor vehicle, vault, hotel room occupancy, general occupancy, and commercial rent). See generally Moody's, supra note 123, at 2512-13; Macchiarola, Constitutional, Statutory and Judicial Restraints on Local Finance in New York State, 15 N.Y.L.F. 852, 862-63 (1969). These non-property taxes are currently budgeted to produce $3.16 billion, as compared to $3.14 billion from general property taxes. 1979 CITY BUDGET, supra note 102, at i. Although this is the first year in which non-property taxes will surpass real estate taxes, they have not been far behind in recent years. The figures for fiscal 1978 are $3.17 billion (general property taxes) and $3.01 billion (other taxes). Id. In fiscal 1977, City real estate taxes produced $3.24 billion and other taxes produced $3.06 billion. See Moody's, supra note 123, at 2513; Official Statement, supra note 67, at 148.

141. The City was empowered, by N.Y. TAX LAW § 1201 (McKinney 1975), to levy a four percent sales tax up until July 1, 1975. The tax was administered, collected, and distributed to the City by the State Tax Commission. See id. § 1210 (McKinney 1975 & Supp. 1978). Since that date, the state has collected the City's sales tax primarily for the purpose of discharging the annual debt service and operating expenses of the Municipal Assistance Corporation (MAC). See N.Y. PUB. AUTH. LAW § 3036 (McKinney Supp. 1978); N.Y. STATE FIN. LAW § 92-d(1) (McKinney Supp. 1978). After these expenses are accounted for, the remainder of the sales tax revenue is transferred to the City. See id. § 92-d(3)(i). See also Official Statement, supra note 67, at 54.

The sales tax produced $867 million in fiscal 1977. See id. at 14. The City's balance sheets include this total as income in the Revenue Budget and then deduct, in the Expense Budget, the $5 million devoted to MAC expenses as "MAC withholdings for debt service." See id. at 14-16.
cial rent and general occupancy taxes, clearly affect owners of commercial property within the City.

Finally, the City has evaded, or at least avoided, the constitutional tax limit by shifting current Expense Budget items to the Capital Budget, that is, by using borrowed funds earmarked for capital projects to finance operating expenses that would otherwise be met by raising taxes. The amount of recurring operating expenses financed by the Capital Budget grew from an estimated $100 million in 1966, to over $500 million by 1974, then to $719 million by fiscal 1978. The City’s Four Year Financial Recovery Plan requires Capital Budget financing of expense items to be phased out by fiscal 1982.

To understand the process of capitalizing expenses, it is necessary to examine the applicable constitutional, statutory, and City Charter language. Section 2 of article VIII of the New York State Constitution provides, in part, "No indebtedness shall be contracted for longer than the period of probable usefulness of the object or

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142. These two taxes produced $205,121,000 in fiscal 1977. Moody’s, supra note 123, at 2513. For a description of how they are calculated, see id. at 2515; Official Statement, supra note 67, at 56.

143. A. Schick, supra note 98, at 47. Another report places the total amount of capitalized expenses for fiscal years 1965-1975 at $2.434 billion. See SEC Staff Report, supra note 124, ch. 2, at 66-70. There has been money in the Capital Budget to finance these recurring expense items only because the devices for evading the debt ceiling have been so successful. See notes 79-129 supra and accompanying text.

144. See 1979 City Budget, supra note 102, at 1. The City contends that $58 million of this total is properly included in the Capital Budget under the New York State Comptroller’s directives. Official Statement, supra note 67, at 16, 31.

145. For details of the recovery plan, see MAC Report, supra note 66, at 12; Shalala & Bellamy, supra note 67, at 1129; Official Statement, supra note 67, at 5-11, 19-34.

146. The Recovery Plan limits transfers from the Capital to the Expense Budget to $445 million in fiscal 1979, $300 million in fiscal 1980, and $150 million in fiscal 1981. No such transfers are to be made in fiscal 1982. Official Statement, supra note 67, at 32. See also N.Y. Pub. Auth. Law § 3038(5) (McKinney Supp. 1978) (allowing until fiscal 1988 to eliminate the transfers). The City plans to finance those capitalized expenses which remain during the phase-out period through the issuance of $900 million of City or MAC bonds, if the necessary legislative approval can be obtained. Official Statement, supra note 67, at 32. The Expense Budget gap created by the phase-out of capital financing is to be filled through direct aid and welfare reform by the federal government, revenue sharing and full financing of senior colleges by the state government, and workforce and public assistance reductions by the City. See id. at 21-22.

There has, however, already been a deviation from the scheduled phase-out. The Recovery Plan has been amended to allow the transfer of $524 million from the Capital to the Expense Budget in fiscal 1979, rather than the $445 million originally called for in the Recovery Plan. See 1979 City Budget, supra note 102, at ii; Official Statement, supra note 67, at 19, 23.
purpose for which such indebtedness is to be contracted, to be determined by or pursuant to general or special laws, which determination shall be conclusive." The state legislature has seized on this broad grant to assign "period[s] of probable usefulness" to various expense items, thereby authorizing their inclusion in the City's Capital Budget.44 The legislature in 1965, for example, gave the City special, one-time-only authorization to issue budget notes for the City's current contributions to the employee pension fund.45 The City financed its 1971 labor settlement with the police and firemen by a short-term loan; it was also given legislative authorization to borrow up to $100 million over a five year period to balance its 1972-1973 Expense Budget.46 In furtherance of this process, the City's Corporation Counsel had denominated certain recurring programs as "capital" expenditures, despite section 211 of the City Charter, which designates only traditional physical improvements as "capital projects."47

Local officials may obtain three major benefits by using the Capital Budget rather than the Expense Budget to finance current operations. The political advantage is that current expenses are paid from borrowed funds, so taxes for repayment are deferred.48 In New York City, however, because this type of borrowing has generally involved short-maturity securities, debt service has required increased taxation almost immediately.49 A second advantage is the possible availability of federal subsidies for local capital projects. The income tax exemption of interest on municipal bonds, which allows their interest

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44. See generally N.Y. Local Fin. Law § 11 (McKinney 1968) (29 pages of legislative determinations of periods of probable usefulness).
47. See State Study Comm'n Report, supra note 149, at 30. The New York State Legislature or the City Corporation Counsel, or both, have approved the transfer of the following items to the Capital Budget: relocation assistance for welfare clients, job training programs, leaseback and rental payments, routine park maintenance, vehicle maintenance, and salaries for many staff personnel of the City Planning Commission and the Bureau of the Budget. See MAC Report, supra note 66, at 7; A. Schuck, supra note 98, at 93-95; Netzer, supra note 66, at 654. Even before this process reached such epic proportions, one report accused the city of "borrowing for purposes for which no big city should borrow, and for some purposes for which no city, big or small, should borrow . . . ." N.Y. State Commission on Government Operations of the City of New York, New York City in Transition 6 (1960).
48. This, of course, is a gross violation of intergenerational equity. See note 25 supra and accompanying text.
49. Netzer, supra note 66, at 712 n.2.
rate to be lower than the taxpayer's actual rate of return on his or her investment, provides an indirect subsidy to local government borrowers. More direct are federal subsidies in the form of matching fund grants, which have paid the major portion of many local government capital projects. These matching funds have, however, decreased in recent years, and very little is likely to be available for operating expenses. A final advantage of capitalizing operating expenses is avoidance of the constitutional tax rate limit. As noted above, while the New York Constitution restricts City real estate taxes to 2.5 percent, real estate taxes imposed to cover debt service are exempt from this overall limit. By swelling the Capital Budget with items formerly in the Expense Budget, the City can impose more real estate taxes (for debt service) without running afoul of the tax limitation.

In its present form, therefore, the New York constitutional tax rate limitation has been ineffective in restraining either the actual level of real estate taxation, currently a full 1.18 percent above the established limit, or the overall tax burden, which has greatly increased. Moreover, the devices that have been employed for evading the tax limit, particularly capitalization of current expenses, have themselves produced detrimental economic consequences.

D. Lessons Derived from the New York City Experience

The New York City fiscal crisis demonstrates that the prevalent form of constitutional debt and tax limitations are ineffective in restraining borrowing and taxing by a large city faced with a declining tax base, mandated expenses, demands for increased public services, and union pressures. Not only were numerous mechanisms devised by New York City officials to evade or avoid the limits; the state

153. See B. Bittker & L. Stone, Federal Income, Estate and Gift Taxation 177-78 (4th ed. 1972); Greenberg, supra note 19, at 339-40 and sources cited therein. This advantage for municipalities is of less significance now that interest rates on municipal bonds have soared.

154. Acceptance of such federal grants in aid, however, requires the City, in committing its matching funds, to follow the spending priorities of the federal government. Moreover, federal agencies and departments impose organizational, policy, and administrative requirements for the receipt and maintenance of these categorical grants. See generally Temporary Commission, supra note 67, at 47; Goetcheus, State House and National Capitol, in Governing the City 68, 70-72 (R. Connery & D. Caraley eds. 1969); M. Gelfand, supra note 73, at 54, 64.

155. See Netzer, supra note 66, at 664.

156. See note 133 supra and accompanying text.

157. See generally note 132 supra and accompanying text.

158. See notes 140-142 supra and accompanying text. See generally C. Harriss, supra note 70.
legislature also assisted by providing necessary authorization for special exemptions, statutory authorities with separate debt incurring capacity, questionable accounting practices, and capitalization of operating expenses.

The New York experience parallels that of other cities and states. Constitutional debt limits have not restricted the amount of state and local debt issued. They have merely changed the composition and increased the cost of state and local capital investment financing. Likewise, both the real estate tax rate level and the overall tax burden have increased substantially despite the existence of constitutional tax limits. Moreover, neither the debt ceiling nor the tax limit has prevented the substantial expansion of local government operations. We turn now to an examination of a device more finely tuned to controlling governmental expansion—the spending limit.

III. SPENDING LIMITS IN ARIZONA

Arizona was the first state to adopt a local government expenditure limit. Interestingly, its ten percent spending limit initially was developed by the Arizona Supreme Court, which saw it as the logical corollary of the ten percent levy limit. A spending limit of ten

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159. Cleveland's fiscal crisis has also received substantial attention in the press. See, e.g., Oh Cleveland, Newsweek, Jan. 1, 1979, at 18. Although the magnitude of that crisis is less and its development somewhat unique, many of the New York City lessons have been taught there as well. In particular, the inadequacy of tax and debt limitations to prevent fiscal mismanagement has been demonstrated.

