

Debt Limits’ End

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ABSTRACT: Debt is a major tool funding American local governments. Local governments are, however, severely constrained in their ability to rely on this vital tool. For over a century now, state constitutions and statutes have strictly curbed local governments’ power to issue debt. The effectiveness of these legal restrictions has often been questioned, but the rationale for their existence has not been doubted. This Article presents the first systematic appraisal of the justifications offered for the limits state laws place on local indebtedness. It finds all the varied normative accounts lawmakers and commentators provide glaringly lacking. Even the most prevalent explanation—portraying debt limits as alleviating the inter-generational conflict between current residents who borrow money and spend it, and future residents who must repay the loans—is inconsistent with the economics of public finances and the laws of local government. After exposing the flaws of this and all other normative ends heretofore assigned to debt limits, the Article uncovers the sole end that may be attributed to them. Debt limits, it establishes, institute a degree of inter-municipal equity in access to credit, ensuring that one municipality does not deplete credit markets to the detriment of other municipalities located within the same state. But although debt limits do thereby serve an end, that lone normative benefit they generate is found to be of meager proportions. The limits therefore often represent unwarranted, costly—and deleterious—legal interferences in local finances. This Article’s novel analysis should hence lead, if not to debt limits’ abolition, then at least to their redesign so that their form corresponds to their inescapably limited end identified here.

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* Associate Professor of Law, Northwestern University Pritzker School of Law. For invaluable comments on drafts of this Article, and for fruitful conversations about the ideas they incorporated, I am grateful to Michelle Wilde Anderson, Kenneth Ayotte, David Dana, Matthew Fisher, Gerald Frug, Amnon Lehavi, Max Schanzenbach, and Richard Schragger. I also benefitted from the input of participants at the faculty workshop at Northwestern University School of Law, at the Law and Economics Workshop at the Hebrew University Law School, and at the Big Ten Junior Scholars Conference. Finally, I am thankful to Jack Licata and Jonathan Saltz who provided exceptional assistance in research.

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I. INTRODUCTION

In a capitalist economy, few financial activities are more routine—yet vital—than the lending and borrowing of money.¹ Accordingly, the law might regulate the form of loans issued and the practices of those involved in the

1. *E.g.*, CHRISTINE DESAN, MAKING MONEY: COIN, CURRENCY, AND THE COMING OF CAPITALISM 2–6 (2014) (relating capitalism's advent to a decision to facilitate lending).

lending market,² but it does not directly limit market participants' freedom to procure debt.³ If Jane desires to assume a debt, she need only find a willing lender. The same is true if Jane Corp. entertains such a desire: as a corporation, Jane Corp. might be subject to reporting obligations,⁴ but the law will not challenge Jane Corp.'s ability to proceed.⁵ The market, not the law, determines who shall qualify for a loan.⁶ This basic truism of American law is abrogated, however, in one exceptional case. The law may assume an indifferent posture towards Jane or Jane Corp.'s credit desires, but when the City of Jane fancies a loan, the law aggressively intercedes. In all states but one, arduous constraints will be placed along the City of Jane's path toward credit.⁷ The City might be flat-out prohibited from borrowing funds beyond a certain amount; it might be required to attain resident approval for the move—perhaps by a supermajority—in a referendum; it might even be subjected to both these restrictions concurrently.⁸ The law thus treats local governments strikingly differently from individuals or corporations, by placing on their debt—and only on their debt—limits.

These limits' unique nature is further accentuated by yet another key contrast contained within the current law. The law not only treats city debt obligations differently from individual or corporate debt obligations; it also separates city debt obligations from other city obligations. Hence, if, for example, the City of Jane desires a new football stadium, it will be, as noted, constrained in its ability to issue debt to fund construction.⁹ At the same time, it will not be constrained in its ability to fund construction through a budget allocation;¹⁰ to grant tax subsidies to the privately-owned football team constructing the stadium;¹¹ to lease to the team, for a fraction of its value, the

2. For example, secured loans are regulated. U.C.C. § 9-109 (AM. LAW INST. & UNIF. LAW COMM'N 2015). States' usury laws limit interest rates. *E.g.*, CAL. CONST. art. XV, § 1.

3. Inevitably, however, the regulation of loans and lending practices leads to the pricing out of certain borrowers from the market, and thus indirectly limits the freedom to procure debt.

4. The Securities and Exchange Commission monitors publicly-traded corporations. *See* 15 U.S.C. § 78d (2012).

5. Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1216–17 (2006). Commercial banks are an exception: they are subject to capital requirements enforcing assets to liabilities ratios. 12 C.F.R. § 324.1 (2016). Banks' unique treatment is revisited *infra* note 136 and accompanying text.

6. The law may do the opposite: *e.g.*, it prohibits lenders from denying mortgages because of applicants' race. 42 U.S.C. § 3605 (2012).

7. *See infra* notes 76–88 and accompanying text.

8. *See infra* notes 76–88 and accompanying text.

9. *See infra* Part II.B.

10. Government funds can only be spent for a “public purpose” and thus seemingly cannot aid private endeavors. However, courts rendered the requirement inconsequential by deferring to legislatures' determination respecting aid's public purpose. Richard Briffault, Foreword, *The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 RUTGERS L.J. 907, 914 (2003).

11. For example, as part of the stadium plan Inglewood approved for the NFL's St. Louis Rams—as they were relocating to Los Angeles—public support was provided through \$100

land for the stadium;¹² or to acquire the land through eminent domain and transfer it to the team.¹³

Thus, both elements of local debt limits' legal functioning—the singling out of the “local” and the targeting of “debt”—stand out. The limits apply to local governments and not to other market participants engaged in identical activities; and they apply to some local government activities but not to similar, indeed often economically identical, local government activities. How—if at all—can these anomalies be accounted for? What normative ends may actually be served by the law's unique limits on local debt? Are the limits, in their current legal form, well designed to serve those normative ends? These are the questions this Article tackles.

The time is ripe, perhaps as never before, for a systemic attempt at confronting these questions. The previous four decades have witnessed an explosion of sophisticated legal interest in local governments' forms, functions, and promises.¹⁴ Largely, however, this interest has bypassed the topic of local finances.¹⁵ As compared to the democratic and community-building potential of local governance, local finances can come across as technical and of secondary importance.¹⁶ Lately, however, dramatic real world events have necessitated a stark reevaluation of this academic attitude. As the city symbolizing the American industrial century entered bankruptcy;¹⁷ as many municipalities confront underfunded pension obligations wreaking havoc with their budgets;¹⁸ and as the investors' rating service Moody's

million in tax breaks. Tim Logan & Angel Jennings, *Tax Breaks Do Figure into NFL Stadium Plan in Inglewood*, L.A. TIMES (Jan. 12, 2015, 8:59 P.M.), <http://www.latimes.com/sports/la-sp-stadium-tax-break-20150113-story.html>. Some states constitutionally limit tax exemptions, but only ineffectively, since they do not block “short term” exemptions. See Peter D. Enrich, *Business Tax Incentives: A Status Report*, 34 URB. LAW. 415, 428 (2002).

12. See Charles V. Bagli, *Giants and Jets, Super Bowl Hosts, Have Already Been Richly Rewarded*, N.Y. TIMES (Nov. 28, 2013), <http://www.nytimes.com/2013/11/29/nyregion/giants-and-jets-super-bowl-hosts-have-already-been-richly-rewarded.html>.

13. Land taken by eminent domain must be put to a “public use.” U.S. CONST. amend. V. However, “public use” equates to “public purpose.” *Kelo v. New London*, 545 U.S. 469, 477–78 (2005). Accordingly, sports stadia are allowable uses. See *Goldstein v. Pataki*, 516 F.3d 50, 50–51 (2d Cir. 2008).

14. See generally Michelle Wilde Anderson, *Mapped Out of Local Democracy*, 62 STAN. L. REV. 931 (2010); Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law*, 90 COLUM. L. REV. 1 (1990); Sheryll D. Cashin, *Localism, Self-Interest, and the Tyranny of the Favored Quarter: Addressing the Barriers to New Regionalism*, 88 GEO. L.J. 1985 (2000); Gerald E. Frug, *The City as a Legal Concept*, 93 HARV. L. REV. 1057 (1980); Richard C. Schragger, *The Limits of Localism*, 100 MICH. L. REV. 371 (2001); Nadav Shoked, *The New Local*, 100 VA. L. REV. 1323 (2014).

15. See, e.g., Gerald E. Frug, *Beyond Regional Government*, 115 HARV. L. REV. 1763, 1826 (2002) (criticizing local finances' structure, but noting that the topic should be further treated separately).

16. See JONATHAN A. RODDEN, HAMILTON'S PARADOX 3 (2006) (lamenting that “[v]irtually all cross-national empirical studies of public sector deficits and debt have ignored subnational governments”); see also ERIC H. MONKKONEN, *THE LOCAL STATE* 11 (1995).

17. Detroit filed for bankruptcy protection in 2013. *In re City of Detroit*, Mich., No. 13–53846, 2013 WL 4761053, at *1 (Bankr. E.D. Mich. July 25, 2013).

18. State and local public pension funds were underfunded by nearly \$1 trillion in 2013. PEW

downgraded the debt of the nation's third largest city to "junk" bond status;¹⁹ municipal financing can no longer be shrugged off as policy, or academic, backwaters.

Accordingly, legal scholars have recently authored innovative works surveying the tools American law affords local entities struggling with unsustainable indebtedness.²⁰ Thanks to these articles the legal story of the settlement of municipal debts has been greatly elucidated. Conversely, however, the legal story of the assumption of municipal debts—debts the municipality may or may not be able to settle later—remains mostly obscure.²¹

Our understanding of the legal regime within which municipalities assume financial obligations is shallow. Most prominently, the legal and other literature only haphazardly answers the questions launching this Introduction, which highlighted the exceptional nature of the limits law places on municipal debt. Scholars in law, economics, and the political sciences examining these limits normally focus on their effect on governments' ensuing fiscal behavior.²² Legal scholars thus highlight mechanisms through which municipalities evade limits and undertake debt in their spite.²³ For their part, economists and political scientists analyze the financial impacts of these alternate revenue-raising mechanisms.²⁴ This emphasis on the *results* of debt limits has been accompanied by a relative neglect of their *rationale*.

Authors tend to simply assume that rationale, finding its validity too uncontestable to warrant serious analysis. Decisions respecting local debt, writers argue, represent the special case where local decision-making cannot generate the result usually attained through such decision-making: policies

CHARITABLE TRS., THE STATE PENSIONS FUNDING GAP: CHALLENGES PERSIST (2015), http://www.pewtrusts.org/~media/assets/2015/07/pewstates_statepensiondebttbrief_final.pdf.

19. In May 2015, Chicago's debt was dropped from level Baa2 to Ba1—commonly known as "junk." See Aaron Kuriloff, *Moody's Cuts Chicago's Debt to Junk: Ratings Firm Drops City's Debt Two Notches to Ba1 from Baa2*, WALL STREET J. (May 12, 2015, 6:49 PM), <http://www.wsj.com/articles/moodys-cuts-chicagos-debt-to-junk-1431470944>.

20. See generally Michelle Wilde Anderson, *The New Minimal Cities*, 123 YALE L.J. 1118 (2014); Clayton P. Gillette, *Dictatorships for Democracy: Takeovers of Financially Failed Cities*, 114 COLUM. L. REV. 1373 (2014) [hereinafter Gillette, *Dictatorships for Democracy*]; Clayton P. Gillette, *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. CHI. L. REV. 281 (2012) [hereinafter Gillette, *Fiscal Federalism*]; Clayton P. Gillette & David A. Skeel, Jr., *Governance Reform and the Judicial Role in Municipal Bankruptcy*, 125 YALE L.J. 1150 (2016); David A. Skeel, Jr., *When Should Bankruptcy be an Option (For People, Places, or Things)?*, 55 WM. & MARY L. REV. 2217 (2014).

21. Only one—albeit important—article has recently reexamined debt limits. See generally Richard C. Schragger, *Democracy and Debt*, 121 YALE L.J. 860 (2012).

22. See *infra* Part II.B.

23. LYNN A. BAKER & CLAYTON P. GILLETTE, LOCAL GOVERNMENT LAW 618 (2010) (titled the chapter about debt "debt limitations and their avoidance"); RICHARD BRIFFAULT & LAURIE REYNOLDS, CASES AND MATERIALS ON STATE AND LOCAL GOVERNMENT LAW 816–75 (7th ed. 2009) (dedicating 56 pages, out of 59 dealing with debt limits, to avoidance techniques).

24. See *infra* notes 106–14 and accompanying text.

corresponding to affected citizens' preferences.²⁵ Indeed, uninhibited local decision-making in this field, they caution, will undermine that pursuit.²⁶ Debt is issued by today's city—that is, today's residents—for its uses, while tomorrow's city—tomorrow's residents—will have to pay back the debt. By definition, debt is a means for one generation to force another, later, generation to fund its current spending.²⁷ Since in some—perhaps many—circumstances this practice is inefficient and unjust, the law sets its contours by placing limits on the current generation's power to issue debt. This reasoning is straightforward and appealing; for most it materializes as unassailable.²⁸ So much so that scholars conclude that in the municipal debt field, legal and academic energy need only concern itself with debt limits' practical results: the limits' rationale introduces no difficulties.²⁹

This Article argues that this common, almost consensual, wisdom is wrong. The dominant reasoning explaining debt limits is logically incoherent, oblivious to the economics of municipal credit markets, and divorced from the tenets of local government law. In fact, this Introduction has already tentatively demonstrated as much. Its second paragraph highlighted the common argument's flaw: a need to remove inter-generational tensions cannot explain the placement in current law of limits on city debt, but not on other city obligations. As when it issues debt, today's city encumbers tomorrow's city when it offers tax exemptions, develops infrastructure, enters leases, conveys public property, or allocates budgets.³⁰ Yet local government law, which according to existing literature is adamant in its opposition to inter-generational burden shifting through debt, leaves unchecked the city's reliance on these diverse mechanisms for comparable inter-generational burden shifting.

This inconsistency is merely indicative of the theoretical inadequacy of this grounding that is most commonly provided for debt limits. Its general

25. Works lauding local government for its capacity to deliver on this promise include: HANNAH ARENDT, *ON REVOLUTION* 283 (1963); Nicole Stelle Garnett, *Suburbs as Exit, Suburbs as Entrance*, 106 MICH. L. REV. 277, 297 (2007); Heather K. Gerken, *The Supreme Court 2009 Term: Foreword: Federalism All the Way Down*, 124 HARV. L. REV. 4, 8 (2010); and Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418 (1956). See generally Jerry Frug, *Decentering Decentralization*, 60 U. CHI. L. REV. 253 (1993).

26. See *infra* Part III.C.1.

27. See *infra* Part III.C.1.

28. See Stewart E. Sterk & Elizabeth S. Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 WIS. L. REV. 1301, 1306 (1991) (“[D]ebt limitations, unlike some other state constitutional provisions, are not merely relics . . . [they] are one response to a systematic flaw in democratic processes: an inability to consider adequately the long-term impact of current decisions.”).

29. See Briffault, *supra* note 10, at 949 (“[Although] it has proven extremely difficult to operationalize in practice” a “debt limit seems attractive in theory.”); Christopher Serkin, *Public Entrenchment through Private Law: Binding Local Governments*, 78 U. CHI. L. REV. 879, 961 (2011) (arguing that debt limits' problem is that they are “porous” as all agree that they are necessary).

30. See *infra* Part III.C.2.

failings will be methodically established in the Article. Other auxiliary justifications writers list in support of the legal limits on local borrowing will also be evaluated, only to be diagnosed as similarly afflicted by diverse logical, doctrinal, or normative defects. Simply put, the ends jurists and scholars have for decades been ascribing to debt limits are illusory.

The limits' existing justifications thus founder; in their stead, this Article will unearth the one lone end potentially promoted by debt limits. The sole valid justification—never considered before—for state-imposed limits on the debt a municipality issues is the desire to control the borrowing costs other municipalities within the state endure.³¹ On account of the market for municipal credit's special attributes, the state's municipalities are enmeshed in a competition over a limited pool of debt buyers. When one municipality borrows—i.e., sells debt—it sates some of this limited market demand, and other municipalities lose potential buyers for their debt. The state is concerned with this price other municipalities pay for the debt one of their peers issues, since the state subsidizes all municipal debt. Buyers purchase municipal bonds thanks to a tax subsidy the state affords them. To assure a fairer distribution among its municipalities of the subsidy's benefits, the state limits each municipality's capacity to draw on the limited market for municipal debt the subsidy it grants facilitates. In this manner debt limits perform a normatively desirable task. The relative importance of this task, however, is questionable; as this Article will explain, the state's interest in the inter-municipal competition over debt buyers may not be particularly compelling.

This Article thus offers the first methodical exploration into the normative grounding for a staple of local government law, only to infer that said grounding is at best weak—and in any event, distinct from the groundings recognized heretofore. The law of debt limits should be rethought in accordance. Debt limits carry a substantial and undisputable cost: by their nature, they meddle in local finances and constrain municipal flexibility, thereby exacerbating cities' financial woes.³² The lone, and modest, normative benefit that they can furnish, this Article illustrates, may not offset these dire costs. Furthermore, in their current legal iteration, molded by lawmakers unaware of the limits' potential end and thus disconnected from it, debt limits may fail to deliver even on that promised benefit. To effectively promote it, the limits' existing statutory form, as well as courts' attitudes toward controversies surrounding their enforcement, must be recalibrated. In other words, the limits should either be abolished, or legislatively and judicially reformed in light of their sole and humble end as identified in this Article.

31. See *infra* Part III.F.

32. See *infra* notes 108–14 and accompanying text.

This conclusion is reached as follows. Part II briefly reviews the manner by which local governments fund their operations through debt, alongside the law and history of the limits placed on such debt. Part III turns to the potential normative ends these limits serve. Six normative accounts will be reviewed and critically assessed, beginning with those that commentators and lawmakers have tended to take for granted. These five prevalent accounts are: the portrayal of debt limits as desired by both parties to the debt transaction (city and lender); the characterization of the limits as addressing the agency problem besetting the relationship between local officials and residents; the common belief that limits soothe the inter-generational tension between current and future residents; the claim that the limits protect the federal government (which subsidizes municipal bonds); and the contention that they shield the state from local debt's effects (experienced when a state bails out a defaulting city). Each of these accounts will fail informed scrutiny, and thus Part III will also suggest a novel normative account whereby debt limits placed on one municipality safeguard other municipalities' interests. Part III's finding—that the latter is the sole valid justification for debt limits—is then employed in Part IV to reconsider existing debt limits law. Reforms in the limits' statutory form are proposed, as are solutions for problems that have for decades bewildered courts enforcing debt limits.

II. DEBT LIMITS LAW

This Article aims at normatively explaining the most prominent element in the law of municipal debt: the limits states place on municipalities' power to issue debt. Setting the stage for that discussion, this Part will sketch the current landscape of local government borrowing. The goal is twofold: to lay out the attributes of the market for local debt, as those must be borne in mind when accounting for debt limits—the task Part III will undertake—and to demonstrate that those limits are a highly consequential legal interference in that market. Thus, this Part will open by describing the current practice of issuing local debt, then review the legal restrictions placed on this practice, and conclude by briefly presenting these restrictions' history.

A. LOCAL DEBT

Local governments are tasked with supplying some of the services most critical to modern society.³³ They are responsible, for example, for education, policing, street maintenance, land-use regulation, public spaces' upkeep, and economic development.³⁴ To foot the bill for this plethora of activities, local governments must draw on a limited number of funding sources. Most

33. For more on local services, see generally Gerald E. Frug, *City Services*, 73 N.Y.U. L. REV. 23 (1998).

34. See BAKER & GILLETTE, *supra* note 23, at 46–51 (listing local government types).

prominently, local governments tax and charge fees or assessments,³⁵ they receive grants from higher levels of government (i.e., federal and state),³⁶ and, finally, they borrow.

In 2012, local governments were liable for close to 1.8 trillion dollars in outstanding debt.³⁷ In 2014 alone, municipalities issued debt bonds to the tune of \$314.9 billion.³⁸ This heavy reliance on borrowing is borne of practical imperatives, but also of normative principles. Practically, local governments, like other governments and all economic actors, resort to borrowing to fill short-term or long-term gaps that are prone to crop up between expenses and income streams.³⁹ Normatively, funding governmental spending through borrowing is justified—in economic and equity terms—given public expenditures' special nature. Governments often spend funds on capital projects—say constructing a park, school, or sewage system—that will benefit not only existing taxpayers but also future ones. Therefore, such projects' costs should be shared between different generations of taxpayers. The borrowing of money to be paid back piecemeal by taxpayers spreads those costs over time.⁴⁰

Practical necessity combined with such temporal justice considerations lead all governments, everywhere, to borrow.⁴¹ American local governments labor under yet another incentive to rely on debt, an incentive peculiar to the American federated system. Interest income derived from holding municipal bonds is exempt from federal taxation.⁴² Municipal bonds thus offer investors a tax advantage over other bonds or investments (since earnings from those other bonds or investments are taxed). This advantage enables American local governments to obtain loans at below-market interest rates. By foregoing

35. In 2012, American local governments' revenue stood at \$1.6 trillion, \$917 billion of which was from taxes and fees. JEFFREY L. BARNETT ET AL., 2012 CENSUS OF GOVERNMENTS: FINANCE—STATE AND LOCAL GOVERNMENT SUMMARY REPORT 7 (2014), http://www2.census.gov/govs/local/summary_report.pdf.

36. In 2012, inter-governmental grants to localities amounted to \$539 billion. *Id.*

37. *Id.* at 9.

38. KYLE BRANDON ET AL., MUNICIPAL BOND CREDIT REPORT: FOURTH QUARTER 2014, at 2 (2014), <http://www.sifma.org/research/item.aspx?id=8589952951> (select download report).

