We Only Pay the Bills: the Ongoing Effort to Disfranchise Virginia's Voters

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Executive Summary

History warns us to restrain government's proclivity to borrow. Heeding this warning, the Virginia Constitution contains important safeguards restricting debt issuance by local governments. These provisions arise from bitter experience. History shows that citizen oversight is necessary to restrain local governments and reduce the risk of overextending local taxpayers with excessive and unnecessary intergenerational debt. These safeguards limit the magnitude of debt and require the approval of voters, usually in the form of referenda, for the types of borrowing that can unduly burden future taxpayers. Currently, these safeguards are being undermined in Virginia by the proliferation of financial instruments that might be called creative but more honestly should be called deceitful.

General obligation (GO) bonds are backed by the full faith and credit of the governments that issue them. In essence, the government pledges all assets and income sources toward their repayment. These bonds thus provide the greatest financial exposure to local government and the greatest security to their purchasers. The strength of such a pledge results in the lowest interest rates and, therefore, increases government efficiency.

Revenue bonds, on the other hand, have particular, income-generating assets as collateral. Though far from trivial, the legal exposure that local governments face with revenue bonds is more limited. Revenue bonds, for example, finance public projects such as toll bridges whose income is later used to repay the bondholders. In such cases, revenue bonds are repaid through a clear, nongeneral fund, usually not a tax (the users of the bridge in our example). The limit on the bondholder's claim on governmental assets likewise is clear.

Of the two types, general obligation bonds hold the potential for the graver harm to future taxpayers from profligate government. As a consequence, they are the more tightly restricted by the Virginia Constitution. Frustrated by the intent and effect of these restrictions, some local governments, under the influence of private interests whose profits are tied to bond issuance, have resorted to forms of borrowing that, except for strained legalisms, are equivalent to general obligation bonds but evade the requirements for responsible citizen oversight. These same government officials and private interests openly admit the nature of their evasion of democratic procedures and the clear intent of Virginia law.

Absent oversight, local governments have incurred debt that ultimately may be unsupportable, should tax revenues decline as a result of economic conditions—a situation now frequently reported in newspapers across the country.

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To add insult to injury, citizen trust in government is seriously undermined by some of the legal contortions necessary to reassure bond investors about the exotic financial instruments in play. Perhaps the worst such insult is local governments suing their own citizens to establish in court the validity of questionable debt transactions to satisfy agents in the bond markets, a process known as judicial validation.

Although such contortions may transform the legal definition of the bonds from general obligation to a less restricted category, these actions do not transform the financial exposure associated with GO bonds. In short, these financial maneuvers flaunt the clear intent of the Virginia Constitution with respect to local government debt and citizen oversight while they undermine the financial stability and competitiveness of the entire state.

Though technically "legal," these maneuvers clearly evade citizen oversight provisions and are an affront to our system of government. For law is more than ink on a page or hollow words that can be skirted with technicalities and legalisms. Law is the codified intent of the people adopted after due consideration and for a purpose. Our system of government does allow for changes in state governing statutes and even in the state constitution. Yet that flexibility does not mean politicians, government employees (public servants), and special interests should be allowed to simply ignore the law and marginalize the voting rights of local taxpayers. The history of these matters in Virginia, indeed nationally, strongly argues that a lack of restraint by local government presents a clear and present danger of fiscal overcommitment, which arises directly from a lack of citizen oversight. Indeed, it is the citizen, forced to endure unnecessary service curtailments and/or higher taxes, who pays the price for profligate government spending.