160. See Mitchell, supra note 1, at 28-29.

161. In other states as well, it is the existence of alternative local tax sources (sales or income tax), not the existence of a real estate tax limit, that produces revenue diversification and decreased reliance upon the property tax. See ACIR, Tax and Expenditure Limits, supra note 32, at 4, 22.

162. See generally id. at 3, 21-22 (reporting empirical research showing that although local tax limits are associated with lower local own-source per capita expenditures, their existence does not affect total state-local expenditures).


percent allowable annual increased for local budgets was codified in 1921. The contemporary version provides,

C. . . . [N]or shall the total of amounts in the budget [of the county, city or town] proposed for expenditure exceed by more than ten per cent the total of amounts proposed for expenditure in the budget adopted for the previous fiscal year, excluding expenditures for school, bond, special assessment and district levy, primary, general or special election purposes, municipal cemeteries, the amount of increase in salaries of public officials whose salaries are set by state law, or municipal utility undertaking as defined in § 9-521.

D. No expenditures shall be made for a purpose not included in such budget, and no expenditure shall be made, nor debt, obligation or liability incurred or created in any fiscal year in excess of the amount specified for each purpose in the budget for such fiscal year as finally adopted except when authorized under and pursuant to the provisions of § 42-308 [emergency situations], whether or not the county, city or town has at any time received, or has on hand, funds or revenue in excess of those required to meet expenditures, debts, obligations, and liabilities incurred under such budget.

When examined closely, the experience of Arizona localities with spending limits strikingly parallels that of New York City with its debt ceiling and tax limits: relatively easy avoidance of the terms and undercutting of the purpose of the limit. A recent study reveals that only 41.4 percent of expenditures by Arizona counties and 44.5 percent of expenditures by Arizona large cities and towns are covered by the ten percent limit. A variety of avoidance devices have been employed. As with the New York debt limit, an increasing number of services have been specially excluded from Arizona's expenditure limit. As a result, fifty-eight percent of county expenditures and

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168. Ariz. Historical Analysis, supra note 163, at 6 (percentages are for the 1973 fiscal year). This study focused on the effects of the budget limit and levy limit upon Arizona's 14 counties, its 13 cities over 10,000 population, and 10 of its smaller cities and towns. Id. at 3.

169. See notes 76-131 supra and accompanying text.

fifty-five percent of city and town expenditures were exempted. In addition, general increases in the expenditure base were permitted on an ad hoc basis for particular years—for cities in 1972 and for certain localities in 1977 and 1978. Because of the formula used for calculating future limits, the establishment of such a new expenditure base will have effects for many years.

An increase in spending above the ten percent limit is permitted when the Arizona Tax Commission determines that a particular local government is faced with a fiscal emergency. Although probably inserted to provide needed flexibility in the system, this override device has been abused by localities that purposely overbudget and then routinely obtain approval from the Tax Commissioner for their planned "fiscal emergencies."

Since certain budget items are statutorily exempt, the expenditure limitation encourages shifting of budgeted expenditures from controlled functions to those that are uncontrolled by simply making an accounting transfer. One aspect of this technique involves the

tax of up to $3.8 million, to be used for local public construction, improvements, and land acquisition). See generally LEAGUE FINANCE MANUAL, supra note 163, at 13-15.

171. ARIZ. HISTORICAL ANALYSIS, supra note 163, at 8. See also note 168, supra.

172. See Act of May 11, 1972, ch. 130, 1972 Ariz. Sess. Laws 684. See generally Koon, supra note 163. This is the functional equivalent of New York’s numerous ad hoc, one-time-only, authorizations of debt exemptions, see notes 78-79 supra and accompanying text, and of authorizations for capitalizing individual expense items. See notes 147-50 supra and accompanying text.


174. See ARIZ. REV. STAT. ANN. § 42-308(A) (Supp. 1978)

In event of epidemics, disease or acts of God which result in damage or disaster to the works, roads, buildings or property of a county, city, or town, or which menace the life, health or property of any considerable number of persons therein, or in event of any other emergency the results of which have not been anticipated in the budget and which will require making expenditures or incurring liabilities or expenses by reason thereof during the current fiscal year, and restricted to instances in which no other funds have been provided or appropriated therefor, the governing body may present to the state board of tax appeals in writing the facts thereof which require making such expenditure or incurring such additional liability or expense during the fiscal year and therein specify the amount which is deemed necessary therefor.

175. Similarly, TANs were made available to solve New York City’s cash flow problem but were then abused by its financial managers. See notes 116-126 supra and accompanying text.

176. Koon, supra note 163. In fact, “[t]here are municipalities in the state of Arizona which ask for this emergency relief each fiscal year.” LEAGUE SUMMARY, supra note 163, at 4.

177. See notes 167-71 supra and accompanying text.

178. ARIZ. HISTORICAL ANALYSIS, supra note 163, at 9.
use of federal funds\footnote{If a principal purpose of spending limits is to restrict the size of local governments, then it can be argued that federal revenue-sharing funds should be included in the controlled budget. Arizona has, however, placed them in the exempt category. The legitimacy of this practice was submitted to the Arizona Attorney General in 1978, Koon, supra note 163, but no opinion has yet been issued.} to expand the revenue budget in particular areas. For example, federal funds are spent on police salaries,\footnote{Traditional local government services, such as police and fire protection, are the most heavily controlled by the Arizona expenditure limit.} and money that would otherwise be used for police salaries is transferred out of the controlled budget into an exempt category and spent on other items.\footnote{See notes 116-26, 135-37, 143-46 supra and accompanying text.} As a result, Arizona’s localities have developed fragmented accounting records, involving numerous fund accounts, reflecting controlled and exempt budget items\footnote{See notes 116-26, 135-37, 143-46 supra and accompanying text.} which are the functional equivalents of New York City’s elaborate accounting systems used to circumvent its tax and debt limits.\footnote{This is the primary purpose of constitutional tax limits, see notes 32-36, 40 supra and accompanying text, and especially of Proposition 13 and its progeny. See notes 50-52 supra and accompanying text.}

Given the array of categorical, ad hoc, emergency, and accounting exceptions to the expenditure limit, it is not surprising that Arizona city and county total expenditures virtually quadrupled between fiscal 1962 and fiscal 1973,\footnote{This is the purpose of constitutional debt ceilings. See notes 21-24 supra and} despite that state’s ten percent spending limit. Thus, like New York tax and debt limits, the Arizona spending limit has not restricted local government expenditures but has merely channeled the directions they have taken.

IV. TOWARD A BETTER SYSTEM OF LOCAL GOVERNMENT FINANCIAL CONTROL

In light of New York City’s experience with avoidance of constitutional tax and debt limitations and that of Arizona with statutory expenditure limits, policymakers in New York, Arizona, and other states may wish to reconsider the effectiveness of the various means available for furthering the goals of lightening the burden on current taxpayers,\footnote{See notes 50-52 supra and accompanying text.} limiting local government debt so as to restrict the burden on future taxpayers,\footnote{See notes 50-52 supra and accompanying text.} and restraining the growth of local govern-
ment.187 There are four principal alternatives available for imposing such limitations. The first involves readjusting debt ceilings and tax limitations to reflect the current realities of municipal taxation. This could be accomplished, for example, by taking into account the entire revenue base available to local governments rather than just the value of real property. Similarly, spending limits could be adjusted to take into account factors, such as inflation, that require increased governmental expenditures. At the same time, these more realistic limitations might be strengthened to prevent the avoidance techniques discussed in Sections II and III above. A second alternative is to replace the yearly overall tax and debt limits with a system that requires voter approval of each large capital project or each tax increment. A variation on this theme would allow voters to override constitutionally established tax, debt, and spending limits. Third, constitutional debt limitations could be repealed, so that the amount of local government debt incurred is controlled by market and political forces. If constitutional tax and spending limitations were also removed, local voters and state legislatures would have to provide a political brake upon city hall excesses. The final alternative involves creation of a state or local administrative oversight agency responsible for monitoring and controlling taxation, spending, and debt incursion by local governments.

A. THE OVERARCHING PRINCIPLES

In order to evaluate the comparative advantages and disadvantages of each of these four alternatives, it is necessary to consider certain general principles that should be reflected in any local government financial system, whatever the details of its operation.

1. Providing More Information—Mandatory and Voluntary Disclosure

Like any other economic entity, a local government must compile accurate information and make it available in a fashion that is intelligible to the relevant decisionmakers.188 In the case of local governments, the recipients of this information are state and city officials, investors, market managers, and voters. Several bills currently and recently before Congress have attempted to apply this principle

accompanying text.

187. This is the immediate purpose of expenditure lids, see notes 59-61 supra and accompanying text, and a secondary purpose of constitutional tax rate limits. See note 51 supra and accompanying text.

by mandating greater disclosure by issuers of municipal securities.\footnote{189} Although a detailed analysis of these bills is beyond the scope of this Article,\footnote{190} they embody three basic approaches. The first requires municipal securities issuers to comply with the comprehensive registration and disclosure requirements of the Securities Act of 1933\footnote{191} in the same manner as issuers of corporate securities.\footnote{192} Another treats municipal securities differently from corporate securities but still requires disclosure.\footnote{193} The third relies on the anti-fraud provisions of


\footnote{192. See, e.g., S. 2574, supra note 189 (Eagleton Bill). Essentially, this bill would amend § 3(a)(2) of the 1933 Securities Act, 15 U.S.C. § 77c(a)(2) (1976), to remove the current exemption afforded to municipal securities. Municipal issuers would be required to file a registration statement with the Securities and Exchange Commission (SEC) before offering a new issue to the public, and would be subject to the Act's civil liabilities. See \textit{Securities Act of 1933}, §§ 11-12, 15 U.S.C. §§ 77 k(a)-(g), 77 l (1976). This would include the possibility of being subject to a stop order by the SEC. See \textit{Securities Act of 1933}, § 8(b), 15 U.S.C. § 77h(b) (1976).}

\footnote{193. For example, the Williams-Tower Bill, S. 2969, supra note 189, encouraged state regulation of municipal issuers, but would have imposed federal disclosure guidelines in the absence of such state regulation. It required that municipal issuers with more than $50 million in outstanding debt prepare various annual reports and distribution statements, to be made available to all investors. Unlike the Eagleton Bill, see note 192 supra, the Williams-Tower Bill would not have required a registration statement to be filed with the SEC prior to a securities offering by a local government. \textit{Federal Regulation}, supra note 189, at 1275. It would, however, have added Section 13A, entitled "Municipal Securities Full Disclosure of 1976," to the Securities Exchange Act of 1934, 15 U.S.C. § 78 (1976). This new provision would have demanded preparation of annual reports and distribution statements and would have permitted the SEC to require filing at a repository open to public inspection. See \textit{State Sovereignty's Impact}, supra note 189, at 688. The Williams-Tower Bill was revised somewhat, expanded, and reintroduced as S. 2339, supra note 189, by Senators Williams, Proxmire, and Javits in the fall of 1977. The new bill is described in detail in Securities.
the securities acts that are already applicable to municipal securities.195

Although these proposed disclosure requirements would impose substantial new costs on local government taxpayers primarily for the benefit of investors, the information, once developed, could also easily be made available to state regulatory agencies and voters.197 Nevertheless, some commentators have argued that imposition of disclosure requirements by the federal government should be avoided,198 because of the movement since the New York City crisis.