39. Short-term debt is vital for government operations. Because taxes are collected at periodic intervals, governments would face inconvenience if forced to await collection before committing money. *People ex rel. Capron v. Nelson*, 176 N.E. 59, 62 (Ill. 1931). Long-term debt can “smooth the periodic fluctuations in government receipts caused by the normal business cycle. . . . [T]he need for government services generally increases” during economic distress, which also reduces tax revenues, and hence government assumes debt at such times of distress which it can then pay back at times of economic growth. Julie A. Roin, *Privatization and the Sale of Tax Revenues*, 95 MINN. L. REV. 1965, 1971 (2011). Thereby, “debt allow[s] government actors to play a countercyclical financial role.” *Id.*

40. BRIFFAULT & REYNOLDS, *supra* note 23, at 792.

41. See *The World Factbook*, CENT. INTELLIGENCE AGENCY, <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2186rank.html> (last visited Jan. 8 2017).

42. 26 U.S.C. § 103 (2012).

tax payments over the interest local governments pay creditors, the federal government participates in local governments' debt servicing costs, rendering debt, as a funding vehicle, cheaper for local governments.⁴³ States supplement this federal subsidy for local borrowing by exempting from state taxation interest paid on municipal bonds issued by in-state localities.⁴⁴ Since local bonds are consequently appealing to investors—particularly those residing in the same state as the issuing locality⁴⁵—debt is a convenient and relatively low-cost funding technique for localities.

Consequently, America houses a vibrant market for local debt. The structure of that market differs, however, from that characteristic of other securities markets. A municipality typically issues bonds as a series in which each bond is a “strip” having its own maturity year and correspondingly its distinct interest rate.⁴⁶ Since the result is a market with a vast amount of issuers of bonds of very discrete varieties, a central exchange or clearinghouse for municipal bonds, such as the one for common stock, does not exist. Rather, new municipal bonds enter the market through the services of a syndicate of major investment banks underwriting them.⁴⁷ The syndicate offers the bonds to investors, sometimes in an open auction process, but more often by approaching specific investors. Therefore, unlike typical securities, municipal bonds are not actively traded, and information on individual bonds' market price is mostly unavailable.⁴⁸

Nonetheless, information is readily available regarding the projected risk associated with an individual municipal bond—which is a key factor determining its price.⁴⁹ Municipalities' riskiness is assessed by three major rating agencies.⁵⁰ Governments preparing to borrow money pay these

43. See *infra* Part III.D.

44. See, e.g., N.Y. TAX LAW § 612 (McKinney 2016) (adding to a taxpayer's taxable federal income “[i]nterest income on obligations of any state other than this state, or of a political subdivision of any such other state”). Three states generally do tax in-state bonds with few and specific exceptions. 20 ILL. COMP. STAT. ANN. 3501/820-60 (2014) (exempting bonds that the Illinois Finance Authority issued); IOWA CODE § 403.9(2) (2017) (exempting Municipality Urban Renewal Bonds); WIS. STAT. § 71.05 (2013–2014) (listing exempt bonds). The Supreme Court has upheld the disparate treatment of out-of-state bonds against a Dormant Commerce Clause challenge. See *Dep't of Revenue v. Davis*, 553 U.S. 328, 332 (2008).

45. Jonathan Rodden, *Market Discipline and U.S. Federalism*, in *WHEN STATES GO BROKE* 123, 136 (Peter Conti-Brown & David A. Skeel, Jr. eds., 2012).

46. Peter Fortune, *The Municipal Bond Market, Part I: Politics, Taxes, and Yields*, 1991 NEW ENG. ECON. REV. 13, 18–19.

47. D. Roderick Kiewiet & Kristin Szakaly, *Constitutional Limitations on Borrowing: An Analysis of State Bonded Indebtedness*, 12 J.L. ECON. & ORG. 62, 93 (1996).

48. Morris Goldstein & Geoffrey Woglom, *Market-Based Fiscal Discipline in Monetary Unions: Evidence from the US Municipal Bond Market*, in *ESTABLISHING A CENTRAL BANK* 228, 239–40 (Matthew B. Canzoneri et al. eds., 1992).

49. Dwight V. Denison et al., *When States Discriminate: The Non-Uniform Tax Treatment of Municipal Bond Treatment*, 69 PUB. ADMIN. REV. 458, 463 (2009).

50. Fitch, Moody's, and Standard & Poor's. Stoyan Bojinov, *Understanding Bond Ratings*, MUNICIPALBONDS.COM (Aug. 20, 2011), <http://www.municipalbonds.com/education/read/67/>

agencies to rate their credit-worthiness—by awarding it a grade—because investors are likelier to buy bonds a third party has evaluated.⁵¹ The agencies can also decide on their own to change a municipality's rating.⁵²

Credit ratings aim at reflecting the chance of non-repayment, which, as with any loan, is the major risk assumed by the bond's buyer.⁵³ Non-repayment takes either the form of a default—wherein the municipality ceases to pay back its obligations—or bankruptcy—wherein a federal court adjusts the municipality's obligations.

Theoretically, a defaulting municipality is treated like any other defaulting entity. According to the Supreme Court, unlike states,⁵⁴ cities do not enjoy sovereign immunity, and creditors can ask courts to enforce obligations against them.⁵⁵ Yet in practice courts offer creditors very little succor—due to a problem with remedies. Unlike private borrowers' assets, creditors cannot seize most assets local governments hold (e.g., parks, schools, municipal buildings) as these are covered by the public trust doctrine—banning their transfer from the public.⁵⁶ Thus a court seeking to enforce a creditor's right must issue a mandamus ordering the city to collect extra taxes.⁵⁷ Understandably, courts are reluctant to approve this radical remedy.⁵⁸ In the rare past instances when they enjoined it, unmotivated tax collectors and taxpayers thoroughly undermined its effectiveness.⁵⁹

A defaulting municipality's creditor will thus be frustrated in her efforts to collect the debt through a court order.⁶⁰ Normally, when contending with

understanding-bond-ratings.

51. John Yinger, *Municipal Bond Ratings and Citizens' Rights*, 12 AM. L. & ECON. REV. 1, 25 (2009).

52. The agencies set their criteria independently. Federal agencies and state governments are barred from interfering. 15 U.S.C. § 780-7(c)(2) (2012).

53. See generally Mark H. Adelson, *Bond Rating Confusion*, 12 J. STRUCTURED FIN. 41 (2007).

54. The Eleventh Amendment grants states immunity against creditor claims. See generally *Louisiana v. Jumel*, 107 U.S. 711 (1882).

55. See generally *Wolff v. New Orleans*, 103 U.S. 358 (1880).

56. *Meriwether v. Garrett*, 102 U.S. 472, 513 (1880).

57. *E.g.*, *Md. Cas. Co. v. Leland*, 199 S.E. 7, 9 (N.C. 1938) ("From earliest times in this State, and generally elsewhere, mandamus has been recognized as a proper proceeding to compel a levy of tax to pay a judgment against a municipality. . . . In fact, it is often the only remedy. . . .").

58. *Rees v. City of Watertown*, 86 U.S. (19 Wall.) 107, 116–17 (1873); *Walkley v. City of Muscatine*, 73 U.S. (6 Wall.) 481, 482–83 (1867).

59. *Faitoute Iron & Steel Co. v. Asbury Park*, 316 U.S. 502, 511 (1942) ("And so we have had the spectacle of taxing officials resigning from office in order to frustrate tax levies through mandamus, and officials running on a platform of willingness to go to jail rather than to enforce a tax levy and evasion of service by tax collectors, thus making impotent a court's mandate." (citation omitted)); *Yost v. Dall. Cty.*, 236 U.S. 50, 57 (1915); Albert Hillhouse, *Lessons from Previous Eras of Defaults*, in *MUNICIPAL DEFAULTS* 13 (Carl Chatters ed., 1933).

60. *Faitoute Iron & Steel Co.*, 316 U.S. at 509–10 ("In effect, therefore, the practical value of an unsecured claim against the city is inseparable from reliance upon the effectiveness of the city's taxing power. The only remedy for the enforcement of such a claim is a mandamus to

a recalcitrant debtor, a creditor can force that debtor into bankruptcy.⁶¹ If the debtor is a municipality, however, this course of action is unavailable. Before 1937, bankruptcy was not a legal option for indebted municipalities, and accordingly during the Great Depression an astounding number of municipalities defaulted on debts.⁶² In response, Congress instituted bankruptcy proceedings for municipalities, currently codified as the Federal Bankruptcy Code's Chapter Nine.⁶³ But the statute provides that a municipality must elect itself to enter bankruptcy, and, in addition, its host state must authorize the bankruptcy.⁶⁴ Creditors, in other words, cannot force bankruptcy on a municipality. They are thus left bereft of any real remedy when a municipality defaults, and, accordingly, local debt should be viewed as a risky investment.

Yet in practice a municipal bond is a relatively "conservative investment."⁶⁵ One of the great puzzles of municipal debt is governments' remarkable tendency to abide by their obligations.⁶⁶ While the parade of horrors mentioned in the Introduction—or, for that matter, newspaper headlines from the last few years—may indicate otherwise,⁶⁷ cases of cities defaulting are rare in modern times.⁶⁸ The three rating agencies calculate the

compel the levying of authorized taxes. The experience of the two modern periods of municipal defaults, after the depressions of [18]73 and [18]93, shows that the right to enforce claims against the city through mandamus is the empty right to litigate.”).

61. 11 U.S.C. § 303 (2012) (authorizing an involuntary bankruptcy case against a debtor).

62. While there were 941 pre-Depression defaults on municipal bonds, 678 municipalities defaulted in 1932 alone, and in 1935, 3251. MONKKONEN, *supra* note 16, at 25.

63. 11 U.S.C. §§ 901–946.

64. Some states enacted general authorization for their municipalities to enter bankruptcy. Elsewhere municipalities must seek permission before entering bankruptcy. Anderson, *supra* note 20, at 1152.

65. Schragger, *supra* note 21, at 876.

66. *Id.* at 874.

67. E.g., IRIS J. LAV & ELIZABETH McNICHOL, CTR. ON BUDGET & POLICY PRIORITIES, MISUNDERSTANDINGS REGARDING STATE DEBT, PENSIONS, AND RETIREE HEALTH COSTS CREATE UNNECESSARY ALARM: MISCONCEPTIONS ALSO DIVERT ATTENTION FROM NEEDED STRUCTURAL REFORMS 2 (2011), <http://www.cbpp.org/research/misunderstandings-regarding-state-debt-pensions-and-retiree-health-costs-create-unnecessary> (“Despite frequent media speculation to the contrary, we do not expect the level of defaults in the U.S. public finance market to spiral higher or even approach those in the private sector.”); see also *supra* notes 17–19 and accompanying text.

68. Between 1976 and 2008, only 30 municipal bankruptcies occurred. Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351, 359 (2010). Often, even in bankruptcy, municipalities honor bond obligations. For example, California's San Jose Unified School District, filing for bankruptcy in 1983, specifically preserved its bond debt. Tonya Chin, *California GOs Different—and Stronger—Than Detroit's*, BOND BUYER (Mar. 20, 2014), http://www.bondbuyer.com/issues/123_55/california-gos-different-226128-and-stronger-226128-than-detroit-1060904-1.html. The Sierra Kings Health Care District, California, filing in 2009, also made payments on its debt. *Id.* More recently, in the Central Falls, Rhode Island, bankruptcy, bondholders were fully protected. Maria O'Brien Hylton, *Central Falls Retirees v. Bondholders: Assessing Fear of Contagion in Chapter 9 Proceedings*, 59 WAYNE L. REV. 525, 529 (2013).

municipal default rate at less than one-third of 1%,⁶⁹ a rate notably lower than that of private corporations.⁷⁰ Even as it downgraded Chicago's bonds in May 2015 to junk grade—an exceptionally rare grade for local debt—⁷¹ the rating agency Moody's clarified that it does not expect the city to default or declare bankruptcy. Noting past municipal experiences, the agency stressed that it predicted “only a relatively small risk of default.”⁷²

Consequently, municipal bonds are appealing investment vessels even for the most cautious investors. As data from the Federal Reserve shows, households own the vast majority of such debt.⁷³ And since municipal debt is such an attractive investment, investors do not charge municipalities particularly high interest rates. Interest payments are a small fraction of local spending: between 4% and 5%.⁷⁴

Debt's low market pricing, coupled with the other reasons for municipal borrowing, render localities eager issuers of debt. But, even though the extensive and robust market for local bonds presents these localities with no hindrance,⁷⁵ their capacity to act on their inclination to borrow is still limited—by law.

B. LOCAL DEBT'S LEGAL LIMITS

While the market is mainly sanguine about municipal bonds, the law is largely skeptic. All states other than Tennessee restrict the municipal power to issue debt.⁷⁶ Mostly in state constitutions, but sometimes in statutes, states place a cap on the amount of debt a municipality may assume, or set special procedures for debt issuance.⁷⁷ A constitutional or statutory cap may be in the

69. Chris Hoene, *Crying Wolf about Municipal Defaults*, CITIESPEAK (Dec. 22, 2010), <http://cityspeak.org/2010/12/22/crying-wolf-about-municipal-defaults>.

70. Joel Seligman, *The Obsolescence of Wall Street: A Contextual Approach to the Evolving Structure of Federal Securities Regulation*, 93 MICH. L. REV. 649, 699 (1995) (noting that between 1983 and 1988 the municipal bond default rate was 0.7%, while the corporate bond rate was 1.1%).

71. Alexis Stephens, *A Quick Guide to What Moody's Ratings Mean for City Governments*, NEXT CITY (June 30, 2015), <https://nextcity.org/daily/entry/city-bond-ratings-moodys-what-they-mean>.

72. MOODY'S INVESTORS SERVICE, CITY OF CHICAGO: FREQUENTLY ASKED QUESTIONS: THE CITY OF CHICAGO AND RELATED CREDITS 4 (2015).

73. SIFMA, HOLDERS OF U.S. MUNICIPAL SECURITIES (updated 2016), <http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/Municipal-US-Municipal-Holders-SIFMA.xls> (summarizing the data).

74. LAV & McNICHOL, *supra* note 67, at 10.

75. David Gamage & Darien Shanske, *The Trouble with Tax Increase Limitations*, 6 ALB. GOV'T L. REV. 50, 65 (2013).

76. Tennessee merely sets a maximum term of 40 years for loans. TENN. CODE ANN. § 9-3-103 (West 2016). A 1986 statute explicitly states that local bonds are unlimited. *Id.*

77. Twenty states have statutory—not constitutional—restrictions. ALASKA STAT. ANN. § 29.47.190 (2015); CONN. GEN. STAT. ANN. § 7-374 (West 2012); DEL. CODE ANN. tit. 22, § 106 (2015); 65 ILL. COMP. STAT. ANN. 5/8-5-1 (2014); KAN. STAT. ANN. § 10-308 (West 2016); LA. STAT. ANN. § 39:746 (2015); ME. REV. STAT. tit. 30-A, § 5702 (2016); MASS. GEN. LAWS ch. 44, § 10 (2015); MICH. COMP. LAWS ANN. § 117.4a (West 2016); MINN. STAT. § 475.53 (2016); MISS. CODE ANN. § 21-33-303 (West 2016); MONT. CODE ANN. § 7-7-4201 (West 2015); NEB. REV. STAT.

form of an absolute figure, say \$5,000, of maximum debt.⁷⁸ More commonly, however, it is a relative figure: a certain percentage, say 2%, of the assessed valuation of taxable property in the issuing municipality.⁷⁹ In some states that prescribed maximum percentage varies in accordance with the local government's type,⁸⁰ population size,⁸¹ or the debt's purpose.⁸² Constitutional or statutory special procedures for debt issuance require a city to gain local voters' approval via referendum whenever it issues debt,⁸³ sometimes by supermajority.⁸⁴ The two forms of limitation can be combined: a constitutional or statutory provision may allow cities to freely assume debt up to a certain cap, but once that cap is surpassed, require voter approval,⁸⁵ or it may require a referendum on every debt issuance while still capping debt's overall amount.⁸⁶ Two states adopted an approach harsher still: Arkansas forbids local debt altogether,⁸⁷ and North Carolina insists on a state-level commission's permission for any local debt issuance.⁸⁸

The normative worth of these various restrictions on local debt is this Article's main concern. But their value can only be ascertained—as it will in Part III—after their specific charge is isolated. Misunderstandings abound respecting both the effects of local debt limits, and the kind of local activities they govern.

ANN. § 14-525 (2015); N.H. REV. STAT. ANN. § 33:4 (2016); N.J. STAT. ANN. §40A:2-6 (West 2015); N.Y. LOCAL FIN. LAW § 104.00 (West 2016); N.D. CENT. CODE § 21-03-04 (2015); OHIO REV. CODE ANN. § 133.05 (West 2015); 45 R.I. GEN. LAWS § 45-12-2 (2016); VT. STAT. ANN. tit. 24, § 1762 (2016).

78. OR. CONST. art. XI, § 10.

79. IND. CONST. art. XIII, § 1; *see also, e.g.*, HAW. CONST. art. IV, § 13 (15%); N.M. CONST. art. IX, § 13 (4%); W. VA. CONST. art. X, § 8 (5%); KAN. STAT. ANN. § 10-308 (30%); ME. REV. STAT. tit. 30-A, § 5702 (7.5%).

80. WYO. CONST. art. XVI, § 5 (authorizing 4% for city or town, 2% for county, 10% for school district).

81. KY. CONST. § 158 (authorizing 10% for cities of 15,000 or more; 5% for cities less than 15,000 but more than 3,000; and 3% for cities less than 3,000).

82. CONN. GEN. STAT. § 7-374 (2015).

83. *E.g.*, FLA. CONST. art. VII, § 12.

84. *E.g.*, CAL. CONST. art. 16, § 18(a) (two-thirds majority); IDAHO CONST. art. VIII, § 3 (same).

85. ARIZ. CONST. art. IX, § 8 (requiring voter approval for debt exceeding 6% of property value and setting an upper limit of 15%); WASH. CONST. art. VIII, § 6 (allowing debt up to 1.5% of taxable property, requiring approval by three-fifths of voters for debt beyond that, setting an outer cap of 5%).

86. *See e.g.*, MO. CONST. art. VI, § 26(b) (voters may approve debt up to an amount not to exceed 5% of the value of taxable property); OKLA. CONST. art. X, § 26 (requiring three-fifths majority vote and limiting debt to 5%).

87. ARK. CONST. art. XII, § 4. In 2000 an exception was introduced: short-term debt for prescribed purposes. *Id.* amend. LXXVIII, § 2. Debt guaranteed by a project's revenue fees is allowed. *Id.* amend. LXV.

88. N.C. GEN. STAT. ANN. § 159-51 (2000). The state also enforces an 8% cap, and a referendum requirement. *Id.* § 159-55; *see also* N.C. CONST. art. V, § 4. Other states requiring such approval do so only for debt exceeding limits. KY. REV. STAT. ANN. § 66.310 (2006); R.I. GEN. LAWS ANN. § 45-12-11 (2009).

As to their effect, it is important to understand that debt restrictions—of the cap as well as of the referendum variety—are not concerned with instituting optimal debt levels.⁸⁹ They are not geared towards *optimizing* debt levels; by design, they are blunt tools for simply *limiting* debt levels.

Numerical caps enshrined in constitutions or statutes are inevitably arbitrary,⁹⁰ and as historical artifacts, they are devoid of any pretenses at economic rationality.⁹¹ Further difficulties are generated by most caps' reliance on taxable property valuations, since localities employ dubious methods in assessing property values.⁹² Finally, even if the figure picked for the cap is rational and the property valuations are accurate, a cap tied to property valuations cannot reflect a municipality's need for debt—which is an inescapably relevant consideration when setting optimal debt levels.⁹³

For their part, referendum requirements do not even purport to nudge governments towards optimal debt levels. Mandatory elections should decrease debt's amount—by adding another hurdle to its assumption—but there is no reason to believe that voters are capable of determining desirable debt levels.⁹⁴ Referenda are particularly unqualified for such an assignment since they tend to be dominated by voters invested in the specific proposition.⁹⁵ Moreover, individual referenda enshrine piecemeal decision-making, the antithesis of the comprehensive budgeting necessary for rational public financing.⁹⁶

Thus the tools American law employs to regulate municipal debt are unrefined; they simply limit debt. The crudeness of their function is augmented by the fact that they do not limit all debt, only debt as they define it. Courts have recognized at least three distinctions that reduce the number of financial activities falling under the legal, rather than common, notion of local debt, and thus covered by debt limits.

First, debt limitations only apply to obligations defined as literal “debt,” not necessarily to financial structures equivalent to debt.⁹⁷ Long-term leases offer an extreme example. Under such arrangements, a developer builds a public facility, and then the city enters a long-term lease with her at a rent

89. See ROBERT S. AMDURSKY ET AL., *MUNICIPAL DEBT FINANCE LAW: THEORY AND PRACTICE* 309 (2d ed. 2013).

90. LENOX L. MOAK & ALBERT M. HILLHOUSE, *CONCEPTS AND PRACTICES IN LOCAL GOVERNMENT FINANCE* 274–80 (1975).

91. AMDURSKY ET AL., *supra* note 89, at 311.

92. See BRIFFAULT & REYNOLDS, *supra* note 23, at 666–72.

93. AMDURSKY ET AL., *supra* note 89, at 311.

94. See Clayton P. Gillette, *Direct Democracy and Debt*, 13 J. CONTEMP. LEGAL ISSUES 365, 372–75 (2004).

95. See *id.* at 385.

96. MOAK & HILLHOUSE, *supra* note 90, at 280.

97. This attitude deviates from practices in other fields. For example, courts recognize “equitable mortgages”: non-mortgage arrangements treated as mortgages due to their economic nature. See JOSEPH WILLIAM SINGER, *PROPERTY LAW: RULES, POLICIES, AND PRACTICES* 567 (5th ed. 2010).

sufficient to pay the developer's costs and allow her to make a profit.⁹⁸ The city thus receives a lump sum today (the construction costs) and pays it back with a premium, over time. Normally, such deals would be dubbed loans. Still, many courts have held that such agreements are not literally "debt" and thus are not subject to debt limits.⁹⁹

Second, for debt limits to apply, the obligation need not only be "debt," it must be "general-revenue debt," i.e., debt guaranteed by the city's property taxes.¹⁰⁰ Thus, most courts hold that debt payable from a dedicated revenue source—a "special fund"—does not constitute "debt" subject to limits.¹⁰¹ Consequently, if a city borrows to fund a project—a highway—and dedicates the project's future revenues—the highway tolls—to the debt's repayment, that debt will not be limited.