Those who support the unbridled extravagance of local government often assert that citizens are chary of necessary expenditures, do not understand the situation, and do not remember prior decisions. Nothing could be further from the truth! All the evidence points in just the opposite direction. Citizens are generous to a fault and consistently vote to take on debt themselves and on behalf of their children when there is good reason to do so. However, citizens are not, in the aggregate, party to the narrow self-interest of those who profit from bond sales nor the irrational exuberance to which local government officials so often succumb. The truth that can be clearly seen in the Virginia's debt referenda record shows that the view of the citizens is long-term, stable, generous, and supportive of necessary government expenditures. What they lack is a tolerance for extravagance and waste. Therefore, we urge the Virginia General Assembly to act, as it has in the past, to correct the situation, restore meaningful citizen oversight, and promote responsibility and efficiency in Virginia's local governments. These goals can be achieved by modifications to the current accountability provisions. The suggested reforms update existing citizen oversight provisions in light of current legal and bond market conditions. The suggested reforms restore meaningful citizen oversight of local government actions, restore popular sovereignty, and return the responsibility for contracting long-term debt back to the people who pay the long-term debt—Virginia voters.

Recommendations

1. Legally define as the debt of a county subject to referendum any agreement, contract, or other instrument currently recognized or later to be determined to have the effect of creating a functionally irrevocable long-term commitment of government revenues, directly or indirectly. This definition should specifically address conduit borrowing. It should also address lease-revenue bonds and similar instruments that incorporate nonappropriation clauses and similar language, effectively changing the nature of these instruments for the purpose of evading citizen oversight and control.

2. Adopt language that specifically directs the courts to look beyond the simple assertions of county government and their affiliated public instrumentalities, and examine their actions in a given transaction so as to ensure that they do not create debt. The language adopted should further direct the courts to conduct an objective, fact-based analysis of the transaction scheme, repayment mechanisms, and default provisions found in the actual instrument to determine if debt is created constructively by the proposed deal.

3. Adopt language that specifically directs county governments and authorities to seek voter approval for long-term commitments of public resources, regardless of the type of guarantee that creates such commitments.

4. Establish a payment mechanism to cover the costs of legal counsel for citizens sued by county governments, authorities, agencies, or other entities seeking judgments to validate questionable public debt-related issues.

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INTRODUCTION

Borrowing that evades citizen oversight provisions incurs nonfinancial costs as well, including an erosion of citizen trust in government generally. A variety of strategies have been employed to evade county referenda election and debt limits.

Our nation's history is replete with examples of overeager public officials issuing bonds to raise money for dubious purposes. As a result, citizens have been burdened by debt that has had no redeeming benefit. In addition, states and political subdivisions frequently have suffered from such lapses of judgment, either because they were morally obligated to help make the debt good or because they saw their own ability to borrow for legitimate reasons undermined by the example of reckless borrowing nearby.

Virginia's restrictions on local government borrowing are designed to limit the probability of default through meaningful citizen oversight. County debt, the primary focus of this paper, is not capped but is subject to referenda. The debt of cities, towns, and villages is not subject to referenda but is capped at 10 percent of assessed valuation by a constitutional provision.

Default and the attendant financial stress it creates are not the only impacts of imprudent borrowing. The costs are considerable even if there is no default. They may include, but are not limited to, higher taxes, reduced services, and reduced flexibility, which restricts government's ability to manage under changing economic conditions. Governments with high debt also are considered a greater risk by lenders and must pay higher interest rates across the board for all borrowing.

Borrowing that evades citizen oversight provisions incurs nonfinancial costs as well, including an erosion of citizen trust in government generally. A variety of strategies have been employed to evade county referenda election and debt limits. The general thrust is to make it appear that the proposal at hand will not create debt for the county government. One common approach is to create a nonprofit agency or quasi-governmental political subdivision that provides an asset to the county government. The government enters into a contract with the agency to lease (purchase) the asset. The agency borrows (issues bonds) with the lease payments as the source of revenue to repay the bondholders. These issuances take on the full character of GO bonds when the contract stipulates that the municipality would, in essence, have to shut down before it could terminate the lease.