The Williams-Tower Bill contained little new with regard to civil liability for fraud. See generally notes 194-95 infra. On the other hand, the more recent revision supplants the implied private right of action under the anti-fraud provisions with an express right of action for initial purchasers who meet fairly strict procedural and substantive burdens and establishes "reasonableness" defenses for issuers and underwriters. S. 2339, supra note 179, at § 13A(g)-(j); see SEC Final Report, supra, at 957-58.


195. See generally Petersen, Doty, Forbes & Bourque, supra note 190, at 1194-97; State Sovereignty's Impact, supra note 190, at 583-84; SEC Final Report, supra note 193, at 954-55 n.5 (citing recent SEC-initiated anti-fraud actions against municipal securities professionals). The Securities Acts Amendments of 1975, Pub. L. No. 94-29, § 3(2),(5), 89 Stat. 97, 101 (1975) (codified at 15 U.S.C. § 78c(9), (29) (1976)), specifically exempt issuers of municipal securities from furnishing more information than is currently required under the anti-fraud provisions, i.e. reports that are already generally available. See also SEC Final Report, supra note 193, at 955 & n.8.

The difficulty with this approach is that the antifraud provisions mandate no specific level of disclosure; they merely create a retrospective claim for damages. Thus, they neither ensure a flow of information nor prevent the purchase of a worthless municipal security. See State Sovereignty's Impact, supra note 190, at 583-84. One bill, H.R. 2724, supra note 189, seems to overcome this criticism. It would employ the antifraud provisions of the 1934 Act as the enforcement mechanism for new municipal disclosure guidelines that would be issued by the SEC under a broad statutory mandate. For further discussion of H.R. 2724, see Dual Sovereignty, supra note 190, at 930-39.

196. According to some authors, the additional costs imposed might even be considered in evaluating the constitutionality of some of the pending bills. See note 200 infra. If taxpayers do not directly bear the cost of supplying municipal financial information, however, it must be borne by investors, who will, presumably, demand a higher interest rate to cover the cost of investigation or the risk of uninvestigated municipal securities.

197. For example, the Williams-Tower Bill would have authorized the SEC to require the deposit of mandated reports and statements in a central repository or other location which is open to the public. See note 193 supra.

198. Historically, municipal issuers were excluded from the federally mandated disclosure requirements applicable to corporate issuers because there had been little
toward voluntary disclosure by local government issuers. Moreover, some of the pending bills may face constitutional obstacles in light of National League of Cities v. Usery.

fraud in the sale of their securities. Municipal bonds were generally considered good investments, and it was believed that taxpayers should be spared the cost of high disclosure standards. See Federal Regulation, supra note 190, at 1261-63.

199. See, e.g., Petersen, Doty, Forbes & Bourque, supra note 190. The survey discussed in that article relied on a sampling of documents (official notices of sale, offering statements, or prospectuses) accompanying debt issue offerings of approximately 150 local governments in 1975 and 1976. The two sample periods were compared to determine the way in which voluntary reporting practices improved in response to the market environment evolving during that period. The analysis sought to capture short-run reactions to the disclosure problem, focusing on the municipalities' adjustment of old procedures to meet newly perceived and still uncertain requirements in the market. Id. at 1182-97. But cf. SEC Final Report, supra note 193, at 959 (because voluntary disclosure measures "have not been uniformly adopted," and because such measures "may deteriorate in periods of stress, . . . reliance upon purely voluntary efforts at improvement is not an adequate response to the need for increased investor protection").

The voluntary disclosure that has occurred came primarily in response to what municipalities perceive as an increased demand by investors for more relevant information. Peterson, Doty, Forbes & Bourque, supra note 190, at 1181. In 1975, banks held 46.1% and property and casualty insurance companies owned 15.4% of the outstanding municipal securities. Id. at 1181 n.17. These large institutional investors possess sufficient market leverage to force disclosure of data they consider important. Id. at 1181. In addition, market underwriters and bond counsel are likely to demand more comprehensive disclosure as their own risk of liability increases. See Federal Regulation, supra note 190, at 1270-74. Although the duty of brokers, dealers, and bond counsel to investigate generally does not extend beyond a survey of information which is available to the public, as more information is disclosed voluntarily in response to market pressures, these three market managers will have more information to investigate and will therefore have an expanded scope of liability. Id.; Johnson & Wheeler, supra note 190, at 1209. Moreover, states have begun to increase the duties of market managers to investigate. See Doty, Municipal Disclosure—Recent Developments II, 10 Urb. Law. vii, xii-xiv (1978); Neugebauer, supra note 190, at 330-37.

The exemption of broker-dealers in municipal securities from the requirements imposed on broker-dealers in corporate securities was removed by the Securities Act Amendments of 1975. The SEC now has discretionary power to survey registration applications and may deny a permit to deal in municipal securities based upon a finding that the applicant has not met certain requirements or has committed prior violations. See 15 U.S.C. § 78o-4(a)(2)(B) (1976).

200. 426 U.S. 833 (1976). Whether the federal government has intruded on state sovereignty is determined by how "essential" the regulated activity is to the separate and independent existence of the states. If a court determines that the regulated activity is essential, it must then decide whether the interfering federal regulation imposes large financial burdens on the state and whether it interferes with the state's freedom to carry out these essential activities. If the regulation does either, it will be invalidated unless justified by a substantial federal interest. See Constitutionality, supra note 190, at 1006. Several commentators have predicted that the Williams-Tower Bill would pass the test set forth in National League of Cities, since it gives the states the option of formulating their own disclosure policies, see note 193 supra, does
2. Providing Better Information

In addition to external disclosure requirements, a local government financial information system, like that of a private corporation, must serve the internal purposes of planning, control, and management. In order to fulfill these disparate goals, "a city must have a single, integrated budget and accounting system, with one set of codes and one set of official financial reports on which all can agree." Recognizing this need, several states have enacted, or are in the process of enacting, mandatory guidelines for municipal book-

not interfere with local policy determinations, and imposes only moderate costs on municipalities. See State Sovereignty's Impact, supra note 190, at 593; Constitutionality, supra note 190, at 1020.

The Eagleton Bill would, however, probably be deemed in violation of state sovereignty, because it gives the SEC authority to refuse a municipal issuer a permit to make an initial distribution of its securities. Such federal control over the borrowing power of state and local governments would probably violate the National League of Cities test. Furthermore, the cost of compliance with the registration provisions of the Securities Act of 1933 may be prohibitive, and the Supreme Court may find that alternative means of mandating the necessary disclosure would be less intrusive. See Federal Regulation, supra note 190, at 1310-19; State Sovereignty's Impact, supra note 190, at 614-16. For a more comprehensive discussion of other local government ramifications of National League of Cities, see Gelfand, The Burger Court and the New Federalism: Preliminary Reflections on the Roles of Local Government Actors in the Political Dramas of the 1980's, 20 B.C. L. Rev. (forthcoming).

201. Lodal, supra note 188, at 1136-40. More specifically, planning requires the presentation of the overall costs for each program rather than merely an agency cost breakdown; control requires obligations to be checked against appropriation balances; management requires evaluation of the efficiency with which specific activities are performed, measurement of revenue collections against projections, and cost accounting of expenditures. Id.

202. Id. at 1147. More specifically,

The key to the solution is a system of basic classifications which can categorize each dollar amount handled by the system according to a set of rigorously defined independent characteristics. Each budget, revenue expense, or balance sheet transaction should have a set of independent codes which classifies the dollar amount associated with the transaction in many different ways. For example, an expenditure from the General Fund (fund) for office supplies (object of expenditure) for the prenatal care program (activity) for the Public Health Department (organizational unit) would receive independent codes for each of these attributes, plus, of course, other classifications as well. Using this type of scheme, it is possible to produce reports showing, for example, summaries of all expenditures for office supplies in the general fund, or all expenditures for the prenatal program, or all expenditures for the Public Health Department, or any combination of these. Not only is the rigidity of the traditional system avoided, but by making each code represent only one characteristic, the confusion and ambiguity of the kind of system which has troubled New York City can also be eliminated.

Id. at 1143 (emphasis in original). See also id. at 1147-48.
keeping and accounting. Oregon, for example, now requires issuers of obligations in excess of one million dollars to follow disclosure guidelines promulgated by the Municipal Finance Officers Association. Michigan requires municipal finance systems to comply with "generally accepted auditing standards." While such a statutory standard raises certain problems, had New York City reports followed it, they could not have mixed different accounting bases nor repeatedly concealed the City's ever mounting deficit.

203. See Doty, supra note 199, at xii-xiv. See also SEC Final Report, supra note 193, at 956, 959-60 (suggesting that state efforts have been fairly limited and calling for federal legislation to standardize reporting methods for accurate, understandable information).

204. OR. REV. STAT. § 287.018 (1977).

205. The Municipal Finance Officer Association (MFOA) is a professional organization composed of finance directors, budget officers, and auditors from state and local governments, as well as certified public accountants. Its focus is on governmental accounting, budgeting, and reporting, which it pursues through regular meetings, newsletters, journals, and research reports. MFOA helped to establish the National Council on Governmental Accounting, which has prepared the widely adopted "blue book" on "generally accepted accounting principles" (GAAP) as applied to government. NATIONAL COMMITTEE ON GOVERNMENTAL ACCOUNTING, GOVERNMENTAL ACCOUNTING, AUDITING, AND FINANCIAL REPORTING (1968); see Lodal, supra note 188, at 1152 & n.37. See also SEC Final Report, supra note 193, at 956 & n.9 (citing three recent sets of MFOA disclosure guidelines for municipal securities).

206. MICH. COMP. LAWS ANN. § 141.427(1) (1976). A similar result is obtained by requiring city councils to designate a qualified accountant to conduct an independent audit in accordance with GAAP. See, e.g., OKLA. STAT. ANN. tit. 11, §§ 17-105 to -106 (West 1978). See also N.C. GEN. STAT. § 159-3,-45,-51 (1976) (requiring both disclosure and independent auditing in accordance with uniform principles).