Third, debt limits apply only to general-revenue bonds issued by the individual municipality—not to all general-revenue bonds issued by entities associated with it. That is, the limits are mostly unconcerned with overall debt burdens,¹⁰² zeroing in on the debt of an individual legal entity instead. Thus a local government seeking to evade, or at least expand, its debt limit can create a 'new' jurisdiction, in the form of a special district (e.g., a housing authority or water district) and have that jurisdiction—which it fully controls—issue the debt.¹⁰³ In many states, the debt of such a jurisdiction is not subject to limits.¹⁰⁴ Even where it is, each jurisdiction enjoys a separate

98. See generally *Dieck v. Unified Sch. Dist. of Antigo*, 477 N.W.2d 613 (Wis. 1991) (holding that a school district that disbursed \$500,000 out of its general fund to use as a payment under a lease purchase agreement did not incur "indebtedness" and thus could not have assumed "debt" in excess of what was allowable under Wisconsin's Constitution and other laws).

99. See, e.g., *id.* at 619; *Jennings v. City of Kansas City*, 812 S.W.2d 724, 734 (Mo. Ct. App. 1991). But see *Montano v. Gabaldon*, 766 P.2d 1328, 1329–30 (N.M. 1989).

100. E.g., *Ziegler v. Witherspoon*, 49 N.W.2d 318, 326 (Mich. 1951) (holding that restrictions only apply to general obligations pledging government's faith and credit); *Gronberg v. Teton Cty. Hous. Auth.*, 247 P.3d 35, 46 (Wyo. 2011) (holding that debt limitation applies only if the debt is secured by property tax revenues).

101. E.g., *Op. of the Justices*, 49 So. 2d 175, 181–82 (Ala. 1950) (holding that bonds are not "indebtedness of the municipality" when payable through revenues from facilities' lease or sale); *State ex rel Atkinson v. Planned Indus. Expansion Auth. of St. Louis*, 517 S.W.2d 36, 47 (Mo. 1975) ("If the obligation to be incurred is payable solely from income derived from the operation of the proposed improvement, the obligation is not considered to be debt of the city within the meaning of the constitutional restrictions." (citation omitted)). The doctrine originated in *Winston v. City of Spokane*, 41 P. 888, 889 (Wash. 1895).

102. Connecticut adopted the alternative approach, limiting the aggregate debt of all municipalities coterminous with one town. CONN. GEN. STAT. ANN. § 7-374 (West 2012).

103. On special districts' creation, see Nadav Shoked, *Quasi-Cities*, 93 B.U. L. REV. 1971, 1979 (2013).

104. E.g., *Fitzgerald v. Walker*, 17 S.W. 702, 705 (Ark. 1891) (declining to characterize a special district as municipal corporation subject to a constitutional debt prohibition); *Walinske v. Detroit-Wayne Joint Bldg. Auth.*, 39 N.W.2d 73, 81 (Mich. 1949) ("Inasmuch as the bonds proposed to be issued by the [special district] are not faith and credit obligations of its incorporators [(the City of Detroit and Wayne County)], they need not be voted on by the electorate, nor are they subject to the debt limitations of the municipalities."); *Boardman v. Okla.*

cap, and hence the new jurisdiction doubles the establishing municipality's debt limit.¹⁰⁵

Thus the effect of current laws dealing with municipal debt issuance is to limit (i.e., not optimize) levels of general-revenue debt assumed by a specific municipality (i.e., not all debt). The restrictions do inevitably lower the amount of general-revenue bonds cities issue.¹⁰⁶ But, also inevitably, because municipalities can circumvent restrictions through disparate legal tools (leases, non-general-revenue bonds, and new jurisdictions), they do not necessarily decrease overall debt.¹⁰⁷

Regardless, the limits are costly. Inescapably, they sometimes block localities from accessing requisite credit since in certain instances a desired loan cannot be converted into non-general-revenue debt.¹⁰⁸ Even when they do not block access to credit—since the desired loan can be converted into non-general-revenue debt—the limits' continual and ineluctable impact on that credit's form inflicts grave harms on American local governance.¹⁰⁹ By diverting local efforts at revenue raising towards less straightforward measures for borrowing, debt limits force governments to pay higher interest rates,¹¹⁰ generate administrative expenses,¹¹¹ give birth to deals suboptimally structured from a public finance perspective,¹¹² spur local fragmentation,¹¹³ and incentivize governments to assume their debt through unfunded pension obligations.¹¹⁴ These costs of debt limits are real, but they might be justified if the limiting of the general-revenue debt of individual legal entities is

City Hous. Auth., 445 P.2d 412, 416 (Okla. 1968) (observing that special districts “are not political corporations or subdivisions of the State as those terms are used” in the constitutional provision imposing debt limitations).

105. See generally *Nelms v. Stephens Cty. Sch. Dist.*, 39 S.E.2d 651 (Ga. 1946); *Noble v. Yancey*, 241 P. 335 (Or. 1925).

106. Briffault, *supra* note 10, at 925.

107. James C. Clingermayer & B. Dan Wood, *Disentangling Patterns of State Debt Financing*, 89 AM. POL. SCI. REV. 108, 116 (1995).

108. Thus data shows that the limits do somewhat impact debt levels. Paul G. Farnham, *Re-Examining Local Debt Limits: A Disaggregated Analysis*, 51 S. ECON. J. 1186, 1198 (1985).

109. Briffault, *supra* note 10, at 926–27.

110. BENJAMIN RATCHFORD, AMERICAN STATE DEBTS 514 (1966) (explaining that since general-revenue bonds are less risky, creditors charge higher interest rates for non-general-revenue bonds).

111. Isabel Rodriguez-Tejedo & John Joseph Wallis, *Fiscal Institutions and Fiscal Crises, in WHEN STATES GO BROKE: THE ORIGINS, CONTEXT, AND SOLUTIONS FOR THE AMERICAN STATES IN FISCAL CRISIS* 9, 24–25 (2012).

112. E.g., THOMAS R. PEGRAM, PARTISANS AND PROGRESSIVES: PRIVATE INTEREST AND PUBLIC POLICY IN ILLINOIS, 1870–1922, at 94 (1992) (concluding that as early as 1906, limits on Chicago's general indebtedness wreaked havoc with its finances); Gamage & Shanske, *supra* note 75, at 68 (noting that long-term leases for debt limits avoidance are more expensive than debt financing).

113. Special districts are created to circumvent restrictions. Beverly S. Bunch, *The Effect of Constitutional Debt Limits on State Governments' Use of Public Authorities*, 68 PUB. CHOICE 57, 68 (1991).

114. On unfunded local pension obligations, see generally Amy B. Monahan, *Statutes as Contracts? The “California Rule” and Its Impact on Public Pension Reform*, 97 IOWA L. REV. 1029 (2012).

beneficial enough. Thus before judgment is passed on their desirability, the limits' normative end must be identified and assessed. That is, of course, this Article's main endeavor.

C. LOCAL DEBT'S LEGAL LIMITS' HISTORY

A natural starting point for an attempt to isolate debt limits' normative end is their history. During the first decades following Independence, states did not limit municipalities' ability to raise funds. Indeed, the right to issue debt was an essential feature of an incorporated city.¹¹⁵ In those early years, however, states, not cities, were the most active governments—in spending and in borrowing.¹¹⁶ Following the dazzling success of New York's Erie Canal, connecting New York City and the Great Lakes,¹¹⁷ many states entered extensive, and risky, economic development undertakings funded through loans.¹¹⁸ Often ill-advised to begin with, many never came close to delivering on their promise, and the deep recession of the late 1830s triggered a succession of state defaults.¹¹⁹ Following the financial crisis of 1837, Arkansas, Louisiana, Pennsylvania, Maryland, Indiana, Illinois, Michigan, Mississippi, and the Florida Territory defaulted on bonds.¹²⁰

While this dramatic collapse engendered surprisingly limited long-lasting financial effects,¹²¹ it generated enduring legal reforms. Intent on preventing a reoccurrence, states, starting with Rhode Island in 1842, amended their constitutions to limit their own ability to incur debt.¹²² These amendments did not, however, extend to municipalities,¹²³ and the results were predictable. Now that states were limited in their borrowing, municipalities stepped into the breach and embarked on a borrowing spree to fund lavish

115. MONKKONEN, *supra* note 16, at 21. Attitudes towards local powers shifted during the nineteenth-century, and by century's end they were dramatically constrained. A state enabling act was necessary for every local activity. Frug, *supra* note 14, at 1105–13. Thus the power to borrow is no longer inherent to local government. *Byer v. Rural High Sch. Dist.*, 219 P.2d 382, 387 (Kan. 1950). Rather, most localities have been accorded express legislative or constitutional authority to issue bonds. AMDURSKY ET AL., *supra* note 89, at 57.

116. States began heavily relying on debt for economic development around 1820. RATCHFORD, *supra* note 110, at 79–80.

117. The project situated New York City as the nation's major metropolis; construction debt was repaid within ten years. JOHN LAURITZ LARSON, *INTERNAL IMPROVEMENT: NATIONAL PUBLIC WORKS AND THE PROMISE OF POPULAR GOVERNMENT IN THE EARLY UNITED STATES* 78–79 (2001).

118. HENRY C. ADAMS, *PUBLIC DEBTS: AN ESSAY IN THE SCIENCE OF FINANCE* 329–31 (1887).

119. A. JAMES HEINS, *CONSTITUTIONAL RESTRICTIONS AGAINST STATE DEBT* 7 (1963).

120. WILLIAM A. SCOTT, *THE REPUDIATION OF STATE DEBTS* 226–28 (1893).

121. States that never repaid their mid-19th century debts were able to borrow at relatively reasonable rates 10 to 15 years later. William B. English, *Understanding the Costs of Sovereign Default: American State Debts in the 1840's*, 86 AM. ECON. REV. 259, 269–70 (1996).

122. RATCHFORD, *supra* note 110, at 121–22.

123. *Pattison v. Bd. of Supervisors*, 13 Cal. 175, 182–83 (Cal. 1859); *Comm'rs Leavenworth City v. Miller*, 7 Kan. 479, 479 (Kan. 1871); *Clark v. City of Janesville*, 10 Wis. 136, 137 (Wis. 1860).

infrastructure projects.¹²⁴ While in 1840 municipal indebtedness was estimated at only \$27 million, it had grown to almost \$850 million by 1880.¹²⁵ Unsurprisingly, by the final quarter of the century, municipal defaults were proliferating.¹²⁶ Prior to 1854 there had been only three municipal bond defaults in American history.¹²⁷ But the decades following 1870 witnessed spectacular defaults involving cities such as Memphis, Tennessee; Duluth, Minnesota; and Mobile, Alabama. Cities sometimes simply dissolved, or employed other legal techniques to renege on their liabilities.¹²⁸ Incredibly, approximately 20% of municipal debt in America was in default in 1873.¹²⁹

The adoption of limits for municipal debt swiftly followed. Beginning in the 1870s, most state constitutions were amended to include municipal debt caps or bond referenda requirements, as discussed in Part II.B.¹³⁰ Little can be discerned from the political dynamics leading to these reforms, as the process did not involve much explicit deliberation.¹³¹ Some historians surmise that the measures were inter-local, anti-competitive efforts put in place to benefit a state's more developed municipalities by limiting less developed municipalities' ability to raise capital in order to compete.¹³² Others argue that the limits were the product of intra-local competition between interest groups within cities.¹³³

The historical merits of these political accounts notwithstanding, they reveal little about the current normative or economic logic sustaining debt

124. See, e.g., OSCAR HANDLIN & MARY FLUG HANDLIN, *COMMONWEALTH* 211–12 (1969) (describing Massachusetts' municipalities loaning millions of dollars for the construction of a railroad).

125. John A. Dove, *Financial Markets, Fiscal Constraints, and Municipal Debt: Lessons and Evidence from the Panic of 1873*, 10 J. INSTITUTIONAL ECON. 71, 75 (2014).

126. Much of the era's local debt problems can be attributed to the inefficiencies and consequent failure of public involvement in rail projects. ALBERT HILLHOUSE, *MUNICIPAL BONDS* 152–54 (1936).

127. MONKKONEN, *supra* note 16, at 25.

128. Duluth reneged on its liabilities in 1874, when the legislature abolished it and replaced it with another entity (the "District of Duluth"), which conveniently lacked a chief executive and hence a person to be sued. *Brewis v. City of Duluth*, 13 F. 334, 335 (D. Minn. 1882). Memphis defaulted in 1879—the Tennessee legislature reorganized it as the "Taxing District for Shelby County" as a means to repudiate the debt. Though the Supreme Court found the new entity liable for those debts, *Meriwether v. Garrett*, 102 U.S. 472, 518 (1880), the model was then followed by Mobile (reorganized in 1879 as the "Port of Mobile." See *Mobile v. Watson*, 116 U.S. 289, 290 (1886)); see also MONKKONEN, *supra* note 16, at 81–85, 90–95 (discussing Duluth and Memphis respectively).

129. HILLHOUSE, *supra* note 126, at 39.

130. Iowa was the first to adopt a cap on local borrowing in the form of a percent—5%—of local taxable property in its constitution of 1857. MOAK & HILLHOUSE, *supra* note 90, at 275. By 1889, 32 states had constitutional constraints on municipal debt. Thirteen of those adopted the measure within five years after the 1873 panic. Dove, *supra* note 125, at 76–77.

131. For example, a book-length analysis of the political dynamics behind debt restrictions, can only rely on two short statements made in Illinois constitutional convention that adopted the restrictions (leaning, instead, on demographic data respecting the delegates and voters). MONKKONEN, *supra* note 16, at 49–51.

132. Mason H. Newell, *Township Government in Illinois*, 1904 ILL. STATE HIST. SOC. 467, 495.

133. MONKKONEN, *supra* note 16, at 8–18.

limits. Mostly the restrictions expressed not a reasoned contemplation of desirable fiscal policies but rather the era's reflexive indignation at spectacular cases of municipal default. But the later advent of municipal bankruptcy, in 1937, revolutionized municipal default's nature.¹³⁴ Today, unlike in the late 19th century, at times of crisis governments can restructure their liabilities through the federal judiciary rather than flat-out default. Thus the late 19th-century attitude towards mounting municipal defaults is not particularly pertinent for current legal and economic realities.¹³⁵ To explain debt limits' persistence we cannot sidestep the challenge of developing our own normative theories taking modern realities into account. The next Part turns to that vital task.

III. DEBT LIMITS LAW'S NORMATIVE ENDS

Born of the specific circumstances of the late nineteenth-century, restrictions on the issuance of municipal general-revenue bonds interfere with a tool that remains vital for government funding. The interference, as seen, occasions undeniable costs. Does it bear offsetting benefits? The history of debt limits indicates that they were established to prevent governments from failing to repay debts. But why are such preventative measures necessary? Borrowers—individuals, corporations, or any other entity—always represent a certain risk of default, but the law leaves this risk to the market to regulate through pricing. A borrower deemed at risk of failing to repay would be charged higher interest rates. Lenders might spurn her altogether. But for its part, the law generally does not foreclose an aspiring borrower's freedom to borrow, just because she is risky.¹³⁶

American law's choice to specifically intrude on municipal borrowing thus cries out for explanation. The intrusion's end ought to be uncovered. A coherent account of that end must explain what entity or interest is served by

134. See *supra* notes 62–64 and accompanying text.

135. The California Supreme Court similarly explained that the history surrounding the adoption of the state's municipal debt restriction is unhelpful for normatively justifying it today. The court highlighted transformations in municipal debt markets rendering outdated fears of uncontrollable borrowing that had animated nineteenth-century thinking. *Westbrook v. Mihaly*, 471 P.2d 487, 492–97 (Cal. 1970).

136. Certain banks represent an exception. Under the Dodd–Frank Wall Street Reform and Consumer Protection Act, the Federal Reserve is required to impose a maximum “debt to equity ratio of no more than 15 to 1” for banks that are determined to be “a grave threat to the financial stability of the United States.” 12 U.S.C. § 5365(j)(1) (2012). The applicability of this rationale to municipal debt limits will be discussed in Part III.E. The Federal Deposit Insurance Corporation enforces further capital requirements on banks accepting deposits, 12 C.F.R. § 325.103 (2016), since, as the insurer of deposits, it holds a stake in their viability. 12 U.S.C. § 1815. Governmental insurance indirectly affects the pricing of loans to risky borrowers elsewhere as well. Thus, for example, the Federal Housing Administration will only insure loans with low down payments if they are issued to borrowers that meet minimal credit rating requirement. 12 U.S.C. § 1709. The absence of governmental insurance inevitably increases the price of credit available to ineligible borrowers.

these limits placed uniquely on municipal borrowing, and why that entity or interest merits this extraordinary service. Judges and writers have suggested several such accounts in the past, of which some have acquired the status of almost dogma. Surprisingly, however, commentators have mostly failed to put these accounts of the limits' ends to test. This Part will scrutinize each of the conventional accounts and suggest still others. With respect to each account, I will first review the argument it offers for justifying debt limits, and then present the argument's flaws or limitations.

The accounts are ordered here in a sequence whereby each represents an attempt to address flaws detected in accounts already reviewed. Thus although the first account to be explored—that debt limits serve lenders and cities' joint interests—is not the most prevalent in the literature, it furnishes a useful launching-pad for the discussion. Its basic flaw sheds light on the one key requirement that any attempt at a persuasive portrayal of debt limits' end must satisfy. As will be explained, an effective explanation must single out a third party, external to the debt deal—i.e., not the lender or city—that warrants protection from the debt deal's effects. Accordingly, the four explanations that are reviewed subsequently, counting among them those most commonly cited by judges and writers, identify different external entities allegedly threatened by a city's debt: residents, future residents, the federal government, and state governments. Unfortunately, as popular as several of these justifications are, they are all, as shall be shown, illusory. Some of the entities they present as aided by debt restrictions are never actually harmed by municipal debt; those that may be harmed by debt cannot be protected through debt limits. Since existing accounts thus do not bring forward an entity whose effective protection could serve as debt limits' end, this Part's final Subpart develops a new account that does. The sole entity that does incur costs when local debt is issued, from which it can be shielded through debt limits, is peer municipalities. This innovative account characterizing debt limits' end as protecting peer municipalities is not flawed—unlike the preceding accounts—although it is, as will be established, subject to severe limitations.

A. *DEBT LIMITS AS MEASURES TO PROTECT MUNICIPALITIES AND LENDERS' JOINT INTERESTS*

1. The Argument

The quest to find the entities that are protected by debt limits and thus provide those limits with an end logically begins with the transacting parties themselves. The parties to the debt deal are the lending investor and the borrowing city, and according to one normative argument, both these parties desire the limits—which are therefore socially beneficial. The lender desires the limits since they provide her protection, while the borrowing city supports them since they provide it reduced borrowing costs.

For a lender, the risk inherent to any loan is the chance the borrower will be unable to repay. That chance increases the more debt a borrower amasses since additional debt means that the borrower will eventually have to repay more funds.¹³⁷ Later creditors can protect themselves—by refusing to issue credit to an over-leveraged entity—but early lenders find themselves in a precarious position.¹³⁸ The entity applying for their loan may be debt-free now, but it may seek more credit from others later. Thus these lenders desire protection against further, future, debt their debtor might assume. State laws satisfy this desire through debt limits—which allow lenders to more easily predict the amount of additional debt a city may acquire.

By thereby allaying lenders' queasiness, the limits also serve the borrowing city. For the borrowing city, credit's most pertinent feature is its cost. Credit's cost, charged through interest rates, is determined by the risk inherent to the loan. Since, as noted, that risk swells in tandem with the borrower's debt burden, research shows that as a government's debt load increases the interest rates it is charged climb.¹³⁹ It follows that interest rates decrease if the overall debt the government may assume is limited. Studies have indeed determined that debt limits hold down the interest rates creditors exact.¹⁴⁰

Therefore, although they restrict city power, debt limits serve the city's own interests. Writers portray them as "pre-commitment" mechanisms the city uses to tie its own hands to thwart the costs its weak-will might generate.¹⁴¹ "In

137. E.g., Kate Litvak, *Defensive Management: Does the Sarbanes-Oxley Act Discourage Corporate Risk-Taking?*, 2014 U. ILL. L. REV. 1663, 1670 (2014) (employing debt level as a proxy for risk).

138. Arguably, even later debtors are faced with a problem, due to an information asymmetry. Unlike the borrower herself they do not necessarily have ready access to information respecting the borrower's finances. See generally Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393 (1981) (providing a famous exploration of the problem). Thus they must incur costs in investigating the amount of debt a specific debtor holds. Debt limits—albeit solely those taking the form of a cap—can be seen as a tool aiding them in this task by setting a standard maximum debt for all debtors. Yet their effectiveness in this regard is highly limited, as they do not reveal the specific level of the municipality's debt. Hence the services of the rating agencies, as described in Part II, are vital and cannot be replaced by debt limits.

139. See Goldstein & Woglom, *supra* note 48, at 246–49; see also Tamim Bayoumi et al., *Do Credit Markets Discipline Sovereign Borrowers? Evidence from U.S. States*, 27 J. MONEY, CREDIT & BANKING 1046, 1057 (1995); John Capeci, *Credit Risk, Credit Ratings, and Municipal Bond Yields: A Panel Study*, 44 NAT'L TAX J. 41, 54 (1991) [hereinafter *Credit Risk*]; John Capeci, *Local Fiscal Policies, Default Risk, and Municipal Borrowing Costs*, 53 J. PUB. ECON. 73, 87 (1994) [hereinafter *Local Fiscal Policies*].

140. Goldstein & Woglom, *supra* note 48, at 246–49 (finding that "a state with an 'average' set of constitutional limitations . . . pays 5 basis points more than a state with the most restrictive set of limitations"). Not all researchers have reached this conclusion. See James M. Poterba & Kim Rueben, *State Fiscal Institutions and the U.S. Municipal Bond Market*, in FISCAL INSTITUTIONS AND FISCAL PERFORMANCE 181, 197, 204 (James M. Poterba & Jurgen von Hagen eds., 2008) (finding that debt limits' effect on borrowing costs is weak).

