

THE \$750,000 CEILING

*Paper Presented To The Kit-Kat Club*

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An article in a recent national magazine entitled *THE FAMOUS BOSTON TEA PARTY* began with this sentence: "An air of uncertainty hung over Boston all day on December 16, 1773, like dark clouds before a storm." By coincidence, as I begin writing this paper, it is December 16, 1973, exactly two hundred years later. I am sitting on a balcony overlooking a picturesque bay in the British Virgin Islands--Little Dix Bay on the island of Virgin Gorda. It is most peaceful here and there are no sounds other than the murmur of the sea on the reef, the rustle of palm leaves, and the voices of several little children at play on the white sand beach below. Consequently "an air of uncertainty hangs over" me as it did over Boston on that memorable day of December 16, 1773--but for a different reason. I am tempted to change my subject and try my hand at poetry. But then, lawyers should know better.

Besides, I am bound by the tradition of our fellowship, which is that a member's title must be both relevant and cryptic. I am sandwiched in between two most intriguing cryptic titles. One was that of Prexy Yochum at our meeting last month, and the other that of Don Weaver at our meeting next month. Both of their titles: "What's in a name?"

With this in mind, I probably may have missed a great

opportunity in choosing my title. Instead of "The \$750,000 Ceiling," it might better have been "What's in a dollar?" But, upon brief reflection it occurred to me that there would have been nothing cryptic about that--certainly not in this great American age of affluence and unbridled inflation. So, despite my urge to join the "What's in" cult of my fore and aft colleagues, I shall stick to my originally chosen subject. It will lead you into some relatively unknown byways of public finance, and will end with some serious questions which I hope you will feel free to discuss and debate.

The \$750,000 ceiling! What is it? Only in an historical sense is it a ceiling. It is one of several debt provisions which became a part of Ohio's Constitution of 1851. Article VIII, Section 1, says:

"The State may contract debts, to supply casual deficits or failures in revenues, or to meet expenses not otherwise provided for; but the aggregate amount of such debts, direct and contingent, whether contracted by virtue of one or more acts of the General Assembly, or at different periods of time, shall never exceed seven hundred and fifty thousand dollars; and the money, arising from the creation of such debts, shall be applied to the purpose for which it was obtained, or to repay the debts so contracted, and to no other purpose whatever."

In addition to the \$750,000 ceiling, the Constitution of 1851 included certain other debt authorizations and restrictions. Article VIII, Section 2, authorizes the legislature to incur debt "to repel invasion, suppress insurrection or to defend the state in war." Sections 4 and 6 prohibit the state and municipalities

from lending their credit to or becoming owners of any business enterprize. Section 5 prohibits the State from assuming the debts of various political subdivisions, unless the debts were incurred in defense of the State. These and other sections I have not mentioned were designed to save the State from debt repudiation and bankruptcy in the mid-1800's. You may be interested in the background.

The Ohio Constitution of 1802 contained no restrictions on the power of the General Assembly to tax, to incur debt, or to grant special charters or privileges. As a result of an increase in the population of the State from 100,000 in 1802 to about two million by 1851, there was a rapid demand for, and spread of, transportation systems which included canals, railroads and turnpikes. These developments were described in *Ohio's Constitution In The Making* which was prepared in 1950 by Lauren A. Glosser for the Ohio Program Commission. He observed:

"The General Assembly, with no restrictions on its power to tax, to incur debts or to grant special privileges and charters, was subjected to the opportunism which was the moving force behind the settlement and expansion of the state. The legislature became a trading center for subsidies, monopolies and special privileges. Private laws-- laws for the benefit of certain individuals, associations or localities--were the principal legislative concern. In 1851, the last session of the 1802 constitution, the General Assembly passed laws in regard to forty charters for insurance companies, sixty-six charters for plank roads, seventy-four charters for turnpikes and eighty-nine laws in relation to railroads. In the first session under the 1851 constitution only twenty-four private laws were passed on all subjects.

"The General Assembly undertook to promote the development of transportation systems in several ways from 1802-1851. First it granted monopolies to companies to build roads, turnpikes and bridges. Later it granted subsidies from tax levies to road and railroad companies and both state and local governments were subscribing to stock issues of these companies. Finally the state was borrowing money for such subsidies and subscriptions and for appropriations for canals. At the end of the half-century, the state was in debt almost twenty million dollars and was paying one million dollars a year in interest, mainly to out-of-state creditors."