States attempting to regulate local government accounting practices need not be restricted to the "blue book" standards developed by the National Council on Governmental Accounting. See note 205 supra. Although other national groups, such as the American Institute of Certified Public Accountants and the Financial Accounting Standards Board, are oriented toward developing accounting standards for private businesses, they also publish guidelines for governmental accounting. See S. DAVIDSON, J. SCHINDLER, C. STICKNEY & R. WEIL, FINANCIAL ACCOUNTING 20-21, 163, 486-87 (1976).

207. The generally accepted accounting principles standard forbids consolidated reports of various funds, gives inadequate attention to planning and management of a government accounting system, and provides inadequate guidance as to the treatment of federal grants. See Lodal, supra note 188, at 1152-53. Moreover, allowing a private agency to set such important governmental standards may raise questions of unlawful delegation in some states.

208. Id. at 1152. See also Supplemental Staff Report, 16 SEC DOCKET 960, 960-61 (appendix to SEC Final Report, supra note 193). The City, under the guidance of the Emergency Financial Control Board, is required by state law to have its expense budget balanced in accordance with generally accepted accounting principles for fiscal 1982 and subsequent years. Act of June 2, 1978, ch. 201, § 25, 1978 N.Y. Laws 391. See Supplemental Staff Report, supra, at 971. For a discussion of the present deviations from GAAP in New York City reports, see Official Statement, supra note 67, at 160.
In short, not only more data, but also better data is essential for effective municipal financial management. An increase in readable information about municipal finance would tend to protect investors, restore voter confidence, encourage governmental responsiveness, and allow for better allocation of governmental resources. In addition, improved financial reporting would probably induce increased voter demand for greater local government fiscal responsibility. For example, California's open and easily understandable budget system made that state's surplus more visible to the public, thus fueling demands for a substantial tax decrease.

3. Balancing Flexibility and Stability

If municipal governments are to remain stable and retain any future options with respect to financial affairs, their overall debt level must be restricted to some extent. Although local governments possess a theoretical ability to tax property, and often income, within their borders at extremely high rates, both voter reaction and fear of business relocation impose restraints, even in the absence of constitutional restrictions. Determinations regarding how much leverage is possible and by whom restraints should be imposed may depend on local political, economic, and social conditions, but avoidance of excessive debt is an economic necessity for the long-term stability of local governments. At the same time, any debt ceiling should be both high and flexible enough to permit municipalities to exploit unique opportunities (such as federal capital funds at favorable matching rates or temporary reductions in interest rates) and to respond to genuine emergency situations.

4. Fulfilling Responsibilities as a Political Entity

In addition to these informational and economic factors, which have parallels in the financial systems of private industry, a local government financial system, because it is part of a governmental entity, must reflect certain other basic principles. Primary among

209. See generally Note, Federal Regulation of Municipal Securities, 60 MINN. L. REV. 567 (1976); SEC Final Report, supra note 193, at 959-60.
210. For this reason, the Advisory Commission on Intergovernmental Relations has repeatedly proposed various full disclosure devices, including indexing income taxes to the inflation rate, disclosing the effects of reassessments upon tax levies, and reimbursing local governments for state-mandated increases. Such devices would inform the public of the government unit or official that should bear the responsibility for tax and spending increases. See ACIR, Tax and Expenditure Limits, supra note 32, at 6-7; Shannon & Weissert, supra note 139, at 8, 9-10.
these is the concept of intergenerational equity, a principle that should pervade all local government taxing, spending, and debt financing policies. Moreover, a local government's financial policies, like other governmental activities in our society, should be responsive to the needs and demands of its citizens. How best to assure such political responsiveness has been, and will likely remain, a subject of intense political debate. One traditional approach is to allow elected local representatives at the level of government closest to the people to make financial decisions for the municipality—fiscal home rule. Another method permits local voters to exercise a direct voice in such decisions through referenda. On the other hand, some argue that local government financial affairs are so intertwined with those of the state that the state-wide constituency must be consulted to provide adequate political responsiveness.

These principles of increased and improved information, stability, flexibility, intergenerational equity, and political responsiveness form the basis for an evaluation of alternative means of reforming local government financial systems.

B. Reform of Current Limitations

1. Debt Ceilings

Nearly all state constitutional debt ceilings are based on a fixed percentage of the value of real property within the municipal boundaries. Although relying on taxable real property as the sole index of a local government's ability to service debt may have been reasonable when the constitutional limits were adopted, the advisability of continued reliance on this sole criterion is open to serious question. Taxes levied on real estate today provide less than half of local government revenue. New York City, because of its reliance on numerous other

212. See notes 25-27 supra and accompanying text.
213. See generally A. Syed, The Political Theory of American Local Government (1969); Macchiarola, supra note 65; Richland, supra note 65. See also Shannon, supra note 58; Shannon & Weissert, supra note 139, at 9-10 (arguing that representative government requires closer scrutiny of financial decisions by elected representatives, not state-imposed financial shackles or local referenda).
214. C. Harriss, supra note 70, at VIII-8 to VIII-11. Professor Harriss also contends that the restrictions must be constitutionalized in order to assure representation of the interests of future voters. He thus attempts to combine the intergenerational equity principle, see notes 25-27, 212 supra and accompanying text, with the political responsiveness principle.
215. See notes 17-20 supra and accompanying text.
216. U.S. Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism 19 (1974); U.S. Advisory Commission on Intergovernmental Relations, Significant Features of Fis-
LOCAL GOVERNMENT FINANCE

1979]
taxes and state and federal aid, derives less than one-quarter of its Revenue Budget from real estate taxes.

The original intention of state constitutional framers—that debt ceilings keep municipal debt within the ultimate resources of the community—can no longer be fulfilled by limiting debt to a specified percentage of assessed (or full) real property values. Nor can contemporary investors be satisfied by a debt ceiling pegged to a single portion of the municipal income base. Their concern is that a municipal borrower exercise prudence in making long-term financial commitments so as to assure its sustained ability to repay its debts from all potential revenue sources. Yet, the current framework of debt restrictions in most states regulates, and places before the courts, only a narrow slice of the total local government resource base.

A constitutional debt limitation can accurately reflect a municipality's long-term financing ability only if based on the average amount of taxable wealth within the city, that is, average personal and corporate wealth if an income tax is used and average sales volume if a sales tax is also employed. Pennsylvania has already

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217. See notes 140-42 supra and accompanying text. Paradoxically, New York City's reliance on this broad range of taxes, once thought to be the solid basis for financial salvation, see, e.g., Richland, supra note 65, at 612, actually hurt the City in the economic climate that preceded the fiscal crisis. This was because sales and income tax revenues decline in a recessionary period more than revenue from real estate taxes. See Shalala & Bellamy, supra note 67, at 1120.

218. See 1979 Crry BUDGEI, supra note 102, at i; Moody's supra note 123, at 2513-14 (budget figures for fiscal 1972-1977). For a description of the relation of real estate tax revenue to total tax revenue in New York City, see note 140 supra.


220. Id. As one frequent commentator on New York's limitations put it:

The debt limit operates on an unwarranted assumption—that debt limit should be related to real property value as a proper indicia of municipal capacity to meet debt obligation. In addition, the numerous exemptions distort any real relation between capacity and power to incur debt. . . . In effect, they afford little meaningful regulation of municipal finance.

Macchiarola, supra note 70, at 285.

221. A constitutional debt limit grants the courts no power to examine the financial viability of particular bond issues; only the relationship between outstanding debt and the debt limit can be reviewed.

222. This may well produce a rather complex formula, if all tax revenues are taken into account in the proper proportions, but it would result in a more realistic debt limitation than the current simpler debt/real property ratio produces.
moved in this direction. Its new constitutional provision on local government debt provides in part:

[T]he General Assembly shall prescribe the debt limits of all units of local government including municipalities and school districts. For such purposes, the debt limit base shall be a percentage of the total revenue, as defined by the General Assembly, of the unit of local government computed over a specific period immediately preceding the year of borrowing . . . 223

A reformer who had devised a satisfactory formula for a more accurate debt limitation would also seek to strengthen this ceiling to prevent the sort of avoidance techniques described in Section II. At the outset, categorical amendments that exempt housing, sewer construction, or other particular activities from the overall debt limit224 should be repealed, to prevent the skewing of capital construction in their direction.225

Even more far-ranging reform would include bringing all statutory authorities, special districts, and general purpose local governments that cover the same geographic area under a single debt limitation based on the wealth of the area. This might largely eliminate the use of special authorities and districts as contrivances to avoid the debt limit,226 while not interfering with their operations that promote economic efficiency or overcome geographic and jurisdictional barriers.227 Although such a reform could make the overall debt limitation a more accurate reflection of total local debt-incurring capacity, its restrictive effect on the activities of special authorities would likely engender strong political opposition from special authority

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223. PA. CONST. art. IX, § 10. Even this limitation does not take account of all possible revenue sources, because the implementing legislation excludes state and federal “subsidies or reimbursements” from the revenue base. See PA. STAT. ANN. tit. 53, § 6780-2(b)(2), -52(c) (Purdon Supp. 1978). See generally Comment, A Look at the Local Government Unit Debt Act, 46 TEMP. L.Q. 322, 335-36 (1973). This may, however, be the correct approach, since there can be no certainty that a particular level of intergovernmental aid will continue from year to year.

224. See notes 75-79 supra and accompanying text.

225. Such a reform need not lead to the elimination of housing, sewer construction, or other currently exempted projects that are considered desirable; it would simply require raising the debt limit so as to reflect more accurately (in a single percentage figure) the overall amount of outstanding debt. It may be desirable, however, to continue the practice of many states of exempting self-liquidating projects from the overall debt limit, see, e.g., N.Y. CONST. art. VIII, § 2-a; PA. CONST. art. IX, § 10, since these projects are not a drain on future local tax revenues.

226. It may be very difficult, however, to prevent evasion through the redrawing of special district boundaries so that they do not coincide with general purpose local government boundaries.

227. See note 92 supra and accompanying text.
managers, recipients of special authority services, and potential bond purchasers.224

Less controversial would be a constitutional restriction upon municipal short-term debt. There is a general consensus that continual growth and refinancing of short-term debt, with its higher interest rates, contributed substantially to the New York City fiscal crisis.229 Prior to its December 1978 default, Cleveland also carried a very high level of short-term debt.230 Of those states that do allow local governments to incur short-term debt,231 nearly all require repayment of TANs and RANs within one year or less232 and restrict total TANs to between fifty and seventy-five percent of the amount of anticipated tax.233 At least four states impose additional approval requirements.234

228. Once adopted, it would engender new political conflicts over what proportion of the local debt limit would be allocated to each special district or general purpose local government in the area.