141. John A. Robertson, "Paying the Alligator": *Precommitment in Law, Bioethics, and Constitutions*, 81 TEX. L. REV. 1729, 1730 (2003); see also generally JON ELSTER, ULYSSES UNBOUND

short, debt limits may be the public law equivalent of an individual who locks the refrigerator to keep from eating too much or who leaves credit cards at home when going shopping in order not to buy too much.”¹⁴² Thus, debt limits promote the joint interests of both parties to the debt transaction—the borrowing municipality and lending investor—and hence they require no further justification: they need not be associated with any independent normative end.

2. The Argument's Flaw

But if both parties desire debt limits, as this account contends, why must the state—rather than the borrowing municipality and the lending investor themselves—impose them through law? The portrayal of debt limits as “tying,” or “pre-commitment,” devices ignores the fact that debt limits are legal injunctions imposed from above on two parties otherwise willing to transact. This attribute of the limits, and its ramifications, undermine the argument conceiving the promotion of the parties' own preferences as the limits' normative end.

Writers ascribing to the “pre-commitment” device account of debt limits conflate limits on municipal debt with limits on state debt. Both are imposed by the state, but, and as a result, only limits on state debt are self-imposed. This misunderstanding breeds a misreading of empirical findings. Studies indicating that limits on governmental debt lower borrowing costs have examined self-imposed limits—limits enacted by the borrowing government itself.¹⁴³ As these studies' authors stress, the conclusion derived cannot be presumed to hold in the distinct case of limits imposed on the government from above—the case of interest here.¹⁴⁴

There is good reason for such hesitation. A wide gulf stretches between the effects of a self-imposed restriction and those of an externally dictated one. Self-imposed limits are faithful reproductions of the parties' desires. When creditors desire that their borrower commit to certain limitations in exchange for credit's award at reduced interest, those limitations are inserted into the loan agreement.¹⁴⁵ Loans thus sometimes contain restrictions on further indebtedness, and such debt limits, chosen and designed by the individual creditor, reflect her preferences.¹⁴⁶

(2000) (examining pre-commitment devices' benefits).

142. AMDURSKY ET AL., *supra* note 89, at 209.

143. The exception is one study exploring debt limits' adoption in the 1870s to 1880s. Dove, *supra* note 125, at 97. The study's findings are somewhat dubious (e.g., it finds that municipalities were charged lower interest rates in states barred from repaying defaulting municipalities' debts). Regardless, in light of credit markets' transformation since those early times, explained in Part II, they cannot be applied today.

144. Goldstein & Woglom, *supra* note 48, at 253–54.

145. For example, they may insist their claims constitute senior debt. Capeci, *Local Fiscal Policies*, *supra* note 139, at 76.

146. E.g., Jonathan Eaton & Mark Gersovitz, *Debt with Potential Repudiation: Theoretical and*

Limits imposed by an outside entity rarely reflect those preferences. They constrain the borrower's financing flexibility even if that flexibility is advantageous for the creditor. By checking debt-raising options, debt limits foreclose on a borrower's freedom in reacting to downturns.¹⁴⁷ Such freedom is sometimes beneficial for the creditor, who, if the indebted government cannot straighten up its finances, is at risk of complete loss of her investment.¹⁴⁸ Creditors thus often support debtor adaptability at troubled times.¹⁴⁹ Yet, regardless of their preferences, creditors can never free their debtor from state-imposed debt limits.

The debtor city is, of course, equally powerless in face of the state-imposed limits. The limits do not reflect its preferences: had the city desired them, it would have adopted them itself.¹⁵⁰ But the limits are not a product of local law—they are a product of state law.¹⁵¹ Thus they are not the public-law equivalent of the individual locking the refrigerator or leaving his credit cards at home.¹⁵² They are the public-law equivalent of an outsider—say a parent—locking the individual's refrigerator or confiscating his credit cards. The end of such a paternalistic device cannot be found in the market actor's own desires. It must be normatively justified as external interference with those desires.

External interferences in freely negotiated transactions may be justified when the transaction the parties will stands to affect other, external parties.¹⁵³ In credit transactions, regulation is accordingly introduced when the borrower and lender lack the ability or incentive to take into account the full risks or costs the debt portends.¹⁵⁴ Thus, to understand the law's specific interference in the market for municipal credit, we must discern risks or costs associated with municipal debt unfelt by the borrowing city and lending investor.

A coherent account of the end of limits imposed from above on local debt cannot, that is, be built around the desires of the transacting parties. It

Empirical Analysis, 48 REV. ECON. STUD. 289, 290, 304 (1981) (finding that creditors impose debt ceilings on governments perceived as judgment-proof).

147. Dennis Epple & Chester Spatt, *State Restriction on Local Debt: Their Role in Preventing Default*, 29 J. PUB. ECON. 199, 200–01 (1986). The problem intensifies since debt limits are often supplemented with tax limits removing another revenue-raising tool. Briffault, *supra* note 10, at 927–32.

148. See *supra* notes 53–60 and accompanying text.

149. E.g., Baird & Rasmussen, *supra* note 5, at 1214–23 (explaining that lenders desire, and gain through loan contracts, mechanisms to actively control a struggling borrower's decision-making to provide flexibility in its confrontation with funding problems).

150. E.g., CHATTANOOGA, TENN., CODE ORDINANCES § 6.107 (2016) (limiting the city's debt to 10% of assessed property valuation).

151. See *supra* Part II.B.

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

153. See, e.g., ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 227 (5th ed. 2007).

154. See, e.g., MARKUS K. BRUNNERMEIER ET AL., THE FUNDAMENTAL PRINCIPLES OF FINANCIAL REGULATION 22–23 (2009).

ought to suggest third parties whose interests are affected by the local government's decision to issue debt but who are not represented in the process prompting that decision. Each of the remaining potential ends attributed to debt limits, reviewed in the ensuing Subparts, tries to identify such a party.

B. DEBT LIMITS AS MEASURES TO PROTECT RESIDENTS

1. The Argument

The notion that debt limits' end must be to police governmental decisions' effects on third parties whose interests are ignored when those decisions are adopted aligns with the formal legal location of the limits and with their mode of operation. Restrictions on debt issuance are constitutional restraints placed on the political process: they constrain elected officials' powers.¹⁵⁵ Most other such constitutional checks are perceived as remedying a failure, or potential failure, of the political process.¹⁵⁶ The legislature is normally free to adopt laws since it expresses the desires of the affected citizens to whom its members are beholden.¹⁵⁷ Constitutional edicts interrupt this political process when it is likely to produce results unreflective of a balanced calculation of the citizenry's preferences. In such cases the constitutional impediment assures a more representative result.¹⁵⁸ Many analyze debt limits within this framework, identifying as their end the correction of a political failure: protecting citizen-residents from lawmakers' unrepresentative decisions.¹⁵⁹

These writers believe that debt decisions should be insulated from the political process—through debt limits—since officials are likely to opt to borrow funds despite local residents' opposition.¹⁶⁰ This alleged eventuality springs from the fusion of, on the one hand, voters' inadequate policing of local debt decisions, with, on the other hand, officials' partiality for debt.¹⁶¹

Voters are arguably prone to ineffectively monitor debt decisions due to the regimented nature of general elections and to debt's lack of salience in

155. See Eppler & Spatt, *supra* note 147, at 200.

156. *United States v. Carolene Prods. Co.*, 304 U.S. 144, 152 n.4 (1938).

157. See JOHN HART ELY, *DEMOCRACY AND DISTRUST* 75–77 (1980).

158. See Daryl J. Levinson, *Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs*, 67 U. CHI. L. REV. 345, 354–56 (2000) (explaining why government officials should not be expected to be voters' perfect agents).

159. *Westbrook v. Mihaly*, 471 P.2d 487, 494 (Cal. 1970) (explaining that the state's debt limit “was intended to compel local legislative bodies to inform the public of projects necessitating long-term expenditures and to give to the people the ultimate power of approving or rejecting them”); Schragger, *supra* note 21, at 866 (“[S]ince the nineteenth century, one of the central assumptions about the problem of state and municipal fiscal policy has been that democracy—at least in its majoritarian and representative forms—is a failure.”).

160. E.g., LENNOX L. MOAK, *MUNICIPAL BONDS: PLANNING, SALE, AND ADMINISTRATION* 114 (1982); Briffault, *supra* note 10, at 947–48; Gillette, *supra* note 94, at 372.

161. Vincent S.J. Buccola, *An Ex Ante Approach to Excessive State Debt*, 64 DUKE L.J. 235, 267 (2014).

those elections.¹⁶² When voting for mayoral or council candidates, a resident picks among bundled products: each candidate offers a menu of positions on varied issues.¹⁶³ The resident must vote for one candidate, though no candidate can perfectly reflect all the preferences that resident holds across the diverse fields of local action.¹⁶⁴ The resident must therefore compromise and settle for the candidate who, while not agreeable to her on all issues, shares her preferences on issues most salient for her. Debt, supposedly, is not salient enough to become a prominent campaign issue.¹⁶⁵ Hence residents are likely to support candidates not sharing their debt aversion, but sharing their preferences respecting other, more salient, policy issues, such as education, taxes, or zoning.¹⁶⁶

Thusly unsupervised by the electorate, officials are left free to act on their own debt predilections. These in turn tend, observers believe, to diverge from residents' tastes. As in all policy contexts, officials may fail to accurately gauge their constituents' tastes.¹⁶⁷ More worrisome, even if officials recognize residents' preferences, there are, commentators argue, two reasons to suspect that those officials would still abide by more pro-debt preferences that are more pro-debt than the residents' preferences.

One reason is that interest groups benefitting from debt wield disproportionate power, and hence their preferences register more with officials than those of the majority of residents. The financial industry profits from handling debt issuances.¹⁶⁸ More important, real estate developers, business concerns, and unions are major beneficiaries of the local spending debt enables.¹⁶⁹ Since these are highly powerful groups in local politics,¹⁷⁰ the legislative process is skewed toward excessive debt.¹⁷¹

162. *E.g.*, Saikrishna Prakash & John Yoo, *Against Interpretive Supremacy*, 103 MICH. L. REV. 1539, 1546–47 (2005) (explaining that elections are an inexact means to discern voter preferences).

163. AMDURSKY ET AL., *supra* note 89, at 312–13.

164. Gillette, *supra* note 94, at 372.

165. Briffault, *supra* note 10, at 948.

166. Gillette, *supra* note 94, at 372.

167. John G. Matsusaka, *Fiscal Effects of the Voter Initiative: Evidence from the Last 30 Years*, 103 J. POL. ECON. 587, 589 (1995).

168. The phrase “pay-to-play” originated in the municipal securities industry, where dealers and underwriters made campaign contributions to officials who in return diverted lucrative municipal underwriting business to them. Jon B. Jordan, *The Regulation of “Pay-to-Play” and the Influence of Political Contributions in the Municipal Securities Industry*, 1999 COLUM. BUS. L. REV. 489, 491. In 1994, the SEC adopted a rule prohibiting dealers from engaging in municipal bonds business with an issuer to whom they had made a contribution in the preceding two years. Self-Regulatory Organizations, Exchange Act Release No. 33868, 56 SEC Docket 1045 (Apr. 7, 1994).

169. Gillette, *supra* note 94, at 398–400.

170. PAUL PETERSON, CITY LIMITS 131–49, 182 (1981).

171. Sterk & Goldman, *supra* note 28, at 1365–66.

A second reason cited for the divergence of debt preferences between officials and residents is officials' own political interest in relying on debt.¹⁷² Debt stretches officials' power into the future: through debt, officials influence their successors' choices.¹⁷³ Moreover, debt affords officials immediate political advantages. With debt financing, officials bestow on voters visible, popularity boosting, achievements—improved infrastructure, better services, new public buildings¹⁷⁴—without charging voters for those amenities. As a mechanism to fund these public goods, debt is an alternative to higher taxes, which voters experience and resent.¹⁷⁵ Issuing debt enables the official to postpone payment for goods, and the attending hardship taxpaying voters endure.¹⁷⁶ By the time payment is due, the official might not be running for office.¹⁷⁷

Due to the factors reviewed—voters' tendency to refrain from insisting on their debt preferences when picking candidates, and elected officials' susceptibility to pro-debt groups and to debt's political allure—many predict a discrepancy between residents' and officials' debt preferences. To preempt this failing of the political process, constitutions cap officials' ability to borrow—thereby forcing them to assume the lower debt levels residents prefer—or require officials to attain residents' approval through debt referenda—thereby verifying that debt-related decisions meet voter preferences.¹⁷⁸ Read in this vein, debt limits are easily justified: their end is the end typical to constitutional decrees—protecting the public from an unaccountable and unchecked government.

2. The Argument's Flaw

This popular account is intuitively appealing; unfortunately, however, it has several fundamental defects. The first of its two key assumptions—that voters do not regulate officials' debt decisions—is questionable, and the second—that officials' and voters' debt preferences diverge—is faulty. Consequently, the argument collapses.

The argument that debt decisions originate in a political failure first assumes, as noted, that debt decisions are insufficiently salient to affect

172. DAVID HUME, *ESSAY ON PUBLIC CREDIT* 3–4 (1752) (“It is very tempting to a minister to employ such an expedient, as enables him to make a great figure during his administration, without overburdening the people with taxes, or exciting any immediate clamours against himself. The practice, therefore, of contracting debt, will almost infallibly be abused in every government.”).

173. Torsten Persson & Lars E.O. Svensson, *Why a Stubborn Conservative Would Run a Deficit: Policy with Time-Inconsistent Preferences*, 104 Q.J. ECON. 325, 326 (1989).

174. JOHN KENNETH GALBRAITH, *AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER* 194–95 (rev. ed. 1956).

175. Roin, *supra* note 39, at 1974.

176. David Gamage, *Preventing State Budget Crises: Managing the Fiscal Volatility Problem*, 98 CALIF. L. REV. 749, 761–62 (2010).

177. Briffault, *supra* note 10, at 947–48.

178. Gamage & Shanske, *supra* note 75, at 65–69.

voting.¹⁷⁹ But in actuality debt issuance is an exceptionally public act widely reported in the media.¹⁸⁰ Even where voters need not approve debt, newspapers closely monitor officials' decisions.¹⁸¹ Some states even require the annual auditing and publicizing of local finances.¹⁸² Unsurprisingly then, research shows that local debt burdens are an important part of the political discourse and that developments such as credit downgrades are politically costly for officials.¹⁸³ The assumption that debt lacks salience for voters is, therefore, at best debatable.

The second assumption upholding the argument that debt limits protect residents from officials—the assumption that left unchecked, officials' propensity to borrow misaligns with voters' preferences—is even more tenuous. The prevalent claim that officials, unlike voters, strongly prefer debt often conflates two distinct policy choices: the decision to spend funds and the decision to raise those funds through borrowing.¹⁸⁴

Officials are clearly biased toward spending projects as these present voters with tangible achievements. A new school, park, highway, or stadium spurs an official's popularity.¹⁸⁵ In reaping praise for such material improvements the official often benefits from voters' failure to register the improvements' price-tag.¹⁸⁶ This cognitive failing is predicted irrespective of the scheme devised for paying that price-tag. There might be reason to believe

179. *E.g.*, Briffault, *supra* note 10, at 955; Buccola, *supra* note 161, at 267–69.

180. *E.g.*, Doug Belden, *Vikings Stadium Bond Sale Delay May Have Led To Better Rate*, TWIN CITIES PIONEER PRESS (Jan. 28, 2014, 6:08 AM), <http://www.twincities.com/2014/01/28/vikings-stadium-bond-sale-delay-may-have-led-to-better-rate> (reporting in detail on interest rates, the different rate that could have been attained had another form of bonds been used, annual debt service costs, and legal and administrative issuance costs); Walter Hamilton, *Municipal Bonds Keep Rallying Despite Some Shaky Issuers*, L.A. TIMES (July 15, 2012), <http://articles.latimes.com/2012/jul/15/business/la-fi-municipal-bonds-20120715>; Michael A. Lindenberger, *NTTA Chairman Kenneth Barr Explains NTTA 'Pinch Point,' Says Private Investors May Be Tapped for Trinity*, DALL. MORNING NEWS (June 6, 2012, 12:30 AM), <http://transportationblog.dallasnews.com/2012/06/ntta-chairman-kenneth-barr-explains-ntta-pinch-point-says-private-investors-may-be-tapped-for-trinity.html> (interviewing a transportation official about the planned bond financing of a road); Mary Williams Walsh, *Borrowing to Replenish Depleted Pensions*, N.Y. TIMES: DEALBOOK (May 27, 2015), <http://www.nytimes.com/2015/05/28/business/dealbook/borrowing-to-replenish-depleted-pensions.html>.

181. *E.g.*, Heather Gillers & Hal Dardick, *Cash-Strapped Chicago Borrows at Rates Approaching 8 Percent*, CHI. TRIB. (July 17, 2015, 6:00 AM), <http://www.chicagotribune.com/news/ct-chicago-bond-issue-met-20150716-story.html>; Aaron M. Renn, Opinion, *Here's How Much Trouble Chicago Is In (But There's a Way Out)*, CRAIN'S CHI. BUS. (July 15, 2015), <http://www.chicagobusiness.com/article/20150715/OPINION/150719897/heres-how-much-trouble-chicago-is-in-but-theres-a-way-out> (detailing mechanisms of Chicago's planned bond issuance).

182. *E.g.*, FLA. STAT. § 218.32 (2015); N.C. GEN. STAT. § 159-34 (2015).

183. Rodden, *supra* note 45, at 133.

184. *See* Roin, *supra* note 39, at 1972–73.

185. James A. Robinson & Ragnar Torvik, *White Elephants*, 89 J. PUB. ECON. 197, 209 (2005).

186. David Haddock et al., *League Structure & Stadium Rent-Seeking—The Role of Antitrust Revisited*, 65 FLA. L. REV. 1, 12 (2013).

that if fully informed of its costs, residents will find a project unacceptable.¹⁸⁷ There is less reason to believe that if fully informed, they will find a scheme to fund those costs through borrowing less acceptable than a scheme involving increased taxation.

In fact, normally the assumption is the opposite. The same cause cited above for officials' supposed bias towards debt, is presumed to mold residents' preferences just as well. An official allegedly favors debt financing since the official spending the money today is not necessarily the official repaying it in the future. The voter-taxpayer is not different.¹⁸⁸ The voter-taxpayer benefiting from spending enabled through borrowing today is not necessarily the voter-taxpayer repaying the loan in the future.¹⁸⁹ Residents' preferences in this regard do not inevitably diverge from officials' preferences.¹⁹⁰

Since, therefore, the motivation predicted to engender an eagerness to issue debt among officials should similarly mark voters, overreliance on debt cannot be blamed on officials' unrepresentative eagerness to issue debt. This observation puts an end to the normative account of debt limits attributing them to a need to rectify a failure of the political process. Concurrently, however, it launches the next account. Debt limits' end cannot be the protection of residents from officials, as the two groups mostly share preferences—but maybe the limits' end is to protect others from these shared preferences.

C. DEBT LIMITS AS MEASURES TO PROTECT FUTURE RESIDENTS

1. The Argument

Political processes are skirted through constitutional restrictions such as debt limits, when, as noted, they do not fairly reflect the preferences of all those affected. Such oversight is likeliest if some of those impacted by the political process cannot politically participate.¹⁹¹ When individuals influenced

187. Thomas Romer & Howard Rosenthal, *Bureaucrats Versus Voters: On the Political Economy of Resource Allocation by Direct Democracy*, 93 Q.J. ECON. 563, 564 (1979) (explaining that officials may generate higher degrees of spending than median voter desires).

188. Richard C. Schragger, *Citizens Versus Bondholders*, 39 FORDHAM URB. L.J. 787, 790 (2012).

189. Some even argue that voters have an incentive to elect politicians more shortsighted than them respecting debt. Christian Schultz & Tomas Sjöström, *Public Debt, Migration, and Shortsighted Politicians*, 6 J. PUB. ECON. THEORY 655, 656–58 (2004).

190. 2 JAMES M. BUCHANAN, PUBLIC PRINCIPLES OF PUBLIC DEBT 120 (Liberty Fund 1999) (“[T]he individual when making his choice between the public debt–public expenditure and the no debt–no expenditure alternatives will always tend to favor the former over the latter. In such cases, the choice processes usually embodied in democratic institutions cannot be expected to provide correct decisions, upon any criterion of correctness. The individual chooser cannot fairly compare benefits and costs. . . . even if the decision making assumes the ideal or town-meeting form.”).

191. Martin Luther King, Jr., *Love, Law, and Civil Disobedience* in A TESTAMENT OF HOPE: THE ESSENTIAL WRITINGS OF MARTIN LUTHER KING, JR. 43, 49 (James Melvin Washington ed., 1986) (“[A]n unjust law is a code which the majority inflicts upon the minority, which that minority had

by city policies cannot vote, the city has no cause to consider their position when adopting those policies.¹⁹² One group of non-voters deeply impacted by certain city decisions is future residents.¹⁹³ Specifically, that group is negatively affected by the current city's decision to issue debt. Accordingly, the need to counter debt's externalities on this group is the end most commonly attributed to debt limits.¹⁹⁴

Inter-temporal externalities are inherent to debt.¹⁹⁵ Debt is money that the borrower receives and is free to use today, in exchange for a promise to return those funds (supplemented by interest) in the future. Today's borrower commits her future self to paying the lender, irrespective of her future self's needs and preferences.¹⁹⁶ When today's borrower is not necessarily the future debtor, this inter-temporal problem intensifies and turns inter-generational. This vexing characteristic distinguishes the city borrower from the individual borrower.¹⁹⁷

Though her needs and preferences might shift, the borrowing individual will remain the same person throughout the loan's life. The borrowing city is different. As a legal entity, the borrowing city's identity remains, almost always,¹⁹⁸ constant like that of the borrowing individual.¹⁹⁹ But the identity of

no part in enacting or creating, because that minority had no right to vote . . .").

192. ELY, *supra* note 157, at 135–36 (discussing political processes' failure when entrenched majorities ignore others' preferences).