A recent case, for instance, in Loudoun County, Virginia, illustrates the point. Seeking to build a new county office complex, the board of supervisors sought voter approval for GO bonds via the normal mechanism—a referendum. Unconvinced of the need for the complex, the voters turned it down. The board of supervisors then created a private, tax-exempt corporation to build the complex (on a scale even grander than previously rejected by county voters) and lease it to the county. The lease payments from the county—derived from general tax revenues—became the sole source of revenue for bond repayment. To assure potential bondholders, a clause in the lease contract with the nonprofit corporation prohibits the county from leasing, renting, or purchasing any other office space for non-constitutional offices should it ever become delinquent or default on its lease payments. Thus the county government is prohibited from using any offices if it doesn't make the lease payments that, in turn, cover the bond payments. Because a county government cannot operate without office space to house essential government functions, Loudoun is fully obligated to see that this debt is repaid. For all intents and purposes, the full faith and credit of the county is on the line, and in every way but name this bond is a GO bond. Such chicanery seriously undermines not only citizen control of local debt but citizen confidence in local government and the institution of *representative* government, where elected

officials are expected to serve the public at large and not special interests that benefit at the expense of local taxpayers.

The Cyclical Battle for Control: Local Government vs. the Citizenry

"Municipal debt" (or bonds) is a generic term applied to the debt instruments issued by state and local governments and other political subdivisions, such as industrial development authorities. At the local level, the history of municipal bonds is the cyclical struggle between citizens and their local governments for control of the decision-making process by which long-term commitments of taxpayer dollars are made.

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During periods when citizen control is effectively asserted, the natural conservative tendency of the taxpayer moderates the enthusiasm of local politicians hungry to build new and impressive monuments. The resulting balance produces reasonable debt loads that preserve the solvency of local governments while providing needed public infrastructure. When citizen control is weakened, excesses routinely occur. Historically, these excesses result in significant financial problems (e.g., higher taxes, reduced services, reduced budgetary flexibility, or default) for the issuing government and its citizens who, in turn, compromise and jeopardize public welfare, safety, and convenience.

The impacts of these ill-advised actions are not limited to the issuing jurisdiction. It is common for them to affect other local governments and not infrequently the state itself, limiting access to capital markets and/or raising the interest rates they must pay. Another common result is in the need for state, and sometimes federal, debt assumption, aid, and intervention. In fact, many states have introduced certain restrictions to improve the accountability of local governments to their constituents and thus avert the need for state intervention or debt assumption.[1]

We are now experiencing a period of reduced citizen control nationwide. As a result, local government debt has increased dramatically in the last thirty years. As has been true in previous eras when accountability has been undermined, the categories of debt responsible for the increase lie almost exclusively outside the current legal provisions that empower citizens to exercise oversight. The current situation is part of a recurrent historical pattern that has routinely required constitutional and statutory responses to restore the appropriate balance to local government finance.

The reason for the cyclical pattern is quite clear. Citizen concern about the appropriateness of using intergenerational resources to underwrite debt obligations is not mirrored in the opinions of local politicians, their staff, or the private sector bond market professionals who advise them. Economists refer to this as the "principal-agent" problem.[2]

Citizens respond to governmental exuberance by introducing statutory and constitutional provisions that restore the fiscal balance until new debt instruments are developed that upset the balance all over again. Virginia's experience reflects this national historical cycle, which once again is at a point at which citizens feel the need to exercise more oversight and reserve to

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themselves approval of long-term financial commitments made by local governments. It is to this issue, the need to restore an appropriate level of accountability in local government finance, that this paper is addressed.

The recommendations that follow are modest legislative proposals to recraft the language of the Code of Virginia to once again capture the spirit of the restrictions placed on county government officials, which require a plebiscite before intergenerational debt may be contracted. The suggested reforms have historical parallels in that they seek to reassert functional accountability in local government consistent with our representative democracy.

THREE MYTHS

Before turning to the central topic, it is important to dispense with three notions that occasionally intrude into and interfere with rational policy discussions concerning local government debt. These myths are (1) all government borrowing is bad, (2) reform proposals will hamstring government, and (3) citizens routinely vote against tax increases and bond proposals out of ignorance or narrow self-interest.

Myth 1: All government borrowing is bad.