229. See, e.g., Mac Report, supra note 66, at 7; Congressional Budget Office Study, supra note 66, at 5; SEC Final Report, supra note 193, at 952; Shalala & Bellamy, supra note 67, at 1124-25.


231. For a relatively recent listing of states with no authorization for short-term borrowing by local governments, see M. Hill, State Laws Governing Local Government Structure and Administration 15-42 (1978). Although Louisiana permits municipalities and parishes (the equivalent of counties) to borrow in anticipation of special taxes or regular revenues, La. Stat. Rev. Ann. § 39:741, :745 (West 1968), the state's largest city (New Orleans) and parish (Orleans) are excluded from doing so. Id.


233. See Ga. Const. art. IX, § VII, para. IV (notes limited to 75% of estimated income from special taxes); Minn. Stat. § 473.11(2) (1978) (TANs of metropolitan governments limited to 50%); N.C. Gen. Stat. § 159-169 (1976) (TANs limited to 50%, RANs to 80%); Ohio Rev. Code Ann. § 133.30 (Page 1978) (both TANs and RANs limited to 50%, except when final tax settlement delayed); Tenn. Code Ann. § 5-1035
So far, however, very few have chosen to constitutionalize such restrictions.235

A constitutional debt ceiling taking account of the local government's true income base, preventing evasion by special authorities, containing no exceptions for specific services, and limiting the amount of short-term debt would be a substantial improvement over the haphazard, exception-riddled system under which most municipalities operate today. This type of tight constitutional ceiling on local government debt financing would emphasize the principles of


The only restriction on ordinary TANs in Indiana, Iowa, and Louisiana is that they may not exceed the total estimated income for the current year. See Ind. Code Ann. § 17-1-24-31 (Burns 1974) (counties); id. § 18-1-4-3 (Burns Supp. 1978) (cities and towns); Iowa Code § 384.10 (1979); La. Rev. Stat. Ann. § 38:746 (West 1968). Louisiana, however, has an additional check by requiring the approval of that state's Department of the Treasury for short-term as well as long-term local government debt. See notes 234, 311-312 infra. Florida grants even broader power for the issuance of TANs, see Fla. Stat. Ann. §§ 166.101 to 166.121 (West Supp. 1979), but requires voter approval for those that mature more than one year after issuance. Fla. Const. art. VII, § 12.

234. North Carolina requires the approval of the Local Government Commission before any local government notes can be issued. In making its determination, the Commission is required to consider the "reasonableness of the budget estimates of the taxes or other revenues" that stand behind the notes and the overall amount of short-term debt issued by the local government. N.C. Gen. Stat. § 159-172 (1976). If properly enforced, this requirement could serve as a check on the type of TAN and RAN abuses practiced by New York City, described at notes 85, 116-126 supra and accompanying text.

Georgia requires local voter approval of short-term debt that exceeds one-fifth of one percent of assessed property value. See Ga. Const. art. IX, § VII, para. I. Florida requires it for "tax anticipation certificates, payable from ad valorem taxation and maturing more than twelve months after issuance." Fla. Const. art. VII, § 12. Voter approval of local government bonds is discussed further at notes 286-92 infra and accompanying text.


235. Georgia's constitution explicitly regulates the substantive aspects of short-term debt by setting the percentage of anticipated income allowed and the time of required repayment. Ga. Const. art. IX, § VII, para. IV. See notes 232-33 supra and accompanying text. Florida's constitution employs a procedural regulation, requiring a vote of the local electorate when the TANs mature more than 12 months after issuance. Fla. Const. art. VII, § 12. The Florida provision, therefore, applies only to those TANs that resemble long-term debt. Maturity limitations of other states are cited in note 232 supra.
economic stability and intergenerational equity. Unless it were fairly high, however, such a constitutional debt ceiling, standing alone, could preclude both local fiscal flexibility and political responsiveness. For example, voters in a particular locality seeking to raise the limit would need to obtain support for a constitutional amendment from voters throughout the state.

2. Tax Limits

Just as the growth of alternative sources of municipal income make debt ceilings based on real estate values unrealistic, so too does it compel a reevaluation of existing restrictions on local taxation. The pattern in many states today is a combination of constitutional restrictions on local real estate taxation rates and statutory authorization for other forms of local taxation. Only those who cling to the claim that property owners still merit treatment as a privileged class can justify such differential treatment in the legal control of real estate and other taxes. Intergenerational equity certainly cannot serve as the justifying principle for these constitutional real estate tax limits. Such limits protect only the present generation of taxpayers, who can effectively protect themselves from excessive taxation.

236. Some means of accommodating the demands of current taxpayers may also be necessary to prevent the financing of long-term expenses through immediate taxation. This is the other aspect of intergenerational equity. See note 27 supra and accompanying text. As argued more fully below, see text accompanying notes 243-44 infra, this is better done by means of referenda requirements than through constitutional tax limits.

237. Restriction on flexibility would be particularly severe in states, such as New York, that mandate substantial financial burdens for local governments. See notes 62-70 supra and accompanying text.

238. Amendment would be particularly difficult in those states that require a vote by two-thirds of the electorate or two-thirds of the legislature.

239. See notes 215-221 supra and accompanying text.

240. See sources cited in note 17 supra. Levy limits, however, have been imposed by statute. See notes 41-47 supra and accompanying text.


242. See notes 20, 35 supra and accompanying text. This claim has been the driving force behind Proposition 13 and its progeny, see notes 48-52 supra and accompanying text, despite criticism by advocates of expenditure limits that the focus upon a single class of taxpayers was shortsighted. See note 61 supra and accompanying text. Recent reports show that the principal beneficiaries of Proposition 13 itself have been commercial landowners and the federal government (through reduced income tax deductions), rather than residential owners or tenants. See Business Bonanza: Companies' Big Saving From Proposition 13 Is Slow to Reach Public, Wall St. J., Feb. 13, 1979, at 1, col. 1. See also Heller, "Meat-Axe" Radicalism in California, Wall St. J., June 5, 1978, at 18, col. 4.
through referenda or ordinary elections. Moreover, constitutional tax limits, like constitutional debt ceilings, reduce fiscal flexibility and undercut responsiveness to the concerns of local voters.

Should state policymakers nevertheless enact constitutional tax limitations, they should make such limitations effective. To do so, they must prevent current forms of avoidance. One long-standing device to prevent overlapping state, county, special district, and city government authorities from multiplying the property tax burden is a limitation on the total annual amount of tax that can be imposed on any particular piece of property. The tax burden can also be controlled by freezing assessments at the rate imposed in an earlier year, with yearly increases strictly limited.

In addition, ad hoc exemptions for taxes used for particular functions should be abolished, so that the stated rate is, in fact, the overall tax rate. Yet, some narrow exemptions may have to be retained. Attempts to remove the current exemptions for taxes imposed to cover debt service on outstanding bonds, for example, would meet with strong political and legal opposition from existing investors. Moreover, retaining that exemption would make marketing of

243. See notes 293-98 infra and accompanying text.
244. See text accompanying notes 282-83 infra.
245. See notes 237-38 supra and accompanying text.
246. They might also want to impose comparable constitutional limitations on other taxes by, for example, indexing the income tax to the inflation rate. See note 210 supra and accompanying text.
247. See, e.g., Nev. Const. art. 10, § 2; Ohio Rev. Code Ann. § 5705.02 (Page 1973); Okla. Const. art. X, § 9(a). See generally, ACIR, Tax and Expenditure Limits, supra note 32, at 11-12; see also ACIR, Local Taxing, supra note 28, at 27-30. A limitation on the total amount of tax would be particularly helpful in those states that permit special districts to exercise independent taxing power.
249. For a discussion of one such exemption in New York, see notes 133-34 supra and accompanying text.
250. For a discussion of the fiscal effects of the New York provision, N.Y. Const. art. VIII, see notes 133-44 supra and accompanying text.
251. Current investors might even be able to argue that repeal of such provisions would impair the security of their investments to such an extent that it would violate their rights under the Contract Clause, U.S. Const. art. I, § 10, cl. 1. See, e.g., United States Trust Co. v. New Jersey, 431 U.S. 1 (1977). Cf. Tron v. Condello, 427 F. Supp. 1175 (S.D.N.Y. 1976) (statute authorizing purchase of MAC and City bonds by New York City teachers' Retirement Fund does not violate Contract Clause, even if such purchase may impair security of Retirement Fund, because legislative authorization of investments was part of original "contract"). See generally Hale, The Supreme Court and The Contract Clause, 57 Harv. L. Rev. 512 (1944); Hurst, Municipal Bonds and the Contract Clause: Looking Beyond United States Trust Company v. New Jersey, 5 Hastings Const. L.Q. (1978). It is probably for this reason that even Proposi-
future local government bonds substantially easier. Because special assessments are directly used to provide localized benefits, they are not easily subject to abuse, and should also remain as an exception to the real estate tax limit.

A special case of tax limit avoidance is presented when localities capitalize current operating expenses. While other local governments may not have employed this device to the same extent as has New York City, it is certainly not an unknown technique. According to the report of an independent accounting firm, Cleveland officials capitalized $52 million worth of operating expenses between January 1972 and July 1978, rather than raise property taxes. The danger exists that other state and municipal officials will exploit this device when the new tighter tax limits begin to impinge. For example, the very severe constitutional tax limitations recently adopted in California made no change in that state's constitutional provision dealing with local debt financing. Local officials, therefore, may be tempted to resort to debt financing for expenses that cannot be paid from current revenues. Such a practice can, however, be curbed by tightening

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250. See generally Robinson, Outline of Proposition 13 and the Impairment of Contract (supplement to COPING WITH CUTBACKS IN MUNICIPAL REVENUES (1978) (New York Law Journal publication) [hereinafter cited as COPING WITH CUTBACKS]) (describing current interpretation problems relating to the coverage of this provision).

251. See generally Robinson, Outline of Proposition 13 and the Impairment of Contract (supplement to COPING WITH CUTBACKS, supra note 250).

252. Local governments subject to severe tax limits without a debt service exception will, at the very least, be subject to lower bond ratings and will be forced to pay higher interest rates, if they can sell their bonds at all. See Guandolo, Tax Limitations: Impact Upon General Obligation Bonds, Rental Bonds, Special Assessment Bonds and Payment of Debt Service 10-13 (supplement to COPING WITH CUTBACKS, supra note 251).