193. Gillette, *supra* note 94, at 391–92.

194. See, e.g., AMDURSKY ET AL., *supra* note 89, at 207–08; William G. Bowen, *The Public Debt: A Burden on Future Generations?* 50 AM. ECON. REV. 701, 702 (1960); Roin, *supra* note 39, at 1972–73; Schultz & Sjöström, *supra* note 189, at 656–58; Serkin, *supra* note 29, at 906–07; Sterk & Goldman, *supra* note 28, at 1305–06.

195. Letter from Thomas Jefferson to James Madison in 3 THE WORKS OF THOMAS JEFFERSON 102, 104 (H.A. Washington ed., 1884) (“[T]he earth belongs to each of these generations during its course, fully and in its own right. The second generation receives it clear of the debts and incumbrances of the first, the third of the second, and so on. For if the first could charge it with a debt, then the earth would belong to the dead and not to the living generation.”).

196. On the resulting cognitive biases see Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1375 (2004) (discussing credit cards); and Eyal Zamir, *The Efficiency of Paternalism*, 84 VA. L. REV. 229, 267–75 (1998) (discussing forfeiture clauses).

197. Like any other individual or entity, a city may fall prey to imprudent decision-making, which is a particularly acute risk when assuming obligations to be repaid in the future. However, because in this respect the city is the equivalent of any other individual or entity, this problem cannot account for the special limits applied to city borrowing. It must be coupled with a peculiar agency problem.

198. A city can, sometimes, dissolve. But while the technique was used in the late nineteenth-century to avoid debt, see *supra* note 128 and accompanying text, it is no longer similarly employed. Michelle Wilde Anderson, *Dissolving Cities*, 121 YALE L.J. 1364, 1400–04 (2012).

199. Roti v. Washington, 450 N.E.2d 465, 473 (1983) (“[T]he City Council is a continuing body, the existence of which never ceases by reason of a change of membership. The continuing body concept serves as the useful legal fiction needed to accomplish such desirable public policy considerations as protecting the contract rights of persons who had contracted with the previous municipal body. . .”).

those the borrowing city serves and represents—the residents—does not.²⁰⁰ Residents benefitting from the spending a loan facilitates may move out of the city (to another city or another world) before the loan becomes due.²⁰¹ Consequently, current residents operate under a strong incentive to fund their spending through debt,²⁰² thereby externalizing their spending's costs onto others—onto future residents.²⁰³

Debt limits tame current residents' power to act on this selfish impulse. The limits' role of blunting the externality debt generates for future residents is thus almost consensually embraced as their end.²⁰⁴ Commentators and courts all rely on this rationale.²⁰⁵ As the leading treatise announces "the animating policy concerns behind constitutional debt limitations [is] balancing the competing priorities of current capital needs against the risk that future generations will be saddled with excessive debt . . . these concerns should continue to inform policymaking and institutional design in this area."²⁰⁶

Debt limits materialize as a vital tool to attenuate, if not quite solve, the inter-generational tension debt portends for municipalities. Their purpose is to restrict residents' use of others' money. That is, inarguably, a compelling normative end.

2. The Argument's Flaw

The validity of this prevalent, and attractive, account has hardly been questioned. But it ought to be questioned, for a fundamental flaw afflicts its most prominent premise. This justification for debt limits is founded on the conviction that debt is special: that the assumption of debt is different from other allowable political decisions in its capacity to generate costs for future residents. Unfortunately, debt is not distinct from other decisions in this regard. Other local decisions generate similar future effects, and the same reason that allows the law to remain unconcerned with the costs of those decisions eliminates the fears pertaining to debt's future effects. As the law need not, and does not, intercede in those other local decisions, it need not, as shall be seen, intercede in local debt decisions.

200. Kevin A. Kordana, *Tax Increases in Municipal Bankruptcies*, 83 VA. L. REV. 1035, 1101–02 (1997) (noting that the identity of local residents changes over time and thus there is little relationship between risk-creators and risk-bearers).

201. Current residents may also expect to be in a lower tax-bracket in the future. Buccola, *supra* note 161, at 267–68.

202. Schragger, *supra* note 188, at 790 ("Current debt spending . . . might be supported by current residents even if future residents would oppose it").

203. Gillette, *supra* note 94, at 391–92.

204. See *supra* notes 184–87.

205. E.g., *The Mayor v. Ray*, 86 U.S. 468, 475 (1873); *Hayes v. State Prop. & Bldgs. Comm'n*, 731 S.W.2d 797, 800 (Ky. 1987); *Dieck v. Unified Sch. Dist. of Antigo*, 477 N.W.2d 613, 618 (Wis. 1991).

206. AMDURSKY ET AL., *supra* note 89, at 313.

Unquestionably, commentators and jurists are correct in noting debt's future effects. But equally unquestionably, debt issuance does not stand alone in this regard: local governments make many other decisions bearing momentous future ramifications. Like the full effects of local decisions about debt, the full effects of local decisions about contracts, zoning, education, and economic policy are highly improbable to last only momentarily or prove fully reversible. In all these diverse fields the city is capable of creating, and inevitably does create, costs or unalterable realities for future generations.

A decision to contract with an entity for the provision of city water for 25 years requires future residents to continuously acquire water from that entity.²⁰⁷ A decision to lease the city's parking meters to a private entity for 75 years in exchange for a lump sum deprives future taxpayers of those meters' income.²⁰⁸ A decision to zone an area for residential uses,²⁰⁹ renders it costly, if not legally impossible,²¹⁰ to shift that land to industrial uses in the future. A decision to underinvest in education inflicts on future society the economic and social toll of an uneducated populace.²¹¹ A decision to dedicate public land to a museum rules out its future preservation as open space.²¹² A decision to enact lax environmental and business regulation to attract business forces the future city to contend with the blight left in industry's wake.²¹³ A decision to adopt policies unfriendly towards business disadvantages the future city in its competition over business with other cities.²¹⁴ And so on.²¹⁵ Through all such decisions today's voters entrench their preferences and commit future generations to those preferences, regardless of those future generations' own

207. *Walla Walla City v. Walla Walla Water Co.*, 172 U.S. 1, 4 (1898) (approving the deal).

208. For an example of this type of lease, see generally *Indep. Voters of Ill. Indep. Precinct Org. v. Ahmad*, 13 N.E.3d 251 (Ill. App. Ct. 2014).

209. *See generally* *Vill. of Euclid v. Ambler Realty*, 272 U.S. 365 (1926).

210. *See* Douglas W. Kmiec, *Deregulating Land Use: An Alternative Free Enterprise Development System*, 130 U. PA. L. REV. 28, 53 (1981) (discussing the limited flexibility zoning allows).

211. *See* Orley Ashenfelter & John Ham, *Education, Unemployment, and Earnings*, 87 J. POL. ECON. S99, S114–15 (1979) (finding that schooling reduces unemployment); Richard R. Nelson, *Recent Exercises in Growth Accounting: New Understanding or Dead End?*, 63 AM. ECON. REV. 462, 467 (1973) (finding that education and capital growth are complimentary).

212. *See generally* *Friends of the Parks v. Chi. Park Dist.*, No. 14-CV-09096, 2015 WL 1188615 (N.D. Ill. Mar. 12, 2015) (involving a claim by plaintiffs that a museum would unduly encroach on open space).

213. For example, in 1969 Cleveland's Cuyahoga River caught fire following decades of lax regulation of the city's polluting industries. *America's Sewage System and the Price of Optimism*, TIME, Aug. 1, 1969, at 41.

214. For example, a city allowing the oil industry to employ hydraulic fracturing ("fracking") may generate environmental harms for future generations. On the other hand, if it bans the practice, the industry may bypass it and future generations will not to benefit from it. *See generally* *Wallach v. Dryden*, 16 N.E.3d 1188 (N.Y. 2014) (empowering a city to make either choice).

215. *See* DAVITA SILFEN GLASBERG, *THE POWER OF COLLECTIVE PURSE STRINGS* 138–39 (1989) (explaining that a myriad of decisions by earlier administrations, not all of them pertaining to debt, led to Cleveland's default in 1978—the first default by a major city since the Depression).

preferences (or the current preferences' wisdom).²¹⁶ In one way or another, future generations "pay" for current decisions made in almost all spheres of local governance.²¹⁷

Yet the law refrains from barring this turn of events. Indeed, it actively facilitates it. The law endows local governments with all these powers to act and prompt future repercussions. Partially, the reason is that government hardly could go on if banned from proceeding whenever affecting others.²¹⁸ Almost every decision contains some, at least minimal, externalities and future effects.²¹⁹ From a purely practical perspective, the law simply cannot concern itself with each and every one.

Still more than practical necessity, though, gives rise to the law's nonchalant attitude towards local decisions' impact on future generations. The law can avoid treating inter-temporal, inter-generational, local externalities since current residents actually internalize them through a market mechanism:²²⁰ property values. Property values ensure that when making political decisions, current residents keenly take notice of future effects—even if these will only ripen after their own departure—and thus the law need not fully regulate those decisions.

The value of an asset reflects, among other things, the quality and quantity of the public services the property receives—e.g., schools, policing, garbage removal—as well as obligatory payments associated with its holding—i.e., taxes.²²¹ Not solely the current state of these services and payments is pertinent to pricing. A property purchase is a forward-looking act: the buyer must assess whether the acquired land will maintain its worth once she takes ownership. Hence "the price of a housing unit is based on the *expected* stream of rent (income) generated by that asset minus associated costs."²²² The

216. E.g., Serkin, *supra* note 29, at 883 (arguing that local governments are entrenching decisions through private law mechanisms).

217. Note that any existing state level regulations governing some local action in these fields—for example, laws setting environmental or economic practices standards—are not necessarily mechanisms for protecting future local generations from local action's effects. Indeed, often times, they would be impermissible interventions in local affairs if this were their goal. In some states, state laws can preempt local acts of "home rule" municipalities only if they address a state-wide concern. See COLO. CONST. art. XX, § 6. Thus there as elsewhere, such legislation is justified as aimed at protecting the interests of other municipalities, or of the state itself, rather than those of the locality's own residents, now or in the future. *Telluride v. Lot Thirty-Four Venture, L.L.C.*, 3 P.3d 30, 37–38 (Colo. 2000), *as modified on denial of reh'g* 3 P.3d 30 (Colo. June 26, 2000).

218. *Pa. Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922).

219. Serkin, *supra* note 29, at 889.

220. See Lee Anne Fennell, *Beyond Exit and Voice: User Participation in the Production of Local Public Goods*, 80 TEX. L. REV. 1, 6–12, 34–35 (2001) (discussing legal intervention's disposability when market mechanisms assure internalization).

221. WILLIAM A. FISCHEL, *THE HOMEVOTER HYPOTHESIS* 45–46 (2001).

222. Jason Bram, *To Buy or Not to Buy? The Changing Relationship Between Manhattan Rents and Home Prices*, 18 CURRENT ISSUES ECON. & FIN., no. 8, 2012, at 1, 1 (emphasis added), <https://www.newyork>

calculation of that expected stream must integrate projections respecting future public services and taxes.²²³

Since the potential property buyer is thus concerned with these factors when fixing the price she is willing to offer the property's current owner, the current owner also cares about them. Therefore, when debating current decisions, the current owner will consider the decisions' potential effects on future services and taxes. The resident of today will not support local decisions that determinately affect the resident of tomorrow—her buyer. In this fashion “capitalization”—the internalization of local public decision-making's effects into home values—justifies the vast decision-making powers the law grants current residents.²²⁴

Public debt decisions in particular are known to capitalize into home values. Research finds that entrants into a municipality are aware of its debt obligations, and that buyers take those obligations into account when determining offer prices.²²⁵ Future residents can easily protect themselves from the debt present residents assume by refraining from moving into the municipality or by insisting on paying a lower price when doing so. High debt levels thus decrease property prices.²²⁶ Inevitably, therefore, current taxpayers finance current expenditures, if not through higher taxes, then through potential reductions in their properties' values.²²⁷ Consequently, residents scrutinize debt's future costs.²²⁸

Although never perfect, the housing market's inescapable dynamics impede the free-rides through local debt that commentators dread. Residents may, for good or bad reasons, still prefer indebtedness to taxation, but they cannot truly use that mechanism to offload costs on future residents. The law need not intervene to protect future residents' interests—as indeed it does not when voters dictate local policies fostering future fallout in land use, education, economic development, etc. Unless uncontroversial tenets of local decision-making power in all those fields are similarly upended, the limitation of the local power to borrow cannot be justified, as it is by courts and writers, through an appeal to future generations' interests. Here as there, these interests are already protected by the market.

fed.org/medialibrary/media/research/current_issues/ci18-9.pdf.

223. Thushyanthan Baskaran, *On the Link Between Fiscal Decentralization and Public Debt in OECD Countries*, 145 PUB. CHOICE 351, 353 (2010) (explaining that citizens calculate future tax burdens into mobility decisions and they are thus capitalized into property prices).

224. FISCHEL, *supra* note 221, at 4.

225. WALLACE E. OATES, FISCAL FEDERALISM 155–56 (1972).

226. Gillette, *supra* note 94, at 391–92.

227. OATES, *supra* note 225, at 156.

228. For residents' tendency to follow debt developments see *supra* notes 180–83 and accompanying text.

D. DEBT LIMITS AS MEASURES TO PROTECT THE FEDERAL GOVERNMENT

1. The Argument

The two preceding Parts concluded that debt limits' end could not be to guarantee that the preferences of local residents—current or future—are reflected in debt decisions. Those decisions already reflect those preferences. Thus, if the limits are to be justified, they must be shown to shield the preferences of non-residents from externalities such local decisions generate.²²⁹ This Part's remaining Subparts will elaborate on the standing of several outsider units whose protection has been, or can be, suggested as the limits' end. The first outsider unit to be examined is the most elevated: the federal government. The proposition presented in this Subpart is that debt limits' normative end is to protect the federal government from the effects of local debt decisions.

The local decision to issue debt impacts the federal government due to local debt's status in federal law. As explained in Part II.A, the interest a municipality pays its bondholders is exempt from federal taxation. Therefore, every bond a locality issues strains the federal fisc. The bond is purchased by an investor who otherwise would have invested elsewhere in a taxable outlet (e.g., private bonds). It thus deprives the federal government of revenue. This loss is substantial: Congress estimates that between 2013 and 2017 the tax expenditure value of the exclusion of interest on state and local government bonds will be \$191.3 billion.²³⁰

Such figures render the exemption the most generous subsidy Washington, D.C. extends to the nation's municipalities.²³¹ The exemption's mode of operation is, however, unusual for a subsidy.²³² Normally, a subsidy is a means for the granting government to single out and incentivize an activity that the granting government deems worthy.²³³ Grants for highway construction fund state and local investment in roads—and only roads—since the federal government wants to support the construction of roads.²³⁴ The

229. See JOHN STUART MILL, CONSIDERATIONS ON REPRESENTATIVE GOVERNMENT 338 (The Floating Press 2009) (“[L]ocalities may be allowed to mismanage their own interests, but not to prejudice those of others . . .”); Epple & Spatt, *supra* note 147, at 200 (arguing that “[a]bsent important spillovers across local jurisdictions,” debt restrictions are inefficient).

230. STAFF OF JOINT COMM. ON TAXATION, JCS-1-13, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012–2017 40 tbl.1 (Comm. Print 2013).

231. See Robert C. Ellickson, *Cities and Homeowners Associations*, 130 U. PA. L. REV. 1519, 1574–75 (1982).

232. Not-unrelatedly, most agree it is inefficient. See, e.g., Calvin H. Johnson, *A Thermometer for the Tax System: The Overall Health of the Tax System as Measured by Implicit Tax*, 56 SMU L. REV. 13, 17 (2003); Stanley A. Koppelman, *Tax Arbitrage and the Interest Deduction*, 61 S. CAL. L. REV. 1143, 1177–83 (1988); Kevin M. Yamamoto, *A Proposal for the Elimination of the Exclusion for State Bond Interest*, 50 FLA. L. REV. 145, 173–78 (1998).

233. RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 532–38, 552–64 (3d ed. 1980).

234. See 23 U.S.C. § 121 (2012).

student loan interest deduction underwrites an individual's investment in her education—and only her education—since the federal government wants to support education.²³⁵ The municipal bond interest exemption is markedly different. Its grantee, the local government, can put the funds raised through the federally subsidized bond to any use it fancies—not necessarily to a use the federal government wants to support.²³⁶

The local government controls the subsidy's use, as well as its amount and frequency. The local government—alone—decides when, for what amount, and for what purpose to issue debt. The federal government foregoes income in tow. In other words, the federal government absorbs the externalities of the locality's debt decision.²³⁷ By limiting the debt the municipality sells, debt limits curb these externalities; their end is thus to protect the federal government.

2. The Argument's Flaw

The notion that an entity merits protection when funding an activity it cannot control is undeniably sound. Unfortunately, it is inapposite to the relationship between the federal government and local debt. The federal government's portrayal as devoid of control over subsidized municipal debt's use is misleading. Fairly depicting an incumbent reality, it ignores the legal dynamics instituting that reality and capable of altering it.

True, localities externalize costs on the federal government when issuing debt. But this externalization is only possible because the federal government enabled it: the federal government enacted the tax exemption. The exemption is an intentional federal subsidy. Moreover, it is discretionary. Federalism principles do not mandate freeing municipal governments from the specter of federal taxation of their interest payments.²³⁸ Therefore, Congress can repeal the exemption for municipal interest payments or narrow the activities it subsidizes. Congress has done so in the past. The Tax Reform Act of 1986, for example, rescinded the exemption for interest payments on municipal bonds used to fund private-purpose development.²³⁹

When the federal government is unwilling to participate in local debt's costs, it acts to withdraw the subsidy.²⁴⁰ As long as Congress refuses—as it

235. See *id.* § 221.

236. Joel Michael, *Reciprocal Intergovernmental Taxation of Federal, State, and Local Bonds*, 48 TAX NOTES 1671, 1673 (1990).

237. Gillette, *Fiscal Federalism*, *supra* note 20, at 300–01 (“The tax exemption creates a federal subsidy for municipal projects, even if the benefits of those projects are enjoyed solely within the issuing jurisdiction. . . . The availability of the subsidy provides municipal officials with incentives to incur more and riskier debt than they would if they were paying the full cost” (footnotes omitted)).

238. *South Carolina v. Baker*, 485 U.S. 505, 527 (1988).

239. 26 U.S.C. § 103(b)(1) (2012); Tax Reform Act of 1986, Pub. L. No. 99–514, 100 Stat. 2085, 2602.

240. Another example is the removal of the exemption when the bond is used by the locality for arbitrage. 26 U.S.C. § 103(b)(2).

consistently has—to act on repeated proposals for the exemption's complete abolition,²⁴¹ it is implicitly choosing to incur local debt's costs. Those costs thus cannot be classified as externalities, and no shields against them are required.

Furthermore, even if such shields were necessary, debt limits would be unfit for the task. As creatures of state law, the limits are enacted, amended, and potentially abolished by state legislatures, not the federal government. Unlike the latter, state governments entertain no desire to shore up federal coffers. Quite the opposite: each state has a strong interest in having the federal government fund its municipalities. Consequently, the purported end of any debt limits states enact cannot be the protection of the federal government. The limits are not controlled by, or interested in, that government.

The argument that debt limits protect the federal government from local debt's externalities ignores the legal architecture of the federal-state-local interface. The federal government controls local debt's costs through the tax regime it voluntarily creates, and hence those costs are not externalities it endures. Conversely, the limits themselves are removed from that government's control and thus their end cannot be the federal government's defense.

E. DEBT LIMITS AS MEASURES TO PROTECT THE STATE GOVERNMENT

1. The Argument

But what of the governments that do control those limits? Could the limits' end be the states' protection? The federal government, whose exposure to local debt's effects was just reviewed, is not the only government located above the local. The state is also positioned atop the locality, and thus debt limits may be justified as antidotes to externalities local debt inflicts on the state. As expounded by its numerous supporters,²⁴² this explanation answers the shortcomings just detected in the explanation focusing on the federal government. Like the federal government, the state government is an outsider unit faced with local decisions' effects. Unlike the federal government, though, the state, so the argument goes, does not freely choose to experience these effects, and thus the debt limits it enforces to regulate them are seemingly essential.²⁴³

241. Yamamoto, *supra* note 232, at 172 (listing the several failed repeal proposals for § 103).

242. See, e.g., Stephen D. Eide, *Defeating Fiscal Distress: A State Responsibility*, 78 CIVIC REP., July 2013, at 1, 8–9; Epple & Spatt, *supra* note 147, at 244; Rodden, *supra* note 45, at 124; see also Schragger, *supra* note 21, at 867 (noting that this is a concern for many as society moves into the 21st century).

243. For example, one state court justified intrusive state intervention in a municipality's self-governing powers due to fiscal crises' extramural consequences. *Moreau v. Flanders*, 15 A.3d 565, 580 (R.I. 2011).

Local debt's effects sustained by the state government are different from those the federal government bears. The federal government participates in local debt's funding by relinquishing its portion of cities' interest payments. The state government stands to participate in local debt's funding even more directly and less voluntarily, and is thus exposed to a much more threatening externality. An exceptionally costly externality of debt materializes when an entity that did not take out the debt must, at some later point, assume it if the debtor defaults. That entity assisting the debtor—in common parlance, “bailing it out”—did not benefit from the original credit, and must fund it when no benefit is to be derived from it.²⁴⁴

A borrower's decision to incur debt can thus be costly for a third-party that stands to bail her out. Many argue that the state is such a third-party whenever a locality borrows.²⁴⁵ Due to its relationship with its municipalities, analysts contend that the state will repay municipalities' debts when they cannot.²⁴⁶ The assertion finds corroboration in states' past behavior and statutes. States have helped cities avert financial disaster since at least 1921, when New Hampshire granted Manchester assistance.²⁴⁷ At least 19 states have statutory mechanisms for bailing out indebted municipalities.²⁴⁸ Normally, the statutory framework involves an infusion of funds into a struggling municipality's budget—so that it can repay its debts—accompanied by a state takeover.²⁴⁹ The takeover may entail supervision of the municipality's budgetary process,²⁵⁰ or placing the municipality in receivership: sidelining local leadership in favor of state-appointed managers.²⁵¹

Importantly, however, while statutes create frameworks for states to bail out municipalities, they do not mandate bailouts.²⁵² The statutes detail

244. See Schragger, *supra* note 188, at 800.

245. E.g., Eide, *supra* note 242, at 8; Ted Roelofs, *Not Just Detroit: New Report Finds Fiscal Troubles for Dozens of City Halls Across Michigan*, MLIVE.COM, http://www.mlive.com/politics/index.ssf/2013/05/new_rankings_find_fiscal_troub.html (last updated May 16, 2013, 8:06 AM).