The first contention, argued by some guardians of the public purse, is that any long-term commitment of public resources, whether technically debt under strict legal definitions or not, is synonymous with fiscal irresponsibility. In fact, the opposite is true. A government that eschews long-term commitments for capital acquisition acts irresponsibly. Because capital facilities operate long into the future, it makes sense to pay for them over the period of time in which their services are provided. Typically, financing over the useful life of a project apportions costs in a way that is temporally consistent with the use of the capital. Those who receive the public services made possible by the capital investment are also those who pay for the capital through debt service payments incorporated into their annual tax bills.[3]

This outcome is particularly typical at the local level. Taxpayers lay claim to the benefits of such facilities by dint of residency and relinquish them when they move. Given the demands a market-oriented society places on labor mobility, taxpayers are reluctant to fully fund local capital services to be received in the future from today's taxes. The rational response of the local official concerned with satisfying the preferences of constituents is to match the timing of the payments to the flow of services, precisely the function served by long-term debt financing.[4] Any attempt to pay for capital facilities from current revenues or from savings is likely to result in a less than optimal rate of pubic capital formation.[5]

Local governments must plan their budgets for the year ahead (or in some cases for two years). This advance planning requires a balancing of revenue forecasts against forecasts of the demand for services and spending. However, even when the forecasts are met, the timing of expenditures may precede the arrival of revenues, creating the need to borrow within an otherwise balanced fiscal year. Property tax collection and its timing vis-à-vis the incurrence of government expenses illustrate this situation very well.

Finally, temporarily high interest rates may prevail at the time bonds are issued to finance a capital project. In anticipation of a drop in rates, short-term borrowing may produce the lowest cost overall. Therefore, local governments have good reasons to borrow funds, and these reasons are accepted both by taxpayers and the investors who loan the funds.

Myth 2: Reforms will hamstring government.

Second, just as extreme views concerning the use of debt are not helpful, neither are views that negatively characterize reform proposals designed to reassert citizen control over the public purse. Unfortunately, however, accountability reforms too often are condemned as ill-conceived schemes that will tie the hands of government, at best, and as antigovernment plots, at worst. Such views are neither productive nor historically valid. Worse, they undermine our tradition of accountability within a representative form of government. As William O. Douglas pointed out "[t]he sovereign of this Nation is the people, not the bureaucracy…public expenditures goes to the heart of the problem of sovereignty. U.S. Constitution, art. 1, sec. 9;" *Garcia v. San Antonio Metropolitan Transit Authority*, 469 US 528, (1985). Accountability for public expenditures lies at the heart of our representative democracy.

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Justice Stephenson of the Virginia Supreme Court wrote that "government is, or ought to be, instituted for the common benefit, protection, and security of the people," Virginia Constitution, art. I, sec. 3, and the preservation of a free government requires "a firm adherence to justice, moderation, temperance, frugality, and virtue." Virginia Constitution, art. I, sec. 15. These quotations are not merely abstract terms; they are found in the Bill of Rights and have been part of our basic law since the Commonwealth was established. *Dykes v. Northern Va. Transp. Dist. Comm'n*, 242 Va. 357, 411 .E.2d 1 (1991), cert. denied, 504 U.S. 941, 112 S. Ct. 2275, 119 L. Ed. 2d 201, 504 U.S. 941, 112 S. Ct. 2277, 119 L. Ed. 2d 203 (1992).

The issues that concerned citizens and policy makers in the nineteenth and early twentieth centuries are strikingly similar to the issues of concern today: bond volume, the appropriate uses of municipal debt, and maintenance of appropriate accountability via citizen control over the decision-making process. The very continuity of this concern over time means that, absent some cap or limitation on the magnitude of debt that may be contracted by local government officials, citizens generally should have the right to vote on such obligations. As an early researcher in the field put it, "voters should be asked to endorse long-run capital improvement programs."[6]

American history has long been characterized by tension between citizens and their government, specifically local officials, as to the debt decision-making process. The primary source of the tension is the fiscally responsible disposition of citizens concerning long-term claims on public funds and their recurring attempts to assert meaningful control over the decision to incur such obligations by government—obligations taxpayers will be called upon to pay without regard to the advisability of the original expenditure.

Myth 3: Citizens routinely vote against proposals out of ignorance or narrow self-interest.