254. See note 230 supra. See also City of Cleveland, Preliminary Official Statement of Dec. 1, 1978, at 2 (relating to sale of various purpose general obligation bonds, limited tax). ("The practice of commingling the proceeds of general obligation bond and note issues with tax and other revenues in municipal treasuries is followed by a number of Ohio municipalities. The City of Cleveland has utilized this commingling practice, expending its commingled funds for both capital and operating expenses.").

255. On February 27, 1979, Cleveland residents voted to increase income taxes from 1% to 1.5% in order to meet part of that city's deficit. Kucinich and Foes Claim Victory in Cleveland Vote on Fiscal Steps, N.Y. Times, Mar. 1, 1979, § A, at 16, col. 1.

256. See Illusory Lightening, supra note 95, at 103, 107.


258. CAL. CONST. art. XVI, § 18.

259. Since California's debt provision requires a two-thirds vote of the qualified
debt limits to eliminate exclusions\textsuperscript{260} or by curtailing legislative discretion to authorize capitalization of particular budget items.\textsuperscript{261}

In short, constitutional tax limits are an unnecessary means of protecting local taxpayers. If, they are adopted in response to current political pressures, however, they should be sufficiently high to allow flexibility,\textsuperscript{262} and opportunities for evasion should be eliminated. In addition, tax and debt restrictions should be coordinated, so that local officials can select between tax or debt financing of projects on the basis of which better satisfies the goal of intergenerational equity, rather than as a means of avoiding one or the other limit.

3. Expenditure Limits

Arizona's long experience reveals that many of the same techniques employed to avoid tax and debt limits can be used to avoid local spending limits.\textsuperscript{263} Accordingly, to be what it purports to be, a spending limit must eliminate both categorical and ad hoc exceptions.\textsuperscript{264} Also, unless state and special district expenditures are controlled, functions will simply shift from one level of government to another, resulting in expansion in government spending and an increased tax burden despite the expenditure lid.

To provide needed flexibility, a spending limit should incorporate into its formula a means of allowing for natural growth of state and local expenditures, in response to inflation, population expansion, and growth in per capita income.\textsuperscript{265} Yet, even if it included such

electors to approve any indebtedness, see id., it might be argued that voters who had approved the severe tax limitations of Proposition 13 would not sanction a substantial local debt; but this argument ignores the fact that Proposition 13 was a tax limitation passed on the basis of a state-wide vote. Voters in particular localities may still approve the use of debt financing for particular projects or even for general revenues. Moreover, local officials, by carefully choosing the subject of the bond referenda may be able to gain substantial voter support even from supporters of Proposition 13.

260. See notes 224-27 supra and accompanying text.

261. In New York, this would require repeal of N.Y. CONST. art. VIII, § 2, which makes the legislative determination of the period of probable usefulness "conclusive." See notes 143-50 supra and accompanying text.

262. Especially in states without California's substantial surplus to cushion the blow, the sudden imposition of a very low tax limit (like Proposition 13) may have severe detrimental effects on local governments. See Guandolo, supra note 252, at 3; R. Odell, untitled presentation (supplement to COPING WITH CUTBACKS, supra note 251). See also Evans, supra note 52, at 79-80; McCarthy, Living with Proposition 13, STATE LEGISLATURES, Sept. 1978, at 16.

263. See notes 163-84 supra and accompanying text.

264. See notes 170-73 supra and accompanying text.

265. A proposed amendment to Arizona's local spending limit that included such growth indices was defeated, apparently because the legislature thought it too complicated. Koon, supra note 163, at 25, col. 4. The new seven percent limit on spending
a built-in escalator, a constitutional spending limit would severely limit local government flexibility, particularly in smaller localities. Since their current budgets are generally modest, the hiring of just one additional police officer or firefighter for the next year might increase their budgets beyond the permitted percentage increase. Some procedure must also be available for permitting unusual levels of expenditure in response to a crisis. Arizona’s experience has shown, though, that such emergency appeal procedures may be subject to severe abuse. Moreover, spending limits encourage economic inefficiencies, even in routine daily operations. They may, for example, offer an incentive for local governments to spend the full amount of money available to them in order to prevent their budget base from being reduced in future years. Spending limits also discourage bulk purchasing and other innovations which, although creating additional short-run costs, result in economies of scale or long-range savings.

C. ABOLITION OF CONSTITUTIONAL LIMITATIONS

Rather than intensifying constitutional restrictions on local debt financing, taxation, and spending powers, the second alternative would abolish constitutional limits altogether, relying instead on securities market forces to limit debt financing and subsequent local voter reaction to restrict taxation and spending. Because these forces would be inadequate by themselves, statutory fiscal controls would also be required.

1. Debt Financing

Prior to New York City’s fiscal crisis, abolition of the New York

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by the state is, however, pegged to personal income, Ariz. Const., art. IX, § 17, thereby building in at least one growth index.

266. League Summary, supra note 163, at 4; see Koon, supra note 163, at 25, col. 1.

267. See notes 174-76 supra and accompanying text.

268. Arizona avoids this problem by allowing the percentage increase to be applied to the proposed budget of the prior year rather than to the actual budget. See Ariz. Rev. Stat. Ann. §§ 42-302(D), -303(C) (Supp. 1978); League Summary, supra note 163, at 2. Thus, local governments are not forced to spend to the full extent of their budget estimates in order to retain the ability to spend at that level the next year. Arizona’s system does, however, encourage local governments to violate the principle of presenting accurate, intelligible information to their citizens, see notes 188, 209-11 supra and accompanying text, because local officials are likely to make their public budget estimates at the highest possible level, whether or not this is an accurate reflection of spending plans. See Koon, supra note 163, at 25, cols. 1-3.

269. See Koon, supra note 163, at 25, col. 55. See generally Shannon, supra note 58, at 24-25; J. Shannon, supra note 50.
constitutional debt ceiling received substantial support from both official sources and commentators. Dissatisfaction with the straight-jacketing effects inherent in constitutional debt ceilings has, in fact, been fairly widespread. The literature emphasizes a history of repeated evasions of current constitutional limits and the detriment that even improved constitutional limits would pose for local fiscal flexibility and home rule.

If financial reporting were sufficiently comprehensible, the overall debt level might be controlled by ultimate voter reaction. In the interim, however, market managers and investors are more likely to provide an effective check. Unfortunately, both voter and market control generally come too late—after a city has already exceeded a prudent leverage level. Furthermore, market controls, when they finally operate, are too draconian to be the sole control mechanism. They may, for example, completely block the sale of securities issued to finance local indebtedness and imperil the credit rating of the affected city and state for many years. For this reason, statutory controls should also be employed. Many states already operate with only statutory limits on local government debt. Even these states should, however, modify their limits so that they take into account

270. See, e.g., Staff Report No. 31, supra note 70; Staff Report No. 11, supra note 70.


273. See notes 188, 209-11 supra and accompanying text.

274. See note 199 supra. See also Illusory Lightening, supra note 95, at 103. For a severe criticism of the very limited amount of research conducted and disclosure made by underwriters, rating agencies, and bond counsel prior to the New York City crisis, see SEC Staff Report supra note 124, at chs. 4-6. For a qualified endorsement of improvements subsequently adopted by some of these market managers and advisers, see Supplemental Staff Report, supra note 208, at 967-70.

275. See C. Harriss, supra note 70, at VII-2 to VII-3.


277. Like constitutional debt ceilings, statutory limits tend to undercut fiscal home rule, but they do allow for greater flexibility and responsiveness.

the total wealth available to a borrowing local government, not merely its assessed real property value.279

2. Taxation

Scholars have also criticized the current constitutional tax limitations in New York280 and other states.281 As noted above, constitutional tax limits are not generally required in order to ensure inter-generational equity.282 Moreover, they can have severe negative effects on local fiscal flexibility and home rule.

There is no doubt that current public sentiment makes abolition of constitutional tax limits unlikely, but it should be made clear that removing constitutional limits would not necessarily cause real estate taxes to skyrocket. State legislatures would retain power to limit excessive real estate taxes, as they currently do with respect to other forms of local taxation. Moreover, local officials would be loathe to impose excessive taxes for fear of voter retaliation. Although this check also appears to suffer from the same post hoc quality that voter and market checks on debt exhibit,283 excessive taxes, unlike excessive debts, can be repealed by a new administration elected on a tax relief platform.

3. Expenditures

Expenditure limits are also better imposed by statute, if at all, than by constitutional amendment, since they regulate short and mid-term financial decisions, not the long-term financial commitments involved in debt financing. In order to maintain effective control over spending levels, however, an expenditure limit should probably be combined with some form of administrative oversight.284

D. Regulation By Prior Voter Approval

Instead of imposing various substantive limits, or relying on subsequent voter and market vetoes, the third approach employs the procedural constraint of prior voter approval for particular local government financial decisions. It emphasizes principles of fiscal flexibility and local responsiveness. The improved financial accounting

279. See notes 215-23 supra and accompanying text.
280. See note 271 supra.
281. See, e.g., ACIR, Tax and Expenditure Limits, supra note 32 at 6, 9-10; Shannon, supra note 58; Sperling, supra note 241; J. Shannon, supra note 50.
282. See text accompanying notes 243-44 supra. Direct voting requirements may, however, be useful. See notes 293-98 infra and accompanying text.
283. See notes 274-77 supra and accompanying text.
284. See notes 300-30 infra and accompanying text.
standards discussed above\textsuperscript{285} are essential, however, if prior voter approval is to operate as an effective procedural check.

1. \textit{Bond Referenda}

There are various means of requiring constituency approval as a prerequisite to local government borrowing. Although a referendum may be the sole requirement, it may also be an adjunct to a substantive limit or be used to override a substantive limit.

Several state constitutions require the electors to cast an affirmative vote before a local government undertakes substantial debt financing, using this as a complete substitute for a substantive limit on the overall debt level.\textsuperscript{286} The North Carolina Constitution, for example, provides that the General Assembly's power to authorize a local government unit to contract debt is ineffective unless approved by a majority of the qualified voters in that locality.\textsuperscript{287} Similarly, local governments in Florida\textsuperscript{288} and large cities in Arkansas\textsuperscript{289} may issue bonds only upon approval of their electors. This approach places responsibility for the debt financing of individual capital projects squarely on the shoulders of local constituents, rather than imposing

\textsuperscript{285} See notes 188-211 supra and accompanying text.