246. Note, however, that states have never been held liable for their localities' obligations. Disappointed creditors may have expected this result following the first municipal defaults of the late nineteenth century given that in American law the city is a state creature. Still, claims that states should pay their municipalities' unpaid debts were hardly raised and were never successful. Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 442–43 (1993).

247. See An Act to Establish a Finance Commission in the City of Manchester, 1921 N.H. Laws 354.

248. PEW CHARITABLE TRS., THE STATE ROLE IN LOCAL GOVERNMENT FINANCIAL DISTRESS 6–7 (2013), http://www.pewtrusts.org/~media/assets/2016/04/pew_state_role_in_local_government_financial_distress.pdf.

249. See *id.* at 15–16. “[Fourteen] states provide in statute for state loans (often no- or low-interest loans), grants, or credit guarantees,” to municipalities subjected to intervention. *Id.* at 16.

250. E.g., OHIO REV. CODE ANN. § 118.12 (West 2015).

251. E.g., tit. 45 R.I. GEN. LAWS § 45-9-1 (2016).

252. Most do not even detail indicators of distress. Philip Kloha et al., *Someone To Watch Over*

triggering events or conditions upon which a state agency may choose to intervene, but no state is under a legal obligation to fund struggling cities.²⁵³ Nonetheless, many still argue that states operate under an obligation to salvage financially wrecked localities. While not legal, that obligation, they profess, is as coercive as any statutory dictate: it is born of economic imperative.²⁵⁴

The state's economic duty to bail out a struggling municipality is occasioned by the threat of "contagion." Contagion denotes the spread of economic distress from one struggling entity to another, previously non-struggling, entity.²⁵⁵ Financial malaise is communicated between entities due to investors' fears—founded or unfounded—that one entity's financial illness is indicative of looming similar troubles for other market entities.²⁵⁶ In the local bonds market, contagion implies that one municipality's financial struggles affect the financial reputation of others in the state.²⁵⁷ Once a municipality defaults, skittish lenders will refuse to issue credit to other municipalities in that state, or increase the interest rates they charge, as they worry that those other municipalities might also succumb.²⁵⁸ The market's reaction to one municipality's default might even affect the state's own ability to borrow.²⁵⁹ Through contagion, thus, a municipality's default portends

Me: State Monitoring of Local Fiscal Conditions, 35 AM. REV. PUB. ADMIN. 236, 252 (2005). The few that do still allow relevant bodies discretion before ordering a state takeover. *E.g.*, N.C. GEN. STAT. § 159-176 (2015) (empowering, but not requiring, the relevant state commission to enforce a refinancing plan for a locality in default); NEV. REV. STAT. ANN. § 354.685(1) (2015) (commencing takeover procedures only following a hearing the relevant state commission "may" decide to hold); OHIO REV. CODE ANN. § 118.04(A) (West 2015) (granting the state auditor discretion to determine the existence of a fiscal emergency in a locality, only upon the request of political officials). It should also be stressed that the mere takeover act does not force the state to infuse funds into the locality. The statutes cited, for example, say nothing about funding.

253. Some state constitutions explicitly prohibit the state from assuming municipal debts. *E.g.*, NEV. CONST. art. IX, § 4; OHIO CONST. art. VIII, § 5.

254. *See, e.g.*, Gillette, *Dictatorships for Democracy*, *supra* note 20, at 1416; *see also* PEW CHARITABLE TRS., *supra* note 248, at 14.

255. For more on contagion in financial markets see generally Steven L. Schwarcz, *Regulating Complexity in Financial Markets*, 87 WASH. U. L. REV. 211 (2009).

256. *Id.* at 225–26.

257. *Id.* at 226–27.

258. PEW CHARITABLE TRS., *supra* note 248, at 11–13 (discussing why states are loath to let municipalities go bankrupt).

259. For example, Michigan's municipal receivership law announces "the health, safety, and welfare of the citizens of this state would be materially and adversely affected by the insolvency of local governments . . . [I]t is vitally necessary to protect the credit of this state and its political subdivisions." MICH. COMP. LAWS ANN. § 141.1543(3) (West 2016). When trying to resolve the Orange County bankruptcy the California legislature explained that "[i]t is in the interest of the state and all public debt issuers within the state to enable the County of Orange to finance an acceptable plan of adjustment in order to improve the credit standing of California public debt issuers and to preserve and protect the health, safety, and welfare of the residents of the county and the state." CAL. GOV'T CODE § 30400(a) (West 2016). Similar claims regarding New York State and its municipalities served to justify New York City's bailout. SEYMOUR P. LACHMAN & ROBERT POLNER, *THE MAN WHO SAVED NEW*

major financial upheaval for a state.²⁶⁰ Consequently, it is an intolerable prospect.²⁶¹ To forestall it, a state is forced to bail out a struggling municipality, notwithstanding the absence of a legal duty to act.²⁶²

Because economic realities thus preclude states from firmly refusing to repay their cities' bad debt, states are inexorably exposed to bailouts' costs.²⁶³ A state can only dodge or minimize those costs by preventing in advance the local conditions calling for bailouts. For this end, the state relies on its status in the governmental hierarchy, entitling it to define, limit, and abolish lower-level governments' powers.²⁶⁴ Specifically, it dictates to localities acceptable debt levels.²⁶⁵ Thereby the state restricts its own future exposure to local debt.

Debt limits' end is thus to serve as ex-ante restrictions on the local assumption of debt, whose potential costs for the state cannot be addressed ex-post, after that debt goes bad.²⁶⁶ Furnishing the only practical way to stave off a major externality local debt generates for states, debt limits are indubitably expedient.

2. The Argument's Flaw

The rising popularity of this rationale, grounding debt limits in the costs that unsustainable debt triggers for a higher-level government, is hardly

YORK 132 (2010). Standard & Poor's lists local government financial difficulties among a broad set of criteria that may move a state's rating, noting "we believe that local government fiscal difficulties can increase and become a funding challenge for the state." STANDARD & POOR'S, TOP 10 MANAGEMENT CHARACTERISTICS OF HIGHLY RATED CREDITS IN U.S. PUBLIC FINANCE 4 (2010), <http://www.ncsl.org/Portals/1/documents/fiscal/Top10Management.pdf>.

260. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, CITY FINANCIAL EMERGENCIES: THE INTERGOVERNMENTAL DIMENSION 7 (1973) ("A financial emergency occurring in even one unit of local government can cause serious damage to the credit of governments throughout the State.").

261. For example, "Michigan's current and former governors rejected requests from Hamtramck . . . to file for bankruptcy protection in both 2010 and 2011," stating worries "it would have a ripple effect on other distressed Michigan governments." PEW CHARITABLE TRS., *supra* note 248, at 11–12.

262. For example, when Jefferson County, Alabama, was nearing bankruptcy, the governor made efforts to avoid bankruptcy after experts advised him "that a Chapter 9 filing by the state's most populous county would spook the municipal bond market." Mary Williams Walsh & Campbell Robertson, *Just Before Deadline, County in Alabama Delays Bankruptcy Move*, N.Y. TIMES (July 28, 2011), <http://www.nytimes.com/2011/07/29/business/economy/alabamas-jefferson-county-postpones-a-decision-on-bankruptcy.html>. Similarly, justifying his 2010 decision to advance \$4 million in loans so that Harrisburg could make a bond payment, Pennsylvania's governor said he was worried that missing the payment "would devastate not only the city, but the school district, the county, and Central Pennsylvania's reputation." Pa. Office of the Governor, *Governor Rendell: Commonwealth Partnering with City of Harrisburg to Help It Meet Immediate Financial Obligations*, PR NEWSWIRE (Sept. 12, 2010, 12:25 PM), <http://www.prnewswire.com/news-releases/governor-rendell-commonwealth-partnering-with-city-of-harrisburg-to-help-it-meet-immediate-financial-obligations-102727519.html>.

263. *E.g.*, Rodden, *supra* note 45, at 140 (arguing that states only "make . . . weak no-bailout commitments to their municipalities").

264. *Hunter v. City of Pittsburgh*, 207 U.S. 161, 178–79 (1907).

265. *See* Rodden, *supra* note 45, at 140.

266. *Epple & Spatt, supra* note 147, at 203–04.

surprising in an age of peaking concern over costs governments incur when assuming others' debts.²⁶⁷ Unfortunately, however, the local-debt market is decidedly different from other financial markets, whence such concerns over bailouts stem.²⁶⁸ Thus a rationale for regulating debt levels inspired by experiences in those markets cannot be transplanted to explain local-debt limits. That rationale—touting the need to protect ex-ante a government later saddled by a borrowing entity's debt—hinges on one key projection: a government's eventual compulsion to rescue a struggling entity.²⁶⁹ Common conjectures reviewed above notwithstanding, when the relevant government is a state and the struggling entity a city, that prediction finds little basis in past records or in the pertinent market's general patterns. Both—first the empirical evidence, then the market's structure—shall be presented now.

State government is allegedly forced to bail out a struggling city due to the risk that credit woes spread from that city.²⁷⁰ But is contagion indeed an all-pervasive risk in the municipal credit market? Commentators and lawmakers fretting over contagion often ignore the question's empirical nature; more troublingly, they overlook the relevant evidence's feebleness.²⁷¹ They are hard pressed to identify actual instances of municipal default engendering financial difficulties for surrounding municipalities.²⁷² As Part II.A reported, the number of municipalities defaulting in the modern era is small to begin with. Studies exploring some of those cases found that to the extent surrounding municipalities were affected, their borrowing strains were confined to the default's immediate aftermath.²⁷³ After a very brief period had

267. See, e.g., Cheryl D. Block, *Measuring the True Cost of Government Bailout*, 88 WASH. U. L. REV. 149, 153, 156–60 (2010); Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 84 WASH. U. L. REV. 1627, 1638 (2006).

268. See Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy or Bailouts?*, 35 J. CORP. L. 469, 488–92 (2010) (describing the bailouts inevitability argument's origins).

269. Adam J. Levitin, *In Defense of Bailouts*, 99 GEO. L.J. 435, 461–65 (2011) (explaining that ex-ante regulation of financial institutions' growth is meant to prevent them becoming too big to fail).

270. Theoretically, one could also claim that a state is forced to save a failing municipality due to the fear it will otherwise be forced to step in and provide local services in the municipality's stead. Many state constitutions have been interpreted as meaningfully mandating the provision of education, e.g., *Claremont Sch. Dist. v. Governor*, 703 A.2d 1353, 1357 (N.H. 1997), but there is no real obligation to provide any other local service. Still, arguably, the political pressures to do so may be irresistible. However, there is little evidence that states experience such pressures when cities fail financially, and, as indicated by the traditionally sad state of local services in poor communities—for example, in urban centers—legislatures representing affluent localities feel little compulsion to prop up their services. Besides, a true concern with the level of public services provided by localities would have implied not only intervention in times of distress, but also ongoing edicts, such as mandated minimum local tax levels. Yet states only mandate maximum tax levels. E.g., CAL. CONST. art. XIII, § 20.

271. E.g., Gillette, *Dictatorships for Democracy*, *supra* note 20, at 1417 (admitting reliance on anecdotal evidence).

272. *Id.* at 1417–18.

273. See generally, e.g., John M. Halstead et al., *Orange County Bankruptcy: Financial Contagion in the Municipal Bond and Bank Equity Markets*, 39 FIN. REV. 293 (2004) (finding effects in the eight days

passed, credit markets re-stabilized for other municipalities.²⁷⁴ Researchers have thus concluded that municipal default's effect should be characterized as "an initial period of economic uncertainty in the region" rather than actual "contagion."²⁷⁵

The relevance of contagion fears to local credit markets is further challenged by evidence derived from the effects of localities' struggles during the Great Recession. Rhode Island offers an invaluable opportunity to supplement existing findings on municipal default's statewide effects. Being the smallest state in the Union (it counts only 39 cities and towns),²⁷⁶ it offers, as many presumed, the most fertile grounds for contagion.²⁷⁷ At least two of the state's handful of municipalities experienced major financial troubles: Central Falls entered state receivership in May 2010 and subsequently bankruptcy in August 2011;²⁷⁸ East Providence was subjected to state oversight in November 2011.²⁷⁹ At the time, observers feared contagion.²⁸⁰ Yet, as data chronicling the credit ratings of the state's municipalities, collected in Chart

following Orange County's bankruptcy); David S. Kidwell & Charles A. Trzcinka, *Municipal Bond Pricing and the New York City Fiscal Crisis*, 37 J. FIN. 1239 (1982) (finding that New York City's crisis had a very small effect on interest rates for other municipalities and even that effect lasted for less than three months); Kelly Nolan, *Muni Investors Make Michigan Pay*, WALL STREET J., (Aug. 14, 2013, 8:05 PM), <http://www.wsj.com/articles/SB10001424127887323455104579013151393668482>. The one study commonly cited as providing contrary evidence, was published during the year of New York's crisis, and thus its findings only dealt with the crisis period itself. See Gillette, *Fiscal Federalism*, *supra* note 20, at 304, referring to Edward M. Gramlich, *New York: Ripple or Tidal Wave? The New York City Fiscal Crisis: What Happened and What Is to Be Done?*, 66 AM. ECON. REV. 415, 423-26 (1976).

274. See Kidwell & Trzcinka, *supra* note 273, at 1246 (finding that the effect of the New York City crisis was brief in duration).

275. Kristin Stowe & M.T. Maloney, *The Response of the Debt Market to Municipal Financial Distress* 21 (Jan. 10, 2005) (unpublished manuscript), <https://www.yumpu.com/en/document/view/18949694/the-response-of-the-debt-market-to-municipal-financial-distress>.

276. See Rhode Island Cities & Towns, RI.gov, <http://www.ri.gov/towns> (last visited Jan. 7, 2017).

277. See Mary Williams Walsh & Abby Goodnough, *A Small City's Depleted Pension Fund Rattles Rhode Island*, N.Y. TIMES (July 11, 2011), <http://www.nytimes.com/2011/07/12/business/central-falls-rattles-bankruptcy-over-pension-promises.html>.

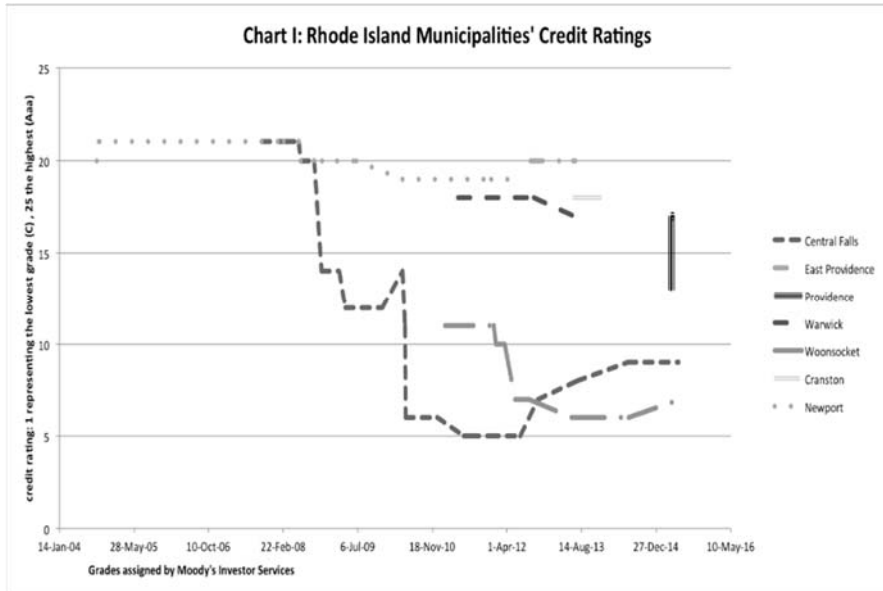
278. *City of Cent. Falls v. Cent. Falls Teachers' Union*, R.I. Council 94 (*In re City of Cent. Falls*, R.I.), 468 B.R. 36, 42 (Bankr. D. R.I. 2012); *Moreau v. Flanders*, 15 A.3d 565, 569, 573 (R.I. 2011) (upholding the city's placement in receivership).

279. The state first appointed a financial overseer before escalating its intervention and appointing a budget commission. See David Klepper, *RI Gov: State to Intercede in East Providence*, BOSTON.COM, (Nov. 14, 2011), http://archive.boston.com/news/education/k_12/articles/2011/11/14/ri_gov_state_to_intercede_in_east_providence/; Press Release, State of R.I., Governor Lincoln Chafee Announces Appointment of Budget Commission to Help East Providence Achieve Fiscal Stability (Dec. 20, 2011), <http://www.ri.gov/press/view/15463>.

280. E.g., Tom Mashberg, *Rhode Island Seeks to Shield Investors Under Central Falls Plan*, PROVIDENCE BUS. NEWS (Sep. 23, 2011, 8:59 AM), <http://pbn.com/Rhode-Island-seeks-to-shield-investors-under-Central-Falls-plan-61355> (quoting the State Revenue Director saying "[w]e don't want Central Falls to become a contagion that spreads around the state"); Hilary Russ, *Bankruptcy Saves Tiny Rhode Island City, But Leaves Scars*, REUTERS (Sept. 3, 2012, 7:59 PM), <http://www.reuters.com/article/usa-rhodeisland-centralfalls-bankruptcy-idUSL2E8K36X220120903>.

I below, illustrates, this menace never materialized.²⁸¹ The hardships encountered by the two cities did not affect the credit ratings of other localities—even those, like Providence, Woonsocket, and Cranston, located in the same county as the two troubled cities.

Figure 1: Rhode Island Municipalities' Credit Ratings



The same trend is detectable in other states containing municipalities struggling post-2008. As Detroit became the largest city to ever enter bankruptcy, two rating agencies actually upgraded Michigan's bond rating.²⁸² Alabama's municipalities have been issuing debt as before, despite the bankruptcy of Jefferson County—the state's largest county.²⁸³ A spate of municipal financial collapses has had little effect on California's governments' access to credit.²⁸⁴

This widespread evidence of contagion's absence from the municipal credit market may surprise those viewing debt limits as anti-bailouts mechanisms, but it is unsurprising given that specific market's dynamics. Contagion is endemic to markets where the assessment of one actor's health

281. In 2011, Rhode Island adopted special protections for local bondholders. 45 R.I. GEN. LAWS § 45-12-1 (2016). Interestingly, however, these did not, as the charts indicate, lead to further confluence in the assessment of the risk different municipalities present to bondholders.

282. Chad Livengood, *Michigan Bond Ratings Upgraded*, DETROIT NEWS (Apr. 3, 2013, 7:00 AM), <http://dashboards.com.network/news/detroit-news-lansing-bureau-chad-livengood-reports-michigan-bond-ratings-upgraded-3180>.

283. PEW CHARITABLE TRS., *supra* note 248, at 10.

284. STANDARD & POOR'S, U.S. PUBLIC FINANCE REPORT CARD: RATINGS ON MOST CALIFORNIA CITIES LIKELY HIT BOTTOM IN 2012 (2013), static.ow.ly/docs/USPublicFinanceReportCard_11If.pdf.

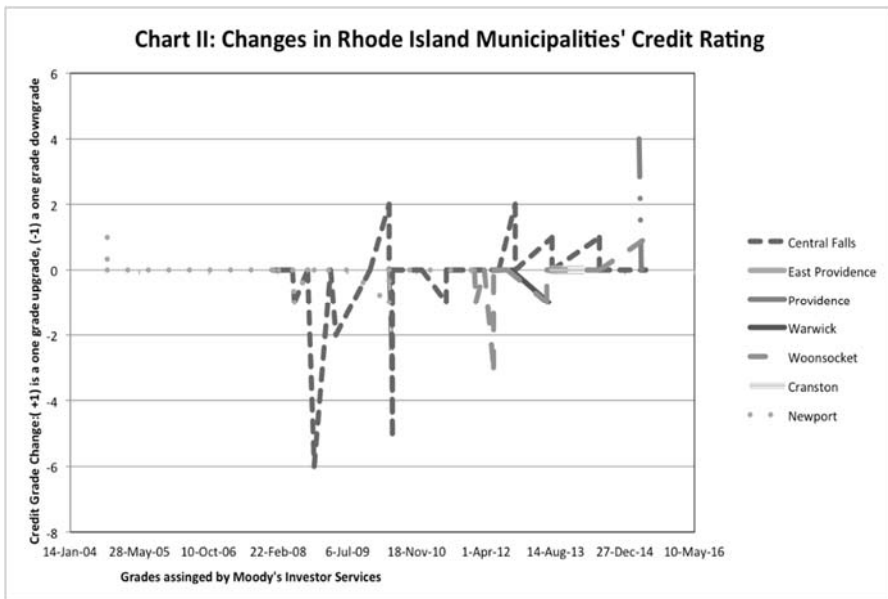
is intertwined with the assessment of another's.²⁸⁵ Unlike other markets where bailouts have occurred, the local-credit market is not such a market. Since localities hardly transact among themselves, there are no economic linkages that may channel economic distress between localities.²⁸⁶ Market participants appear aware of this fact, and do not generate such linkages through mistaken perceptions. All indicators point at the sophistication of the municipal bonds market.²⁸⁷ Research demonstrates that in good times as in bad, market participants tell municipalities apart.²⁸⁸ Again, data respecting Rhode Island's municipalities substantiates these claims. The state's different municipalities are not only awarded different credit grades, as seen in Figure 1, but, as Figure 2 shows, their grades are adjusted at distinct times. This fact signals that the grade awarded to one municipality is largely independent of others' grades.

285. Gary Gorton & Andrew Winton, *Financial Intermediation*, in [1A CORPORATE FINANCE] HANDBOOK OF THE ECONOMICS OF FINANCE 431, 516–18 (George M. Constantinides, Milton Harris & René M. Stulz eds., 2003).