The third myth asserts citizens routinely oppose necessary expenditures and bond measures out of a mindless indifference to the long-term impacts on the community and a lack

S. A. MacManus (1998) found that votes against school bonds are not motivated by petty interests but rather by an informed demand for accountability for previous expenditures.

of appreciation of actual needs. In fact, bond measures pass routinely. Nationally, between 1946 and 1997, in only eight years did the percentage of favorable votes dip below 50 percent, and those all occurred during poor economic times. In 1997, voters nationally approved 100 percent of the environmental and housing bonds put before them, 79.8 percent of the public facility bonds, and 61.5 percent of the school bonds.[7] As we will see later, Virginia voters follow the national trends, routinely voting to create debt for responsible public purposes.

An often-heard canard advanced by the bond industry, as well as by local government officials and their senior staff, is that citizens are uninformed on the issues, cannot sort out fact from fiction, and vote "no" reflexively or out of a narrow, shortsighted self-interest in low taxes. Independent research presents quite a different picture. S. A. MacManus (1998) found that votes against school bonds are not motivated by petty interests but rather by an informed demand for accountability for previous expenditures. In her survey of people in Florida who rejected school bonds and levies, the most often cited reason for rejection was a failure on the part of government to explain why additional funds were needed. A lottery, approved by the same voters only four years before, had been billed as the solution to education funding by government officials across the state. Voters whom MacManus surveyed, especially those who voted *for* the lottery, were disturbed by the failure of those same officials to justify the apparent contradiction and the need for more money. In contrast to the stereotype, these citizens were well aware of the situation and felt that their demand for accountability had not been met.[8]

The Historical Growth of Local Government Debt

Until the 1840s, states took the lead in issuing debt for capital facilities requirements. In 1840, outstanding state debt amounted to $175 million, compared with municipal debt of only $25 million. The depression of 1837 brought a rash of defaults to state debt issues and began the ascendance of municipalities as the primary borrowers for the state and local sector. By 1870, state debt had roughly doubled to $353 million, but local debt had outstripped state debt and grown to $516 million in Virginia fueled in part by Reconstruction. Net state issuance was negative during the next thirty years, reducing outstanding state debt to $239 million in 1902. Local debt more than filled the gap, breaking the billion-dollar ceiling and rising steadily to $1,630 million by 1902.

Net state issuance turned positive in the twentieth century, enabling the outstanding stock of state debt to increase to $2,274 million by 1932. However, this growth paled in comparison with that of municipal debt, which increased to $15,216 million. The three decades following 1932 continued the rapid increase in outstanding debt of state and local governments. By 1962, state debt had grown to $21,614 million and municipal debt to $55,931 million.[9]

Today total debt figures are considerably harder to assemble because U.S. Census categories do not reflect the development of new instruments and other subterfuges designed to evade voter control. The U.S. Bureau of Census category of "guaranteed" debt reflects the general obligation debt of local governments, generally approved by local taxpayers or subject to state constitutional caps. However, "nonguaranteed" debt (the only other category), originally created to account for legitimate revenue bonds issued for toll roads, water systems, and the like, is now a catchall for any obligation that is not a general obligation. Further, the Census

Bureau relies on self-reporting by local governments. Because both Census categories refer to "debt," the increasing reliance by local governments on instruments that, under narrow legal definitions, do not constitute debt results in underreporting of an unknown magnitude. Within these constraints, the widely accepted figure for local government debt is $1.2 trillion.[10] Unfortunately, this figure does not include the debt instruments most commonly used today by local governments, as they are not technically considered debt by local government officials. As a result much larger figures, some as high as $4 trillion, are claimed by some.

What is inescapably true is that the vast majority of the new long-term commitments of local public resources occur in what the Census Bureau terms "non-guaranteed" debt, that is, all debt not considered a general obligation of the issuer. There are two primary kinds of nonguaranteed debt: genuine revenue debt and lease instruments. Unfortunately, the Census Bureau lumps together these two distinct types of instruments—instruments between which important distinctions exist. These distinctions are described in some detail below.