\textsuperscript{286} See, e.g., ARK. CONST. art. 16, § 1 (of the local units only "cities of the first and second class" may utilize debt financing, and then only upon the consent of a majority of the voters in that city); CAL. CONST. art. XVI, § 18 (requirement of two-thirds vote by qualified local electors, except simple majority can approve reconstruction of structurally unsafe school buildings); FLA. CONST. art. VII, § 12 (exception for refunding at lower interest rate); LA. CONST. art. VI, § 33(A) (exception for refunding at lower interest rate; requirement of administrative approval in addition to voter approval). In other states, only a referendum requirement is imposed by the Constitution, while substantive limits are merely statutory. See, e.g., IDAHO CONST. art. VIII, § 3; IDAHO CODE § 50-1019 (Supp. 1978).

\textsuperscript{287} N.C. CONST. art. V, § 4(2). Prior voter approval is not, however, required for bonds issued

(a) to fund or refund a valid existing debt;
(b) to supply an unforeseen deficiency in the revenue;
(c) to borrow in anticipation of the collection of taxes due and payable within the current fiscal year to an amount not exceeding 50 per cent of such taxes;
(d) to suppress riots or insurrections;
(e) to meet emergencies immediately threatening the public health or safety, as conclusively determined in writing by the Governor;
(f) for purposes authorized by general laws uniformly applicable throughout the State, to the extent of two-thirds of the amount by which the [local] unit's outstanding indebtedness shall have been reduced during the next preceding fiscal year.

\textit{Id.}

\textsuperscript{288} FLA. CONST. art. VII, § 12.

\textsuperscript{289} ARK. CONST. art. 16, § 1.
an overall constitutional limit amendable only by a state-wide vote.

It can be argued, however, that local voters are either unaware of the consequences of bond issues or discount their full implications. They might, therefore, approve an inordinate amount of debt-financing, thereby violating the intergenerational equity principle.\textsuperscript{20} On the other hand, bond referenda require local political leaders to "sell" every capital project to their constituencies, perhaps resulting in the rejection of important projects because of their social rather than their financial implications.\textsuperscript{21} In either case, too much direct responsiveness to the immediate demands of voters may thus result in a diminished policymaking role for local elected officials.

Several other states have constitutional or statutory provisions making voter approval an adjunct to their overall debt ceilings. Pennsylvania, for example, permits political subdivisions to incur indebtedness beyond the overall debt limit only with the assent of a majority of qualified local electors.\textsuperscript{22} Such an approach seems designed to encourage local participation as well as prudent investigation of the worthiness of individual bond issues, because voters are clearly informed that they are being asked to approve borrowing in excess of the state-wide constitutional ceiling. Some danger of misinformed voter evaluation of individual bond issues may, however, still remain.

2. Tax Referenda

Tax referenda are probably most effective as adjuncts to constitutional or statutory tax limits.\textsuperscript{23} They allow local residents to decide whether to exceed the state-mandated tax limit in order to pay for particular desired services.\textsuperscript{24} This approach furthers both home rule and local fiscal flexibility principles.

\textsuperscript{290} This danger may be exacerbated by demographic developments in large American cities that give rise to an increased public-sector-dependent voter population. For a discussion of these developments in New York City, see note 71 supra.

\textsuperscript{291} Historically, such difficulties have arisen when bonds are used to finance an activity involving intergenerational transfers such as school construction. In the present economic and political climate, negative voter reaction may well spread to other social services. See generally D. Mandelker & D. Netsch, supra note 83, at 375; Herbers, Deciding by Referendum Is a Popular Proposition, N.Y. Times, Nov. 12, 1978, § E, at 4, col. 3; Lipset & Rabb, supra note 51.


\textsuperscript{293} See notes 239-62, 280-83 supra and accompanying text.

\textsuperscript{294} In this respect, they are analogous to the use of voter override provisions for debt limits. See note 292 supra and accompanying text.
A possible objection to voter override provisions is that, in cities with a large welfare-sector-dependent population, voters will tend to approve inordinate tax levels. Such a hypothesis seems incorrect, however, since property owners and taxpayers are generally better organized than are welfare recipients, and renters generally recognize, or can be persuaded, that higher taxes mean higher rents. A more serious problem would be presented if tax levels were totally determined by prior voter approval. The likely effect would be blocking of real estate taxes, forcing local government to rely on taxes that the electorate could not veto: sales, development impact, and commuter income taxes. Revenue collection would be seriously skewed under such a procedure.

3. Expenditure Level Referenda

It would be unworkable for a locality to seek a direct vote of its citizens prior to each major expenditure. Such an approach not only violates the principle of fiscal flexibility but also precludes local officials from making priority determinations. This is not to say that local governments should never use referenda to gauge public sentiment on particular types of projects. But it is better to provide that, through use of direct voting, citizens may override expenditure limits in those states that impose constitutional or statutory spending limits on local government.

A referendum requirement may be a useful ingredient in any local government fiscal control system. Such a requirement is particularly valuable for capital projects, because debt financing involves long-term financial commitment by the community as a whole. Referenda may also be useful for taxing and spending determinations.

295. See note 290 supra and accompanying text.
296. Even the strictest rent control ordinances and statutes permit rent increases to reflect higher property taxes. See, e.g., New York State Division of Housing and Community Renewal Rent and Eviction Regulations, § 33(6), reprinted in N.Y. Unconsol. Laws, at 147, 203 (McKinney 1974).
297. Although nonresidents have attacked municipal commuter income taxes on the ground that they are denied the right to vote on the taxation level, courts have generally rejected such claims. See D. Mandelker & D. Netsch, supra note 83, at 553-58 and sources cited therein.
298. They are especially useful for municipalities without strong political party organizations. For example, the City of Miami, which has a non-partisan government, has frequently chosen to use referenda to test voter sentiment on zoning and other issues. Interview with George Knox, City Attorney of Miami, in Miami, Florida (July 1978).
If local representatives are to establish priorities for public expenditures, however, local referenda should be employed only as override mechanisms.

E. REGULATION BY ADMINISTRATIVE OVERSIGHT AGENCY

Even if constitutional and statutory debt and tax limitations can be reformed to provide for a more realistic measure of a locality's financial capacity and to restrict current avoidance devices, they are nevertheless an incomplete means of ensuring local government fiscal integrity. For this purpose, a more comprehensive approach must be employed. Though expenditure limits have a broader scope than do limitations on debt and taxes, they provide no method of monitoring local techniques of avoidance. Moreover, large cities, particularly those that are expanding to the level of diseconomies of scale, have an acute need for comprehensive administrative coordination of, and systematic accountability for, financial affairs.

A semi-independent administrative oversight agency may be able to perform these overlapping functions of monitoring, coordinating, and assuring accountability. If administered by the state, such an oversight agency would face serious opposition from fiscal home rule advocates concerned about its potential for influencing local policy decisions. Many authors have contended that even present systems of borrowing restraints impose too much state control over local finances, and others have noted the extreme policy controls imposed by the federal government in matching-fund urban renewal, mass transit, and highway programs. Extension of state administrative control over local finance may be just as politically objectionable. Much potential opposition could, however, be diffused by care-

300. See notes 219-23, 240-45 supra and accompanying text.
301. See notes 224-38, 246-61 supra and accompanying text.
302. For a discussion of the many diseconomies of scale created by extremely large local governments, especially New York City, see W. Farr, L. Liebman & J. Wood, Decentralizing City Government: A Practical Study of a Radical Proposal for New York City 26 (1972); M. Gelfand, supra note 73, at 13-14.
303. See W. Lovett, Economics, Law and Governance (1974), at ch. VIII (unpublished manuscript on file with author). Professor Lovett argues that bodies such as the Office of Management and Budget, General Accounting Office, and Congressional Budget Office should be greatly expanded and that similar bodies should be created at the state and local level. Id. at 13, 21.
304. See, e.g., Macchiarola, supra note 140, at 864-65; Richland, supra note 65, at 620-21, 628-29.
305. See note 154 supra.
306. See, e.g., Kucinich and Foes Claim Victory in Cleveland Vote on Fiscal Steps, N.Y. Times, Mar. 1, 1979, § A, at 16, col. 1 (describing the opposition of Cleveland’s mayor to a state-dominated fiscal oversight board to be used to assist in that city's financial recovery).
ful attention to the means of selecting members and powers granted to the oversight agency.

1. Means of Selection

The necessary independence of an administrative oversight agency from local government political pressures can be supplied in a number of ways: through state government appointment, independent election, long-term appointment by the local government chief executive, or appointment by several local officials.

Local governments in England and Wales provide a model for control of local finance by a higher level of government. There, nearly all local authorities are required to obtain a "loan sanction" from the central government for each act of borrowing. While the Department of the Environment issues the local sanctions and keeps records of approved loans, the actual decisionmaking occurs in the individual central departments, e.g., the Home Office for the construction of police stations, whose procedures for approval vary widely. The loan sanction procedure is primarily intended to enhance central government control over the economy and to minimize competition between the Treasury and local authorities for private capital and, secondarily, to influence local policy. Localities in states with a strong tradition of home rule would no doubt oppose the adoption of a comparable system, which would shift control to the hands of state administrators. In Louisiana, however, political subdivisions wishing to issue bonds or notes or to levy any special tax have long been

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307. The Greater London Council and the London County Council, its smaller predecessor, have been excluded from the loan sanction system. An annual Act of Parliament has set the overall debt ceiling for these local governments. E. Sharp, The Ministry of Housing and Local Government 30 (1969).

308. P. Richards, The Reformed Local Government System 91 (1973); J. Griffith, Central Departments and Local Authorities 76 (1966). In 1970, an attempt was made to reduce the detailed central review of relatively minor local projects. Local capital investments were divided into "key sector" projects—education, housing, principal roads, police, health, social services, water supply, and sewerage—which remain subject to the loan sanction, and "locally determined" projects, for which local authorities may use a ration of loan sanction as they see fit. P. Richards, supra, at 91. The latter type of projects, which previously fell into the "miscellaneous programmes" category, had in the past often been dropped in times of economic stringency. E. Sharp, supra note 307, at 30.

309. J. Griffith, supra note 308, at 93. See generally M. Gelfand, supra note 73, at 55-56.

310. See J. Griffith, supra note 308, at 88-89; P. Richards, supra note 308, at 91. The potential impact of the loan sanction system as a policy instrument of the Department of the Environment, however, is rather limited. See M. Gelfand, supra note 73, at 55-56.

311. Special taxes are levied for "the purpose of acquiring constructing, improv-
required to obtain the approval of a state agency, currently the Department of the Treasury.\textsuperscript{312} Other states already have state boards with limited advisory powers on local borrowing\textsuperscript{313} that could be granted mandatory powers, should state policymakers decide that more centralized control is needed.