286. On linkage's role in producing contagion, see, e.g., RICHARD J. HERRING & ROBERT E. LITAN, *FINANCIAL REGULATION IN THE GLOBAL ECONOMY* 51–53 (1995).

287. E.g., Capeci, *Local Fiscal Policies*, *supra* note 139, at 87 (empirically finding that an individual municipality's "borrowing rate is positively related to the amount borrowed per dollar property value . . ."). Local bond markets are, naturally, not perfect. Some believe investors lack information. Theresa A. Gabaldon, *Financial Federalism and the Short, Happy Life of Municipal Securities Regulation*, 34 J. CORP. L. 739, 746–52 (2009). But few markets are perfect, and it is thus dangerous to conclude that investors fail to tell municipalities apart. See Gillette, *Fiscal Federalism*, *supra* note 20, at 303.

288. K. Larry Hastie, *Determinants of Municipal Bond Yields*, 7 J. FIN. & QUANTITATIVE ANALYSIS 1729 (1972); Daniel Rubinfeld, *Credit Ratings and the Market for General Obligation Municipal Bonds*, 26 NAT'L TAX J. 17, 25 (1973); Schragger, *supra* note 188, at 800; Wanda A. Wallace, *The Association Between Municipal Market Measures and Selected Financial Reporting Practices*, 19 J. ACCT. RES. 502, 513 (1981).

Figure 2. Changes in Rhode Island Municipalities' Credit Rating

The situation is identical elsewhere. While Chicago's rating plummeted throughout 2015 all the way down to "junk bond" grade, grades awarded to other Illinois municipalities were not affected.²⁸⁹ As these and other examples illustrate, rating agencies differentiate municipalities,²⁹⁰ cities' individual grades are adjusted often,²⁹¹ and borrowing costs accordingly vary by municipality. "[B]oth the credit rating and the cost of borrowing are sensitive

289. The ratings for Chicago bonds in 2015 were A2, then A3, and then Ba1. MOODY'S INV'RS SERV'S, <https://www.moodys.com> (last visited Jan. 7, 2017). At the same time, and through December, Champaign's bonds were rated Aaa—the same rating as in 2012 to 2013. *Id.* Throughout the year Bloomington's ratings were Aa2. *Id.* Rockford was always ranked A1—the same grade as in 2014. *Id.* While one of Springfield's issuances in 2015 was graded A2, all others, before and after, were graded A1. *Id.* Even Chicago suburbs issuing debt during the year experienced no effect. Arlington Heights remained Aa1, Rockford A1, and Joliet Aa2. *Id.* Agencies were even making distinctions between Chicago's own bonds: some, issued by city authorities or secured differently, retained high grades. Brian Chappatta & Elizabeth Campbell, *Junk or AAA? Rating Split Plagues Chicago as It Borrows Billions*, BLOOMBERG, <http://www.bloomberg.com/news/articles/2015-10-01/junk-or-aaa-rating-split-plagues-chicago-as-it-borrows-billions> (last updated Oct. 1, 2015, 2:08 PM).

290. Yinger, *supra* note 51, at 27–33 (finding that agencies distinguish cities based on population characteristics). Consider Ohio's major cities' grades in 2015: Columbus-Aaa; Cleveland-A1; Cincinnati-Aa2; Toledo-A2; Akron-Aa3; Dayton-Aa2. *See* MOODY'S INV'RS SERV'S., *supra* note 289.

291. For example, Moody's updated Los Angeles's rating 16 times between September 2006 and May 2015; Flint, Michigan's rating was updated 11 times between February 1997 and November 2006; East St. Louis, Illinois' rating was updated five times between April 2003 and June 2008. *See* MOODY'S INV'RS SERV'S., *supra* note 289.

to changes in the fiscal condition of the issuer”²⁹² Credit troubles do not spread between municipalities, nor do they ascend upwards to the state. The rating agency S&P’s, for example, “has never lowered a state’s [credit] rating specifically because one or more of its cities was distressed”²⁹³ Noting similar findings, a working paper published by the International Monetary Fund in 2011 concluded that the market for municipal bonds is “prone not to contagion.”²⁹⁴ Instead, it is predisposed “to flight to quality.”²⁹⁵ During volatile periods, investors do not exit the local bonds market, but rather seek “safer” local bonds.

Contagion claims are thus overstated,²⁹⁶ and states do not labor under an economic imperative to bail out struggling municipalities.²⁹⁷ During the past two decades, states have accordingly stood defiantly idle as the most spectacular municipal financial collapses in American history unfolded.²⁹⁸ Where state bailouts were extended, they were the product of states’ voluntary choices.²⁹⁹ Those choices probably had little to do with financial compulsion, and much to do with political calculation. As noted, when bailing out a municipality, the state takes over its management.³⁰⁰ The state is empowered to interfere in the municipality’s fiscal affairs in ways otherwise unavailable.³⁰¹

292. Capeci, *Credit Risk*, *supra* note 139, at 54; *see also* Poterba & Rueben, *supra* note 140, at 195.

293. PEW CHARITABLE TRS., *supra* note 248, at 12.

294. Rabah Arezki et al., *Are There Spillover Effects from Munis?* 10 (Int’l Monetary Fund Inst., Working Paper No. WP/11/290, 2011), <http://www.imf.org/external/pubs/ft/wp/2011/wp11290.pdf>.

295. *Id.*

296. *See also* PEW CHARITABLE TRS., *supra* note 248, at 13 (quoting David Skeel, Jr., concluding “[t]he restructuring of one city is a lot less likely to have contagion effects on other cities in those states than people in the bond market tend to believe”).

297. Other motivations for bailouts in other markets are irrelevant to local bond markets. Municipal debt holders are not key financial institutions whose losses may destabilize the system. *See supra* note 73 and accompanying text.

298. For example, California’s Governor vetoed modest efforts to assist Orange County as it neared bankruptcy. Leslie Wayne, *Gov. Wilson’s Veto Deals Setback to Orange County*, N.Y. TIMES (Aug. 3, 1995), <http://www.nytimes.com/1995/08/03/business/gov-wilson-s-veto-deals-setback-to-orange-county.html>. In 2012, the state did not even consider aiding two cities entering bankruptcy—although one, Stockton, was at the time the largest city to ever enter bankruptcy. PEW CHARITABLE TRS., *supra* note 248, at 10, 39. The Alabama legislature never adopted a plan to aid Jefferson County, as it became the largest county to ever enter bankruptcy. *Id.* at 10, 25–26. Michigan’s Governor refused to bail Detroit out, preferring that it declare bankruptcy. Erik Wasson, *Michigan Governor: Detroit Had ‘No Other Viable Options’ Than Bankruptcy*, HILL (July 21, 2013, 3:22 PM), <http://thehill.com/video/in-the-news/312443-michigan-governor-detroit-had-no-other-viable-options-than-bankruptcy>. Recently, Illinois’ Governor indicated he would rather see Chicago Public Schools enter bankruptcy than provide aid. John Byrne & Monique Garcia, *Emanuel Scoffs at Rauner Suggestion that CPS Declare Bankruptcy*, CHI. TRIB. (Apr. 15, 2015, 5:24 PM), <http://www.chicagotribune.com/ct-emanuel-rauner-cps-bankruptcy-met-0416-20150415-story.html>.

299. For the example of Harrisburg, Pennsylvania *see generally* Juliet M. Moringiello, *Specific Authorization to File Under Chapter 9: Lessons from Harrisburg*, 32 CAL. BANKR. J. 237 (2012).

300. *See supra* notes 250–52 and accompanying text.

301. Michelle Wilde Anderson, *Democratic Dissolution: Radical Experimentation in State*

Seeking this advantageous position, some states have propelled cities to accept aid, even though those cities preferred to be left to their own devices.³⁰²

States are far from compelled to assume localities' bad debt. Contagion, a source of fascination for writers, and a valid concern in other financial markets, is a marginal problem in municipal debt markets.³⁰³ As illustrated by past defaults' limited effects, and as prescribed by the sophisticated municipal credit market, one municipality's failure to repay debts portends little danger for others. Hence the state is not irresistibly pressured to swoop in and repay a struggling municipality's debt, and therefore the initial debt issuance does not impose this potential cost.

The current preoccupation with bailouts' toll notwithstanding, debt limits' end can hardly be conceived as shielding states from the need to reimburse municipalities' lenders. Thus, this end, like all others lawmakers and commentators attribute to the limits, is by and large illusory. If the limits are not to be pronounced endless, an end heretofore unacknowledged must be associated with them. The next Part will suggest such an overlooked end.

F. DEBT LIMITS AS MEASURES TO PROTECT OTHER MUNICIPALITIES

1. The Argument

The preceding Subpart concluded that one municipality's default does not generate costs for other municipalities necessitating state interference. But maybe the mere act of issuing debt—whether or not it is defaulted on later—does. While, as just seen, commentators have explored default's possible statewide costs, the possible statewide costs of debt issuance itself have received no attention in debates over debt limits' role. Yet a debt issuance generates real costs for the issuing municipality's brethren, and, furthermore, these costs justify state regulation. By unpacking both elements of this claim, this Subpart will establish that these costs are distinct from those offered by previous works and reviewed in the preceding Parts: unlike those previously reported costs, the need to counter these costs actually provides debt limits with a normative end.

Takeovers of Local Governments, 39 FORDHAM URB. L.J. 577, 581 (2012).

302. For example, in both Michigan and California, cities objected to the strengthening of state bailout laws. See Stephen C. Fehr, *State Officials Propose Ways to Detect Cities' Fiscal Troubles Before They Worsen*, GOVERNING (Dec. 17, 2012), <http://www.governing.com/news/state/sl-officials-propose-ways-to-detect-cities-on-fical-brink.html>; Steven Yaccino, *Michigan Voters Repeal a Financial Law*, N.Y. TIMES (Nov. 7, 2012), <http://www.nytimes.com/2012/11/08/us/michigan-voters-kill-emergency-managers-for-city-finances.html>. Earlier, in 1978, Cleveland, fearing loss of local control, opted to default on its loans rather than invite the state to intervene. GLASBERG, *supra* note 215, at 127.

303. One unique case where contagion fears were probably rational was New York City's 1970's crisis, which did culminate in a bailout. New York's exceptional size and stature probably rendered it "too big to fail." MARTIN SHEFTER, *POLITICAL CRISIS/FISCAL CRISIS* 128 (1985). That is not the case with almost all other cities. Clayton P. Gillette, *What States Can Learn from Municipal Insolvency*, in *WHEN STATES GO BROKE*, *supra* note 45, at 99, 101 (speculating that states may be assuming their municipalities are "small enough to fail").

So far, this Part explored costs that a locality's debt might generate for parties *within* it—current and future residents—or parties located *above* it—federal and state governments. Now it will suggest costs a locality's debt imposes on parties positioned on *the same level* with it: i.e., other localities. Though those costs are hardly acknowledged, municipalities pay for each and every bond one of their peers' issues.

That cost they pay is the draining of the pool of potential buyers for local debt. It is, at heart, the upshot of a simple supply and demand story. Municipalities are sellers—suppliers—of a product—debt. The more of that product is made available by one seller on the market, the less of that product can other sellers peddle or the less they can charge.³⁰⁴

These routine market dynamics are amplified when the sellers are municipalities located in the same state. Due to the attributes of the local bonds market, all the state's municipalities compete for the same, and limited, class of potential municipal bonds' buyers.³⁰⁵ As should be recalled, the majority of local debt buyers are households residing within the state.³⁰⁶ The cause for this tight supply of lenders is the law, which dis-incentivizes many other investors from buying local bonds. Households are the main buyers of local bonds since most institutional actors, such as pension funds and 401(k)s, are already exempt from federal taxation, and hence will not pay, through lower interest rates, to acquire the exemption offered by the municipal bond, an exemption they enjoy regardless.³⁰⁷ Among the resultant primary group of local bond buyers, households, in-state households dominate, since that subgroup of households enjoys not only the federal tax exemption for the interest payments it collects from the borrowing municipality, but also benefits from those payments' exemption from state income taxation.³⁰⁸ Unlike the federal government, state governments do not exempt all interest payments made on local debts. Rather, they solely exempt payments made on local debts issued by an in-state local government.³⁰⁹ Consequently, out-of-state buyers of a city's bonds do not benefit from this exemption: their home state will consider the interest payments they receive from the foreign municipality taxable

304. FRANK FABOZZI, MUNICIPAL BOND PORTFOLIO MANAGEMENT 116 (1995) (establishing that supply and demand imbalances are key determinants of local bond yields).

305. See *supra* Part II.A.

306. Rodden, *supra* note 45, at 136.

307. Arguably, if such actors do buy such bonds, thereby senselessly settling for lower return rates, they would be in breach of their fiduciary duties towards their members.

308. See *supra* notes 42–45 and accompanying text.

309. The exception is Utah, which does not tax bonds issued in states that do not tax Utah bonds. UTAH CODE ANN. § 59-10-114(5) (West 2016). Consequently bonds from states with no income tax are tax-exempt in Utah.

income.³¹⁰ Out-of-state taxpayers thus have a weaker interest in entering the local debt market.³¹¹

On this account, as data indicates, most owners of municipal bonds are households,³¹² primarily those located within the same state.³¹³ The state's municipalities are hence thrust into a competition over this tightly defined group of buyers.³¹⁴ When one municipality sells debt, it satisfies some of the demand for debt among these buyers. The inevitable corollary, confirmed by existing data, is decreased demand for the debt other in-state municipalities issue.³¹⁵ The pool of buyers of local debt is a common resource,³¹⁶ and each municipality entertains an incentive to exploit it: to borrow early and often, before other municipalities exhaust in-state credit markets.³¹⁷

The fierceness of this inter-municipal competition over credit might not, in itself, suffice to justify state regulation. After all, free inter-local competition

310. *E.g.*, OKLA. STAT. ANN. tit. 68, § 2358.5 (West 2016) (exempting bonds issued by Oklahoma municipalities); *id.* § 2358(A)(1) (taxing bonds issued by non-Oklahoma municipalities).

311. An indicator of bonds' in-state tax appeal's importance is the tendency of states with no income tax to offer higher yields "to offset for the fact that their bonds are not specifically attractive to their own citizens." Daniela Pylypczak-Wasylyszyn, *Are Municipal Bonds Exempt From State Taxes?*, MUNICIPALBONDS (June 24, 2015), <http://www.municipalbonds.com/tax-education/tax-exemption-from-state-income-taxes>; *see also* Denison et al., *supra* note 49, at 465.

312. The Federal Reserve indicates that of the \$3,721 billion outstanding municipal debt in 2013, households held \$1,647 billion. The next largest group of holders, U.S. chartered depositories, held \$390 billion. *Market Data*, BOND BUYER, http://www.bondbuyer.com/marketstatistics/?data-type=market_snapshot (last visited Jan. 7, 2017). *See also* Jason Appleson et al., *The Untold Story of Municipal Bond Defaults*, FED. RES. BANK N.Y.: LIBERTY STREET ECON., (Aug. 15, 2012, 7:00 AM), <http://libertystreeteconomics.newyorkfed.org/2012/08/the-untold-story-of-municipal-bond-defaults.html> (noting that "individuals . . . hold more than half, or \$1.879 billion, of U.S. municipal debt; when \$930 billion in mutual fund[s] . . . is included, the household share rises to three-quarters").

313. Tom Herman, *Tax Report*, WALL ST. J., Sep. 6, 2006, at D2 (finding 530 municipal bond funds focused on bonds issued within a single state); David S. Kidwell et al., *The Impact of State Income Taxes on Municipal Borrowing Costs*, 37 NAT'L TAX J. 551, 557–58 (1984); *see also* Denison et al., *supra* note 49, at 459.

314. David S. Kidwell et al., *Issue Size and Term-Structure Segmentation Effects on Regional Yield Differentials in the Municipal Bond Market*, 39 J. ECON. & BUS. 339, 339 (1987) ("Market segmentation . . . suggests that borrowers and investors cannot substitute securities between geographic markets.").

315. Patric H. Hendershott & David S. Kidwell, *The Impact of Relative Security Supplies: A Test with Data from a Regional Tax-Exempt Bond Market*, 10 J. MONEY, CREDIT & BANKING 337, 341–42, 345 (1978); Mary E. Lovely & Michael J. Wasylenko, *State Taxation of Interest Income and Municipal Borrowing Costs*, 37 NAT'L TAX J. 37, 47 (1992); Christo A. Pirinsky & Qinghai Wang, *Market Segmentation and the Cost of Capital in a Domestic Market: Evidence from Municipal Bonds*, 40 FIN. MGMT. 455, 468 (2011) (finding the yield on new municipal bonds positively related to in-state supply of municipal bonds).

316. *Cf.* Clayton P. Gillette, *Fiscal Federalism and the Use of Municipal Bond Proceeds*, 58 N.Y.U. L. REV. 1030, 1055 (1983) (explaining that the federal tax exemption creates a commons: a resource open to the community of political entities which cannot be exploited without limit).

317. *See* Garrett Hardin, *The Tragedy of the Commons*, 162 SCI. 1243, 1244–45 (1968).

is a hallmark of American local government law.³¹⁸ To attract taxpayers (residents and businesses) from other municipalities, each municipality is at liberty to proffer a menu of services that it believes best meets taxpayers' preferences for quality and price (charged as local taxes).³¹⁹ Notwithstanding this baseline of freedom, however, when inter-local competition threatens statewide interests, the state curbs it.³²⁰ The state then steps in and sets a floor or ceiling for the quality or pricing of services municipalities offer. An example is education: while local governments are tasked with operating schools,³²¹ whose quality serves them to attract residents,³²² the state still sets minimal schooling standards,³²³ and, in many jurisdictions, minimal funding standards.³²⁴ The state's impetus to rein in municipalities' competitive freedom in the market for education are the effects of schooling that register beyond a municipality's boundaries.³²⁵

Debt limits can be viewed in the same light as these interventions in the education market. As in the latter, in the local credit market the state discerns a compelling reason to damp inter-municipal competition.³²⁶ That statewide concern is the state-provided subsidy the competing municipalities capitalize on.³²⁷ The state exempts from taxation the interest its own municipalities—but not others—pay on their bonds. By forgoing these payments lenders would otherwise make to it, the state participates in municipal debt's funding.³²⁸ As the subsidy's grantor, the state holds a strong, and legitimate, interest in controlling its distribution. It may justifiably desire that the subsidy be equally shared among its municipalities.

To achieve this goal, the state limits the sum of the subsidy each municipality can consume. It does so by limiting the amount of debt each can issue. Debt limits guarantee for each municipality a certain, fair, share of a

318. ESTER R. FUCHS, *MAYORS AND MONEY* 284 (1992) (noting the "dysfunctional competition among American local governments" existing under current local government law's structure).

319. Tiebout, *supra* note 25, at 422–24.

320. *Johnson v. Bradley*, 841 P.2d 990, 995–96 (Cal. 1992).

321. *Brown v. Bd. of Educ.*, 347 U.S. 483, 493 (1954).

322. Caroline M. Hoxby, *Does Competition Among Public Schools Benefit Students and Taxpayers?*, 90 AM. ECON. REV. 1209, 1211 (2000).

323. For example, states enact mandatory attendance laws and enforce curriculum guidelines. CHARLES J. RUSSO, *REUTTER'S THE LAW OF PUBLIC EDUCATION* 774, 795 (7th ed. 2009).

324. *Id.* at 308.

325. *See supra* note 211.

326. *Dep't of Revenue v. Davis*, 553 U.S. 328, 350 (2008) (acknowledging the state's interest in promoting municipalities' ability to borrow).

327. *Lovely & Wasylenko*, *supra* note 315, at 48 (assessing the reduction in borrowing costs the exemption generates).

328. *Id.* at 49 (estimating the state's revenue loss).

common resource: state subsidized debt funding. No municipality will be able to overuse the resource, depriving others of the opportunity to draw on it.³²⁹

Debt limits thereby play an important normative role typical of the dynamics of state-local relationships. The limits are instituted by the state—the government creating, defining, and empowering localities³³⁰—to arbitrate externalities localities create for each other. In this telling, the limits' nature materializes as more complex than assumed before. The limits are normally viewed as contributing to city powerlessness in American law.³³¹ As noted in Part II, debt limits are state interferences with local autonomy—they are constraints on the city's ability to set its fiscal course. Following this Subpart's analysis, we see that they are also, paradoxically, a state measure that empowers the city. By protecting the city from the impacts of other municipalities' acts, by assuring it that those acts will not price it out of the market for credit, debt limits extend the city's realm of freedom. The limits' normative logic is mutuality: they limit all cities' power to borrow, to empower all of them to borrow.

2. The Argument's Limits

This end suggested here stands out among the ends attached to debt limits reviewed in this Part. Unlike the prevalent accounts—characterizing debt limits as protecting the parties to the debt deal, residents, future residents, the federal government, or the state government—this account identifies a cost of municipal debt uncontrollable by its bearers but controllable by debt limits. Thus, unlike those other explanations, no fundamental flaw incapacitates it. Nonetheless, the account has its limits. It isolates a normatively beneficial end debt limits pursue, but, as shall be explained now, that benefit might not suffice to outweigh the limits' costs—described in Part II.B.

Once debt limits' end is understood as assuring equitable distribution of the subsidy that states provide to municipalities through the tax exemption, the inquiry turns quantitative. The question becomes how sizable is the subsidy, and, accordingly, how pronounced the need for its fair distribution. For three reasons the answer might cast doubt on the magnitude of the benefit debt limits supply by equitably dispersing that subsidy.

First, some states do not offer any tax subsidy to local debt and hence a tool for its equitable distribution is useless there. Three states do not exempt municipal bonds from taxation.³³² Seven others do not tax income at all,³³³

329. Cf. MONKKONEN, *supra* note 16, at 128 (characterizing debt limits as a form of price control).

330. *Hunter v. Pittsburgh*, 207 U.S. 161, 178–79 (1907).