Here then were the circumstances which led to the \$750,000 constitutional debt limitation of 1851. Nevertheless, at the end of fiscal 1972, the state's outstanding bonded indebtedness totaled \$1,237,090,000! How did this come about? Did the General Assembly simply flout the Ohio Constitution? The simple answer is that, over the years, the people favorably voted a series of amendments to the Constitution authorizing in the aggregate over two and one-half billion dollars of state debt. Here is a list of the debt amendments presently in the Constitution:

<i>Purpose</i>	<i>Year Passed</i>	<i>Original amount (in millions)</i>	<i>Section of Article VIII</i>
World War II compensation fund	1947	\$300	2b
State highways	1953	500	2c
Korean conflict compensation	1956	90	2d
Capital improvements	1955	150	2e
Long range public works program	1963	250	2f
Highways	1964	500	2g
Development	1965	290	2h
Capital improvement and highways	1968	759	2i

At this point I must tell you that the \$750,000 debt ceiling is now in fact a false ceiling, not because of all the amendments I have listed, but primarily because of one of them. The 1968 amendment last listed, Section 2 i of Article VIII, made it so. This amendment contained a number of needed provisions-- for highways, water pollution control, higher education, technical education, vocational education, juvenile correction, parks and recreation, mental hygiene, fire training, airports, and state buildings. But the significant fact is that all of these projects, save one, were "one-shot" projects. With highways, however, the legislature was given "roll-over" bonding authority. It can authorize more than \$500 million for highway purposes providing it does not have more than \$500 million outstanding at any one time. This amendment also authorized the issuance of revenue bonds, not tax supported, for a number of purposes, without regard to dollar limitations.

Thus, the \$750,000 limitation, plus the \$500,000,000 roll-over highway authorization, means that our debt ceiling at any one time has now moved up to \$500,750,000. *(Without a referendum)*

What I thus far have written is prologue. Already formulated are proposals for further unprecedented state debt escalation in Ohio, an understanding of which is one of the purposes of my paper. The 108<sup>th</sup> General Assembly (1969-1970) created the Ohio Constitutional Revision Commission. Its purposes are to make recommendations from time to time to the General

Assembly and the electorate for amendment of the Constitution. The Commission is composed of thirty-two members, twelve of whom are members of the General Assembly, and twenty of whom are selected from the general public by the legislature. The Commission operates through committees, one of which is the Finance and Taxation Committee. On December 31, 1972, based upon the work of this committee, the Commission submitted to the General Assembly its recommendations for amendments to the Ohio Constitution in respect of State Debt. These recommendations are both revolutionary and controversial. If approved by the General Assembly and ratified by the people, State debt authorization in Ohio may well become a financial space vehicle.

Before submitting to you a brief analysis of the proposals, let me give you some of the Commission's thinking. First, it concluded quite accurately, that the state's present general \$750,000 debt ceiling is illusory. Second, it concluded, also quite accurately, that the present method of incurring additional debt by constitutional amendments is unnecessarily cumbersome and potentially ineffective as a device to control state debt. Accordingly, the Commission considered the following constitutional alternatives:

1. Maintaining the present debt limit, and the present method for incurring additional debt.
2. Maintaining the present debt limit, and requiring only a referendum instead of a constitutional amendment to incur additional debt.

3. Increasing the present debt limit to some higher amount, and either permitting the legislature to incur debt within this limit or requiring referendum approval within this limit.
4. Omitting any constitutional debt limit.
5. Creating a flexible debt limit, within which the General Assembly may incur debt for capital improvement purposes without voter approval, and providing that debt outside the constitutional formula should be subject to referendum.

In considering these alternatives, the Commission found that "at the present time, Ohio is one of 16 states requiring constitutional amendment to incur guaranteed debt for capital improvement purposes. Twenty-one states require referenda for this purpose, and eleven states have no constitutional debt limit whatever. In addition, the Constitutions of Hawaii and Pennsylvania contain formulas fixing these states' general obligation debt limits at a multiple of general fund revenues or annual tax revenues, respectively, while the Constitution of the Commonwealth of Puerto Rico limits debt service payments to a maximum percentage of the average of a two-year revenue base." The Commission adopted the approach of Hawaii, Pennsylvania and Puerto Rico, and thereby chose the fifth alternative which I have outlined above. Here, then, are some of the principal proposals as to Article VIII.

Section 1 (A)

In lieu of the existing general \$750,000 limitation and the \$500 million highway limitation, there would be substituted

a flexible debt ceiling which is related to annual state revenues.