Another alternative is separate election of the chief officer of the fiscal oversight board. Several cities already have elected comptrollers, who could be given additional auditing and oversight powers.\textsuperscript{314} A difficult problem, however, is determining what powers such a directly-elected official should be granted.\textsuperscript{315} The directly-elected New York City Comptroller, for instance, has long exercised substantial policymaking and administrative duties in addition to his post-auditing functions.\textsuperscript{316} He has thus acted as both chief financial officer and fiscal watchdog.\textsuperscript{317} While this range of powers and responsibilities—exceeding those granted to any other municipal comptroller—has given him substantial power to implement his financial policy decisions, the result in practice is that he often audits his own work.\textsuperscript{318} Involvement of the Comptroller’s Office in many of the questionable financial practices that preceded the City’s fiscal crisis is evidence of an undesirable conflict of roles.\textsuperscript{319} On the other hand, an
elected comptroller without substantial power may be unable to influence other powerful public officials by direct persuasion or through popular political pressure. Just how effective a comptroller can be is ultimately determined by the powers the office is granted, the political alignments in the locality, and the range of other local fiscal control devices employed.

An alternative to direct election is appointment of a comptroller by the local chief executive to a term extending beyond that of the current administration. This pattern has been adopted by several federal oversight agencies. Yet, in cities that have a single dominant political party, terms spanning even several administrations may not result in substantial independence for the comptroller.

The final selection device is used by the General Obligation Bond Commissions in Nevada counties. They are comprised of representatives from the county government, the school district, incorporated cities or towns, general improvement districts, and the public. Before a political subdivision can submit to its voters a proposal to issue general obligation bonds, it must be approved by a majority vote of the Commission. While this approach nicely balances home rule considerations with the need for agency independence, its effectiveness may be reduced in counties having but a single city or in those with strong political party organization at both the city and county level.

expenses. S. CLIFFORD, supra note 314, at 41-42. Although these changes did not increase cash flow in the 1973-1974 budgets by one cent, they allowed the Board [of Estimate] and [the City] Council to both lower taxes and increase expenses.

In the corporate world, it is the responsibility of accountants and auditors to prevent such manipulations. But the City's structure encourages this kind of activity by making the Comptroller the accountant, auditor and budget-maker. This is somewhat analogous to having a corporate treasurer serve as both CPA and SEC examiner.

Id. at 42-43. See also SEC STAFF REPORT, supra note 124, ch. 2, at 39-45.

320. S. CLIFFORD, supra note 314, at 35.

321. In the present climate of fiscal concern by voters, this may not be a serious problem. A comptroller with substantial auditing and investigative power, media access, and an institutionalized referendum procedure may be able to summon the necessary public support.

322. The Comptroller General of the United States, who heads the General Accounting Office, is appointed for a 15-year term by the President, with the advice and consent of the Senate. 31 U.S.C. §§ 42-43 (1976). He may be removed for limited reasons and only upon a joint resolution of Congress. Id. § 43; see W. Lovett, supra note 303, at 13, 21.


324. Id. § 350.004.
2. Functions of an Oversight Agency

Before-the-fact approval powers of the fiscal oversight agent or agency should largely be confined to debt financing. Authority to approve individual expenditures and taxes should be severely limited. Post-audit powers of a locality's capital, revenue, and expenditure budgets should, however, be far-ranging.\textsuperscript{325}

A fiscal oversight agency can make a great contribution to local government fiscal responsibility by monitoring attempts to circumvent the debt limit in violation of the intergenerational equity principle, particularly through capitalization of expense items.\textsuperscript{326} If there is no debt limit, the agency's role becomes even more important, since it then must ensure stability as well as intergenerational equity. Under these circumstances, it should be given the power to approve or disapprove individual note or bond issues as well as the more traditional functions of auditing and "whistle-blowing." To preserve home rule, however, such approval power should be strictly circumscribed, so that financial rather than policy aspects of capital projects will be reviewed. Thus, only the adequacy of revenues projected for the repayment of revenue bonds, the accuracy of estimates for taxes and revenues anticipated by TANs and RANs, and the useful life of projects to be financed by general obligation bonds would be reviewed. Excluded from the agency's consideration would be a project's social desirability and the relative priority of various projects.\textsuperscript{327}

Similarly, local spending patterns should be closely reviewed to prevent dual budgeting, overestimates of revenues and underestimates of expenditures, transfers of expense items to the capital budget, and timely payment of obligations. While important aspects of fiscal integrity can be handled by such post-audit "whistle-blowing" and the setting of accounting standards, the delay inherent in this after-the-fact review may make some pre-approval powers necessary. It is in this area, however, that considerations of home rule and fiscal flexibility loom large. While lack of review presents the danger of local government fiscal irresponsibility, especially in the absence of a spending limit, there is also a serious risk that a fiscal oversight agent who can review local spending decisions before the

\textsuperscript{325} For a summary of post-auditing powers currently possessed by elected and appointed comptrollers, see S. Clifford, supra note 314, app.

\textsuperscript{326} See notes 143-50 supra and accompanying text.

\textsuperscript{327} It is, of course, often difficult to draw a definite line between "financial" and "policy" decisions and the decisions of a powerful financial overseer may easily fall into the latter category. Thus, great care must be taken to delineate the criteria that should be employed in making approval decisions, recognizing always that some policy power will inevitably be exercised by this independent financial agent.
fact will become entangled in policy disputes or role conflicts. To safeguard against the erosion of local control, therefore, the agent’s pre-approval powers over spending should be inversely proportional to the degree of local responsiveness permitted by his selection procedure.

Very little direct administrative regulation of local taxation powers is required. The level of taxation can be determined by the voters through elections or referenda. Some review of the amount of real property and other wealth actually standing behind revenue estimates, the extent of taxation needed to meet estimated expenditures, and the coherence of the overall tax package may, however, be necessary.

3. Coordination With Other Financial Limits

While an independent fiscal oversight agent or agency can produce many benefits for a local government financial system, its effective operation requires special arrangements. It must be given substantial staff support and access to all local government financial records. In addition, local government officials must be required to produce these records in a manner that will satisfy the informational principles discussed above. The fiscal overseers can then be responsible for presenting the overall figures in a coherent manner to the general public. Most of all, in defining the function of the oversight agency, policy-makers must take into account the other control devices regulating local government finance. Thus, in a state with realistic debt and spending limits, the agency would primarily monitor potential avoidance techniques and recommend revisions in the system. In a state without such limits, the oversight agency may need additional approval powers in order to ensure fiscal stability and intergenerational equity.

328. See S. CLIFFORD, supra note 314, at 29-30, 37-38, 50-51; note 319 supra.
329. For example, there is less compromise of local responsiveness and fiscal home rule if a powerful fiscal overseer is directly elected at the local level than if a state agency exercises the same oversight powers. Even if directly elected, however, the fiscal overseer’s pre-audit powers should not be so extensive as to emasculate other local officials in the exercise of their discretion.
This Article has evaluated the various alternatives for furthering the historical and contemporary goals of local government debt ceilings, tax limits, and expenditure limits, and has suggested means of preventing the type of circumvention that has occurred in New York, Arizona, and other states.

Debt financing appears in need of greatest reform. If constitutional or statutory debt limits are to be retained, the base must be expanded to include all sources of revenue available to the local government to pay its debt service, not just real property assessments. Current avoidance mechanisms must be prohibited and a fiscal oversight agency established to monitor future attempts at circumvention if local government debt financing is to reflect the principles of fiscal stability and intergenerational equity. Short-term debt in particular requires close attention to prevent abuse. Fiscal flexibility and local responsiveness can be introduced by allowing referendum override of the limit.

Severe constitutional taxation limits on local government are very likely counterproductive. They will not lower overall government spending but instead will shift power and responsibility to state government, in the process violating principles of fiscal home rule, fiscal flexibility, and local responsiveness. Tax limitations should be imposed, if at all, by statute. Not only real property taxes but also income and sales taxes must be statutorily controlled to prevent inequity and to curtail excessive government growth.

Expenditure limits even more severely constrain home rule, local fiscal flexibility, and local responsiveness. If they are to be employed, they should be adopted by statute, include growth factors, and allow for override by referenda.

This Article has evaluated alternative approaches to ensuring local government fiscal integrity by reference to overriding informational, economic, and political principles. The fiscal controls considered should be coordinated to create a general local government financial control system. The actual mixture of constitutional, statutory, administrative, voter, and market controls on debt financing, taxation, and spending by local governments must, however, be determined by the political, economic, and social climate in the particular state considering such limits. Thus, strength of home rule or

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331. It has been argued that the same is true of local government structural reform. See Note, Conflict Resolution in a Politically Decentralized Local Government System, 11 Colum. J.L. & Soc. Prob. 629, 661-62 (1975) (student work by author).

332. Even the strongest home rule tradition may give way in the face of a serious financial crisis. In order to weather the New York City fiscal crisis, for example, nearly all groups have accepted the virtually complete financial control assumed by the state-
voter referenda traditions, type of political party organization, size of cities, existing local government structures, tax base peculiarities, and extent (if any) of local government fiscal crisis must determine the final configuration of any local government financial system.

dominated Emergency Financial Control Board, see Act of June 2, 1978, ch. 201, 1978 N.Y. Laws 391; Official Statement, supra note 67, at 40-43, and by the Municipal Assistance Corporation, see N.Y. PUB. AUTH. LAW §§ 3030-3040 (McKinney Supp. 1977). See generally MAC REPORT., supra note 66; Shalala & Bellamy, supra note 67, at 1127-32. Moreover, in order to obtain federal guarantees for some of its securities, the City has to agree to subject itself to the fiscal monitoring and control of the Emergency Financial Control Board for the life of the guarantees (possibly through 1997), to have its financial statements audited by the United States General Accounting Office, and to appoint a City Productivity Council to improve labor productivity. See 31 U.S.C.A. §§ 1521-1527 (West Supp. 1979); Supplemental Staff Report, supra note 208, at 972-73.

333. California already has a strong tradition of voter referenda, see James v. Valtierra, 402 U.S. 137, 141-42 (1971), and the popularity of initiatives and referenda is rapidly increasing in other states. See Herbers, supra note 291.

334. Strong organization by a single political party at both the city and county level may make it more difficult to obtain a truly independent fiscal overseer at the local level by either election or appointment. See text following note 322 supra. On the other hand, local political party organization may increase voter participation in local referenda. Relative strength of political parties at the state and local level is also important in determining the degree of state control exercised by any local government financial system.

335. Localities that rely primarily upon real estate taxes imposed on land with diminishing natural resources may be subject to special controls. See, e.g., MINN. STAT. § 471.71-.83 (1978).

336. See note 332 supra.