331. Frug, *supra* note 14, at 1061–67.

332. See *supra* note 44.

333. JARED WALCZAK, TAX FOUND.: FISCAL FACT, STATE INDIVIDUAL INCOME TAX RATES AND BRACKETS FOR 2015, 1, 3–5 (2015), http://taxfoundation.org/sites/taxfoundation.org/files/docs/TaxFoundation_FF462.pdf (including chart showing that Alaska, Florida, Nevada, South Dakota,

and since no income is taxed, there is no special exemption for bond interest income, and no tax subsidy awarded to municipalities. In these ten states the state does not forego income when municipalities issue debt, and there can be no competition among municipalities over the non-existent subsidy. Thus in these states, debt limits cannot be said to institute a fairer inter-local relationship.

Second, in the remaining 40 states, which do impose income taxation and exempt municipal bond interest from it, the subsidy provided therein to local debt is rather modest, and hence the advantages of that subsidy's fair allocation might be minor. A tax exemption excuses the taxpayer from paying tax on the amount excluded, thus its worth hinges on the tax rate that would apply to that amount.³³⁴ The higher the rate, the higher the charge the taxpayer would have paid in the exemption's absence, and accordingly the higher her savings thanks to the exemption. The federal tax exemption for municipal bonds interest is momentous, as noted in Part III.D, since the federal rate for incomes in the highest bracket is 39.6%.³³⁵ State income tax rates are dramatically lower. The highest top marginal rate of any state's tax in 2015 was California's 13.3%, and most other states imposed a much lower rate: only two relied on a top rate exceeding 10%, and in 36 (including those with flat rates) the highest rate was below 8%.³³⁶ Subjected to a relatively low state income tax rate, the savings afforded to the taxpayer who buys the tax-exempt municipal bond issued within the state rather than the non-exempt one issued elsewhere are humble.³³⁷ The cost of the subsidy to the state—the revenue foregone—is correspondingly limited.³³⁸ The import of the state subsidy afforded to municipal credit is simply not that marked. Its restrained role is patent when considered against the background of the myriad other subsidies states offer municipalities. The Census indicates that the nation's localities receive annually \$469 billion in state grants.³³⁹ The subsidy states extend to those localities through the tax exemption pales in comparison, and accordingly the importance of equitably distributing it is secondary.³⁴⁰

Third, the state's need to interfere in the municipal credit market is checked not only by the limited importance of the subsidy it provides that market, but also by that market's relatively low levels of deleterious

Texas, Washington, and Wyoming do not tax income at all).

334. Paul A. Leonard, *Tax-Induced Segmentation in the Tax Exempt Securities Market*, 37 Q.J. BUS. & ECON. 27, 45 (1998).

335. 26 U.S.C. § 1 (2012).

336. Walczak, *supra* note 333, at 3–5.

337. Research established that tax rates affect the demand for tax-exempt bonds. The higher the state's tax rate, the lower the interest rates its municipalities must pay. Denison et al., *supra* note 49, at 464.

338. Lovely & Wasylenko, *supra* note 315, at 49 (estimating the subsidy's magnitude).

339. BARNETT ET AL., *supra* note 35, at 7 tbl. A-1.

340. Kidwell et al., *supra* note 313, at 346 (providing data in Figure 2 indicating that many municipal bond issuances are unaffected by changes in state income tax).

competition.³⁴¹ As explained, states limit local action when that action engenders substantial costs to statewide interests.³⁴² Local debt issuance produces a statewide cost since it ratchets up credit prices for the state's municipalities. But data yields at least circumstantial evidence that this cost is insubstantial. Municipalities are not saddled with particularly high interest payments, as noted in Part II.A. Furthermore, credit's cost has remained relatively stable since the 1970's, despite fluctuations in market conditions and debt policies.³⁴³ In all likelihood, therefore, borrowing costs generated for one municipality by another's borrowing are manageable, so the benefits of controlling them through limits are small.³⁴⁴

For these three reasons, the benefits accruing to the state's municipalities from the limiting of each other's power to issue debt should not be overstated. The idea that debt limits function to protect other municipalities from the costs of another's debt and assure them their fair share of the state-based market for credit has genuine weaknesses. Still, these shortcomings do not discredit this final account of debt limits' end; they challenge the account's weight, not its validity. Unlike the ends conventionally associated with debt limits and reviewed in this Part's preceding Subparts, this normative end is real. But it is of humble proportions. Therefore, this Part's conclusion is that there is a case to be made for debt limits. But it is not the case(s) the literature currently makes, and it is only a weak case.

IV. DEBT LIMITS LAW REFORMED

How should the law of debt limits, as presented in Part II, be adjusted in light of Part III's normative conclusion? In other words, how should the limits be designed if their sole normative end is injecting a degree of equity into the inter-local relationship, an end of qualified importance? This closing Part will grapple with that question. It will provide a blueprint for improving municipal debt law. Any such blueprint must have two prongs: legislative and judicial. As constitutional or statutory creations, debt limits' rewriting requires either constitutional amendment or legislative action. At the same time, most ambiguities in debt limits law stem from courts struggling to define the "debt" that constitutional or statutory provisions cover. Thus, after highlighting potential paths for constitutional or statutory alteration of debt limits, this Part will suggest a desirable judicial approach to this interpretive concern, revisiting some key controversies first introduced in Part II.B.

341. This limited competition may, of course, owe to the limited impact of the state subsidy, which does not wholly repel out-of-state buyers.

342. See *supra* notes 320–25 and accompanying text.

343. LAV & McNICHOL, *supra* note 67, at 9.

344. Kiewiet & Szakaly, *supra* note 47, at 66 (finding localities are rarely constrained by their constitutional debt limits.).

A. REDRAFTING DEBT LIMITS

The rethinking of debt limits' normative ends necessitates a rewriting of the limits contained within state constitutions and statutes. The most obvious—yet also dramatic—redrafting this Article's normative finding should prompt is the abolition of debt limits in certain states. The single normative end of debt limits³⁴⁵—the equitable distribution of state-subsidized debt—is irrelevant for states that do not subsidize debt through their tax systems. Bereft of rationale, the limits are superfluous there. Those ten states that lack an income tax or refrain from exempting local bonds interest payments from their income tax should thus do away with their debt limits. Several of these states, perhaps vindicating this Article's thesis, already enforce some of the nation's least stringent debt limits.³⁴⁶

Abolition might merit consideration elsewhere as well. While the limits' end of fairly allocating credit access is relevant where bonds' interest is exempt from state income taxation, it might not, as seen, be a particularly cogent end.³⁴⁷ A conclusion that their end's humble utility cannot outweigh the limits' costs is, at the very least, plausible.

Plausible, but not inescapable: the fair distribution of state-subsidized debt may still be deemed worthy enough an end to justify debt limits' retention. Even if it is a worthwhile end, however, existing limits must be recalibrated to fit that one limited end they can serve. As currently drafted, many states' limits are disconnected from their end.

Most conspicuously, the fact that some state constitutions and statutes condition the issuance of debt on an affirmative vote by residents is unrelated to the end of protecting peer municipalities from the municipality's decision. Incongruously, limits of this form explicitly entrust debt levels' regulation to the municipality's residents—those same insiders whose debt decisions' effects on outsiders are to be countered by the limits. True, voter approval is not always forthcoming and thus a city subject to the voting requirement issues less debt.³⁴⁸ Still, this crude form of volume control can hardly be expected to maintain inter-municipal equilibrium in debt issuance, as is the limits' normative end.

345. See *supra* Part III.F.2.

346. For example, Texas applies a cap only to cities of 750,000, and that cap is not only high (10%), but also explicitly overrides lower caps cities may have adopted. TEX. GOV'T CODE ANN. § 1331.051 (West 2015). Illinois only limits non-home rule governments. 50 ILL. COMP. STAT. 405/1 (2014). Nevada only limits counties. NEV. REV. STAT. ANN. § 244A.059 (2015). Alaska and Florida only require referenda. FLA. CONST. art. VII, § 12 (considering, but not adopting, a cap as discussed in FLA. S. JOURNAL, 1929 Leg., Reg. Sess. 272 (1929)); ALASKA STAT. ANN. § 29.47.190 (2015).

347. See *supra* Part III.F.2.

348. In an average year only 71.6% of state and municipal bond referenda pass. Gillette, *supra* note 94, at 387.

For debt limits to serve their one attainable end they must subject each municipality's debt to a defined cap informed by an explicit criterion for the fair allocation of credit among municipalities. The specific criterion chosen may vary. Possible criteria can be inspired by one of two distributive principles: a formal principle of equality basing the distribution on size, or a substantive principle of equality basing it on need.

Criteria serving the first principle, the formal principle of equality, try to mechanically correlate the municipality's allocated share of the credit market with the municipality's relative size. The larger the municipality, the larger the portion of investors' demand for in-state local debt it may draw on. Criteria implementing this equation may differ in the measurements they employ to discern the municipality's size. One possibility is population.³⁴⁹ Another approach, already employed by many states, is property values: local borrowing is capped at a certain percentage of the assessed valuation of taxable property in the locality.³⁵⁰ Such a standard ties the municipality's debt allocation to its portion of the state's taxable property: a municipality containing more of the tax-base can issue more debt. Local amount of taxable property may also be conceived as a proxy for size more generally: The law assumes that the municipality encompassing more taxable property is larger and thus allows it more access to the pool of subsidized debt. Unfortunately, however, tax-base is not a particularly accurate proxy for general size. A small municipality might encompass a great amount of highly valued taxable property, if, for example, much of its real estate is commercial.³⁵¹ Conversely, a large municipality might host a very small tax-base if most of its land is vacant or dedicated to low-income housing.³⁵² Under debt limits guided by amount of taxable property, such a large but tax-base poor municipality will be limited in its debt issuance ability. The problem might be even more severe: in all likelihood, the tax-base poor municipality has a greater need to rely on debt, precisely because of its limited tax resources.³⁵³

This tension is inherent to any criterion serving the formal principle of equality basing the distribution on size, since that principle is purposefully indifferent to a municipality's needs. Conversely, the second alternative principle of equality—substantive equality basing the allocation on need—specifically wishes to soothe this tension. The distributive principle targeting need conceives the distribution of credit access as geared towards equalizing

349. E.g., New York has several caps applicable to municipalities of different sizes. N.Y. LOCAL FIN. LAW § 104.00 (McKinney 2016).

350. See *supra* note 79 and accompanying text.

351. *Serrano v. Priest*, 487 P.2d 1241, 1252 (Cal. 1971) ("The commercial and industrial property which augments a district's tax base is distributed unevenly throughout the state. . . . [Such property's presence is] fortuitous . . .").

352. The problem of property-poor local governments animates the school financing litigation. E.g., *Edgewood v. Kirby*, 777 S.W.2d 391, 392–93, 397–99 (Tex. 1989).

353. AMDURSKY ET AL., *supra* note 89, at 311.

financial opportunities, not only credit opportunities. That is, a need-based debt limit would aim to institute a just distribution of *all* revenue sources among the state's municipalities. Under such a limit, a municipality that has great need for revenue but few autonomous income sources would be permitted to access more credit than a municipality of decreased need and extended funds. Criteria serving this goal will vary in the standard they employ to gauge a municipality's need. Such a criterion might, for example, rely on the amount of taxable property within the municipality, but reverse the current standard's approach; so as to compensate for resource inequities, it will decree that the smaller the municipality's tax-base, the greater its debt allowance. Other imaginable criteria serving the need-based principle include the number of low-performing schools, of low-income students, or average household income.

These measures—let alone a combination thereof—are not as straightforward as the mechanical linking of debt to size or to assessed taxable property values. The need-based criteria's complexity, however, is the inevitable cost of the ambitious attempt to institute through debt limits a substantive principle of equality, aiming at remedying financial disparities between municipalities.³⁵⁴ In contrast, the formal principle of equality expressed through size-based criteria, such as taxable property values, is more elegant as its ambition—simply assuring uniformity in credit access—is modest.³⁵⁵

At the end of the day, the choice between these two principles is ideological: it pivots on one's outlook in the debate over equality's meaning and its relationship to redistribution.³⁵⁶ Either option for a debt limit—a size-based or need-based distributive principle—can be justified; as could, as noted above, the option of abandoning debt limits altogether. There is only one option that is clearly normatively unsustainable: maintenance of debt limits grounded in no distributive principle at all, i.e., referenda requirements. Since the limits' sole imaginable normative end is fair distribution of local credit, limits instituting no distributive rationale are pointless.

B. REINTERPRETING DEBT LIMITS

In some states the redrafting of constitutional or statutory debt limits is called for. Regardless of, and in addition to, such constitutional or legislative reform, this Article's findings should inform courts everywhere

354. "Formal equality" emphasizes equal opportunity, whereas "substantive equality" emphasizes equal outcomes. See Michel Rosenfeld, *Substantive Equality and Equal Opportunity: A Jurisprudential Appraisal*, 74 CALIF. L. REV. 1687, 1696–98 (1986).

355. On this inevitable tradeoff inherent to the choice between rules and standards see generally Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976).

356. For canonical works in the debate, see generally FRIEDRICH A. HAYEK, *THE CONSTITUTION OF LIBERTY* (1960); JOHN RAWLS, *A THEORY OF JUSTICE* (1971).

when applying debt limits. The main task debt limits, irrespective of their form, foist on courts is the identification of the debts the limits cover. This is an interpretation challenge: courts must decide which local obligations statutory or constitutional restrictions intended to limit. That determination can only be made by reference to the limits' normative end: the limits intended to restrict obligations that, left unregulated, will generate the normative costs the limits were set to combat. Therefore, now that those normative costs have been re-identified by this Article, courts should reconsider their characterization of certain contested forms of municipal obligation as "debt" and of others as "non-debt."

For decades, the categorization of three specific forms of obligation has been contested.³⁵⁷ In cases where a municipality entered a lease, issued special fund bonds (bonds secured by a specific revenue stream, e.g., tolls from the road the bonds fund), or established a special district that then issued its own bonds, plaintiffs have brought suit contending that the local obligation should be regarded as debt the limits regulate. The vast majority of courts have rejected such claims challenging special fund bonds and special districts' bonds, while the claims disputing leases have encountered a somewhat better, yet still modest, success rate.³⁵⁸

As previously discussed, courts reach these conclusions by inquiring whether the municipal obligation (lease, special fund bond, or special district bond) represents a mandatory charge on the municipality's general-revenues (i.e., its tax revenues)³⁵⁹—in which case it is held a debt subject to limits.³⁶⁰ As can now be appreciated following the findings of Part III, this question is divorced from the limits' normative end.³⁶¹ Since that end is the fair distribution of access to credit among the state's municipalities, the relevant inquiry should be whether the obligation the municipality entered allows it to exploit the common pool of potential municipal credit providers, thereby lessening demand for other municipalities' debt. The question becomes technical: Is the local obligation sold on the municipal bonds market? Analyzed through the prism of this question—rather than of the currently prevailing, yet normatively impertinent, inquiry respecting the obligation's links to general-revenues—the fates of the three contested obligations shift.

Leases should never be considered debt governed by debt limits. Currently, when a lease is challenged as debt, courts aim to determine whether the municipality will be able to break the lease and avoid permanently burdening its general-revenues with future rent payments.³⁶²

357. See *supra* Part II.B.

358. BAKER & GILLETTE, *supra* note 23, at 639, 647–52.

359. See *supra* Part II.B.

360. See *supra* notes 93–101 and accompanying text.

361. See generally *supra* Part III.

362. E.g., *Jennings v. City of Kansas City*, 812 S.W.2d 724, 732 (Mo. Ct. App. 1991) (holding that school buildings' lease was not debt when the city could terminate it); *St. Charles v. St.*

Some courts find that either the lease's terms or the municipality's investment in the leased premises will foreclose this option, and thus deem the lease debt.³⁶³ This characterization of some leases as debt is unsound in light of the question actually relevant for the analysis, as presented in this Article. By entering a lease—no matter how firmly binding—the municipality does not partake in the market for municipal credit, and thus its action does not affect other municipalities' standing there. Hence leases are irrelevant to the ill debt limits are meant to address, and should not be barred by them.

On the other hand, special fund bonds and special districts' bonds should be considered debt that debt limits govern. Currently, courts demand whether the municipality's general-revenues—its tax base—are isolated from these bonds.³⁶⁴ Since technically the repayment of both kinds of bonds is to be made from external sources—the specific income stream in the special fund bond's case or the special district's reserves in the district bond's case—most courts remove these bonds from debt limits' reach.³⁶⁵ The inquiry suggested in this Part generates the opposite outcome—highlighting the senselessness of the current attitude given the limits' real end. Other municipalities are affected by all bonds a municipality issues—regardless of the source of funds dedicated to those bonds' discharge.³⁶⁶ The bonds are all sold to the same group of investors. Thus the distinction between a municipality's general-revenue bonds and its special fund bonds or the bonds of a special district it created is irrelevant. All these bonds enable the municipality to increase its share of the market for credit to the detriment of other municipalities and thus constitute the activity debt limits are set to regulate.

The almost uniform judicial mishandling of special fund bonds and special districts' bonds is symptomatic of the general legal ailment this Part has diagnosed. The normative failings of debt limits law are not only theoretical. The fault is not confined to the work of commentators who have failed to accurately locate the limits' end.³⁶⁷ Perhaps even more troubling, the fault also lies in the way the limits are employed in American law, which too often disconnects them from any viable normative end. The limits in many states' law books are irrationally drafted, and throughout the land, courts are applying limits in a normatively groundless manner. This Article should be read as a call for reform.

Charles Library Bldg. Corp., 627 S.W.2d 64, 68 (Mo. Ct. App. 1981) (holding that an option to terminate the lease kept a lease for a public library building from violating debt-limitations).

363. *E.g.*, *Montano v. Gabaldon*, 755 P.2d 1328, 1329 (N.M. 1989) (arguing that the increased equity in the project the municipality acquires with each rent payment renders it economically impractical for it to exercise its termination right).

364. *See supra* notes 96–101 and accompanying text.

365. *See supra* notes 96–101 and accompanying text.

366. *See supra* Part III.F.

367. *See generally supra* Part III.

V. CONCLUSION

Two anomalies launched this Article: the placement of limits on the city's—but not the individual's or corporation's—borrowing; and the placement of those limits on city borrowing—but not on other city obligations. Arguably, at Article's end, these puzzles remain. The common answers commentators and courts provide to account for these discrepancies were all found lacking. The alternative explanation the Article offered—that limits are needed here but not elsewhere to regulate the allocation of a state subsidy—is valid, but the qualified normative end it attributes to the limits may not suffice to justify their costs.

American law's current approach to debt limits thus emerges from this Article as mostly detached from a coherent normative theory. But before signing off on this conclusion, one other possibility must be considered: the possibility that it is this Article's approach that is detached from the sentiments animating the American approach to debt. This Article sought a coherent normative explanation for debt limits; it assumed that to persist, the limits must promote ends outweighing their costs. That assumption may be naïve. Perhaps the roots of the limits American law places on debt are to be found not in the realities of the credit market, but in a peculiarly American attitude towards debt.

Since its inception, the nation has exhibited an almost visceral fear of debt. In the writings of Thomas Jefferson from the early 19th-century,³⁶⁸ as in polemics against federal deficits authored in the 2010s,³⁶⁹ debt is painted as tolling the knell for the republic.³⁷⁰ In none of these writings does serious analysis play a particularly prominent role.³⁷¹ The discourse of debt is more myth-based than fact-based. So is, perhaps, the case for debt limits. Debt limits may have more to do with political culture and national psyche than with economics and logic. In such an environment trying to assign a rationale to

368. Thomas Jefferson, Letter from Thomas Jefferson to Samuel Kercheval (July 12, 1816), in 10 THE WRITINGS OF THOMAS JEFFERSON 37, 42 (Paul Leicester Ford ed., 1899) (“[With the decline of society] begins, indeed, the *bellum omnium in omnia* [war of all against all] . . . And the fore horse of this frightful team is public debt.”).

369. E.g., Chris Edwards, *The Need to Balance the Budget and Reduce Federal Debt*, CATO INST. (June 17, 2015), <http://www.cato.org/publications/testimony/need-balance-budget-reduce-federal-debt> (last visited Jan. 7, 2017).

370. E.g., Thomas Jefferson, Letter from Thomas Jefferson to Nathaniel Macon (Aug. 19, 1821), in 12 THE WORKS OF THOMAS JEFFERSON 206, 207 (Paul Leicester Ford ed., 1905) (“There does not exist an engine so corruptive of the government and so demoralizing of the nation as a public debt. It will bring on us more ruin at home than all the enemies from abroad . . .”); Matt O’Brien, *Rand Paul on What America’s Been Doing All Wrong Since 1835*, WASH. POST: WONKBLOG (Aug. 14, 2015), <https://www.washingtonpost.com/news/wonk/wp/2015/08/14/rand-paul-on-what-americas-been-doing-all-wrong-since-1835> (citing a Tweet by Senator Rand Paul that mourned the fact that “[t]he last time the United States was debt free was 1835”).

371. E.g., Paul Krugman, Opinion, *Debt is Good*, N.Y. TIMES (Aug. 21, 2015), <http://www.nytimes.com/2015/08/21/opinion/paul-krugman-debt-is-good-for-the-economy.html> (“[T]he power of the deficit scolds was always a triumph of ideology over evidence . . .”).

debt limits is a fool's errand. The issue is not the rationality of debt limits, but the morality of debt.

Still, appealing as this cultural story is, its reach is limited, and the charge of dispassionately and judiciously evaluating debt limits' ends and merits stands. A national scorn for debt cannot explain the structure of the law of debt limits or acknowledge its costs. An abhorrence of debt cannot reconcile the anomalies this Article tackled. American thinkers may obsess about debt's immorality, but American law is concerned not with the alleged immorality of debt, but with the alleged immorality of municipal general-revenue bonds. Inevitably, this very particular legal concern, as seen, does not necessarily decrease debt—but rather channels it into other, and potentially more threatening, forms of debt.³⁷²

Therefore, even conceding the role of morals and culture, the challenge persists of rationally accounting for the distinct limits American law places on local debt. This Article undertook that challenge, yielding startling conclusions. The deficient normative grounding of debt limits should be a major cause of concern for American law. Feelings about debt may continue to diverge. Feelings about debt limits should not.

372. See *supra* notes 102–09 and accompanying text.