The General Assembly, by a 3/5 vote, would be authorized to contract debt for capital improvements, capital acquisitions and land, and for refunding debt contracted for such purposes. The amount of debt which could be contracted in any fiscal year would be limited in two ways:

- (1) The amount required for principal and interest payments on such debt and all outstanding debt could not exceed 6% of the State's revenue base; and
- (2) New debt could not be contracted in any fiscal year in a total principal amount exceeding 8% of such revenue base.

The revenue base in (1) and (2) above would be "the average of the annual revenues of the State subject to appropriation by the General Assembly, excluding borrowed moneys, funds received from the Federal government, and moneys required to be returned by Section 9 of Article XII of this constitution, received by the State during the then two preceding fiscal years." (Sec. 9 of Article XII pertains to income and inheritance taxes.)

*Section 1 (C)*

This section would authorize the State to contract additional debt to meet appropriations during any fiscal year, but provides that such debt shall be paid not later than the end of such fiscal year. The Committee states that its purpose is to alleviate cash-flow problems within a fiscal year.



*Section 1 (D)*

This section would authorize the State to contract debt in addition to that above, or for any other purposes, but requires a referendum to the people for approval by a majority vote. This referendum proposal, the Commission points out, has the virtue of avoiding additional debt authorization by constitutional amendments, as now is required -- in other words, it would avoid cluttering the constitution.

*Section 1 (G)*

This section requires that at least 4% of the principal of the debt outstanding at the beginning of a fiscal year shall be paid in that fiscal year, or money for its payment be set aside.

*Section 2*

The new Section 2 provides that no State debt shall be contracted nor shall the credit of the State be used except for a "public purpose declared by the General Assembly" in the law authorizing such debt or use of credit. Under existing Section 4 the credit of the State may not be used for any private persons or corporations whatever. The Commission did not undertake to define what constitutes "public purpose." Rather, it fell back upon the somewhat euphemistic expression of Mr. Justice Holmes that: "A word is not a crystal, transparent and unchanging, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used."

*Section 3*

This section is a transfer of the "hybrid" revenue bond authority from present Section 2i of Article VIII. No substantive changes are proposed. Thus the Constitution would continue to authorize the issuance of revenue bonds for capital improvements

for purposes of mental hygiene and retardation, parks and recreation, state supported and state assisted institutions of higher education, including technical education, water pollution control and abatement, water management, and housing of branches and agencies of State government. Revenue bonds, as you know, are not payable out of tax revenues and do not constitute "debts" of the State. Incidentally, a "pure" revenue bond is one to the repayment of which only the revenues generated by the facility being financed with the proceeds of the bond are pledged. A "hybrid" revenue bond is a bond to the repayment of which other revenues or receipts may be pledged as well. Neither a "pure" nor "hybrid" revenue bond creates a full faith debt of the state.

*Section 4*

This section would permit the General Assembly to permit a local government entity to become a stockholder in, raise money for, or loan its credit to or in aid of, any joint stock company, corporation, or association. Under existing Section 6 of Article VIII, which would be repealed, this is absolutely prohibited.

*Section 13*

This section, adopted in 1965, permitted the General Assembly to authorize state and local government and their agencies to make guarantees and loans and to lend aid or credit for industrial revenue facilities.

This provision would be retained as a new Section 6, but with two modifications. The first would permit revenue bond financing of industrial projects to preserve existing jobs as well as to create jobs. The second would permit financing for electric or gas utility service to the public, but only for pollution control facilities.

Already the foregoing and other Commission proposals have been submitted to the legislature as Senate Joint Resolutions 18, 22, 23, 24, 25 and 26, together with companion resolutions in the House. If approved they must be ratified by the people as constitutional amendments. Obviously, our judgment as a people must be objective, and the guidelines to objectivity are clear. As the Commission itself has stated:

"If the debt is too severely limited, our proper public purposes will have been jeopardized. If the debt becomes excessively great--or the repayment thereof is not completed within the useful life of the facilities financed thereby--future taxpayers will be unfairly burdened with paying for facilities benefiting earlier taxpayers who did not carry their fair share of the repayment burden."

The Ohio Constitutional Revision Commission has labored long and hard in formulating its recommendations, and is to be commended. Many of these recommendations are sound and deserve public support.

On the other hand, some of the Commission's proposals are not only quite liberal but are revolutionary in character. Let me cite three illustrations.

(1) The 6% debt service cost limit would initially restrict non-voted debt to approximately the present level, that is, about \$1.2 billion. The mechanics surrounding the 6% limit computation will not be easily understood by the public--certainly not as easily as would a presently equivalent fixed-dollar limit of some \$1.2 or \$1.5 billion. Moreover, there is a substantial body of public opinion which favors a fixed-debt ceiling, whatever it may be, over a flexible ceiling.

(2) The proposal that the General Assembly be authorized to contract debt "to meet appropriations during any fiscal year," provided such debt be paid not later than the end of such fiscal year may have some merit. But there are those who believe that this proposal would be a prescription for fiscal irresponsibility. Moreover, there are better ways of solving the cash-flow problem, notably the timing of tax collections.

(3) The provision in new Section 2 that no State debt shall be contracted nor shall the credit of the State be used except for a "*public purpose declared by the General Assembly*" is a complete reversal of historical constitutional protection. State debt could be created and state credit could be used for virtually any financing objective, including participation with private capital, that the *General Assembly* declared to be a "*public purpose*." The same is true of Section 4 which would permit the General Assembly to give local governmental entities ~~entit~~ carte blanche in underwriting private projects.

However, after more than one hundred years some changes are in order, The \$750,000 ceiling is unrealistic. Moreover, the necessity for amending the constitution every time a needed bond issue is required is wholly unnecessary. Therefore, it seems to me that a reasonable approach to this whole problem would

involve the following steps:

First, the over-all debt limit of the state without a further vote of the people should be frozen at about its present level--\$1,250,000,000, which would include both general and highway financing.

Second, the General Assembly should be required to submit to the voters any question of creating and approving debt in excess of the above limit, and such question should be resolved by the voters, not by constitutional amendment, but by a simple form of referendum.

Third, the Commission's proposal that at least 4% of the total principal amount of debt outstanding at the beginning of a fiscal year shall be paid, or moneys for such payment set aside, during such fiscal year should be made a mandatory part of the Constitution.

Before closing I want to present a panoramic view of public debt in the national context. Ohio is but one of fifty states in a federal government whose spending and borrowing powers transcend all of them. The really gnawing question is how many "credit cards" our federal, state and local governments should continue to have if fiscal responsibility in government is to be preserved.

I shall spend no time with the federal government because Congress, not the Federal Constitution, is completely in the driver's seat. Last December, Congress raised the so-called

"temporary" federal debt ceiling to \$475.7 billion, or almost one-half trillion dollars. Incidentally, I need not remind you that, in terms of public finance, the word "temporary" means "permanent." (Refer to Appendix)

But what of state and local governments? As of 1970, according to the U.S. Department of Commerce, Bureau of the Census, their total outstanding debt was \$143.6 billion. The Tax Foundation has projected a total state and local debt of \$211.2 billion by 1975 and \$310 billion by 1980. The Tax Foundation, as you may know, is a private, non-profit organization engaged in non-partisan research and public education on the fiscal and management aspects of government. Incidentally, the foregoing figures do not include state and local general revenues which amounted to \$130.8 billion in 1970 and which the Foundation projected to reach \$227.6 billion in 1975 and \$329 billion by 1980.

And so I press my question: how many credit cards should federal, state and local governments continue to have, especially as we continue to be engulfed in the vortex of seemingly uncontrollable inflation?

The tragedy of our times is that, in terms of state and local finances, our public officials have not spent money for wholly unworthy purposes, but have been guilty, for the most part, only of weak administration. Again, according to the Tax Foundation, forty cents of every dollar of state--local general outlays support public education. Public welfare moved into second position in 1971. The provision and maintenance of some

3.8 million miles of highways and streets represent the third ranking state-local service in terms of dollar costs. Health and hospitals represent the fourth largest category -- and the foregoing four categories make up about 70% of all state-local general spending. All other categories -- 30% -- include such services as police and fire, interest on debt, sanitation and sewerage, and others.

Which of the foregoing services will the people give up. The answer, of course, is none--nor should they. But this is not the relevant question. Rather, which of the foregoing services will the people be willing to cut back from recent accelerated rates of expenditure growth to increases which are more in line with longer-term averages? Obviously, barring a depression, there will be some revenue growth resulting from increased population, increased economic productivity and normal inflation. But these may not bridge the gap suggested by the projections of the Tax Foundation, and we well may face some tax revolts. Incidentally, as a "straw in the wind," the voters of New York last November defeated the largest single general obligation bond issue ever before put before the voters of any state or local government body-- a \$3.5 billion proposal for transportation purposes. And public transportation has become our No. 1 problem, beyond our environmental obsessions of course!

Finally, and my ultimate question for your comments, have we become so accustomed to affluence-- to the luxury of having *today* what can be charged to governmental credit cards and passed on to our children and grandchildren--that we have forgotten that governments can flirt with bankruptcy as Ohio did in the 1850's?