The primary characteristics of nonguaranteed debt that distinguish it from guaranteed debt are that they: (1) carry a higher interest rate than the corresponding guaranteed (general obligation) instrument, and (2) avoid constitutional and statutory citizen oversight and accountability provisions. Genuine revenue instruments are secured by a pledge of revenues other than tax revenues (e.g., bridge tolls, water rates). Investors make purchase decisions based on their assessment of the security offered by the revenue source.

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Lease-revenue debt shares the general characteristics of all nonguaranteed debt but goes much further. First, lease-revenue obligations are secured by payments made from tax revenues and represent continuing claims on the general fund of the issuer. Second, the obligation to pay is enforced by contractual provisions, which are tantamount to a pledge of the full faith and credit of the issuing locality because of the nonsubstitution clause, as the case of Brevard County, Florida, discussed below, clearly demonstrates.

Debt Issuance and Default 1800–1962

Overview

The history of the municipal bond market is checkered with defaults. Default occurs when a government fails to make principal and interest payments in full and on time. Indeed, "[o]ne conclusion that can be made at the outset is that we have a long and rich history of municipal bond defaults."[11]

Prior to the beginning of the nineteenth century, most state and local capital improvements were modest and were financed with some combination of loans, sales of public lands, donations, subscriptions, lotteries, and current taxation.[12] As the demand for public services grew, state legislatures approved the issuance of bonds for specific projects. Shortly thereafter, states and localities began to issue bonds in earnest to finance internal improvements.[13]

As debt issuance began in earnest, accountability and expediency clashed. The clash was precipitated by the financial difficulties that arose from ill-conceived commitments of public

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funds. The early use of debt without citizen approval provided the impetus for citizen control provisions, as it continues to do today.

As the growing population filled the eastern states and expanded westward in the early nineteenth century, economic development "opportunities" created a demand for transportation facilities to tie the expanding country together and facilitate trade between its far-flung sections. The rapid evolution of science and technology caused the nature of this transportation network to change several times over the period, forcing economic obsolescence on many facilities long before their useful lives would have expired in a less technologically dynamic economy.

Many of the original state development efforts were devoted to such things as canal construction and plank roads. Government attention then switched to the arrival of the railroad and local government became the primary funder. Eventually, the railroad was supplanted by the automobile and supplemented by the airplane. All of these change necessitated, or at least elicited, public, especially local government, investments to facilitate their development.

Early Nineteenth Century—State Focus

This history of debt issuance is replete with examples of what has come to be called conduit financing—the issuance of bonds by a governmental unit and the use of the bond proceeds by or on behalf of a nongovernmental entity. It is in this capacity that state governments began borrowing in earnest. Maryland and Ohio initiated the practice to finance construction of the Chesapeake and Ohio Canal. The success of that venture led to further borrowing for canal construction in New York, Pennsylvania, Indiana, Illinois, and Michigan during the 1820s and 1830s.

Following the financial collapse of 1837, most state canal building programs came to a halt. As the financial pictured darkened into the depression of the early 1840s, many states were forced into default on these bonds (i.e., they failed to make timely interest and principal payments). Many canals were never completed and the revenues, which were supposed to retire the bonds even for many completed canals, never materialized. By 1842, nine states had defaulted on their debt—Mississippi, Florida, Arkansas, Indiana, Illinois, Michigan, Maryland, Pennsylvania, and Louisiana. Four of these states actually repudiated (i.e., denied the legality of or otherwise refused to honor) some of their debt—Arkansas, Florida, Michigan, and Mississippi. Where default did not occur, taxes were raised and/or services curtailed. In either case, the reaction of an outraged citizenry was swift and comprehensive. State after state adopted constitutional or statutory restrictions on borrowing, which are discussed more fully in the next section.

Rise of Local Government Borrowing and Early Defaults

Following the Civil War, railroads clamored for public investment, supplanting the still unpaid-for canals as the primary transportation technology. Finding state governments constrained, developers turned to cities and counties. Because municipalities were not generally included in the citizen-imposed restrictions on state borrowing, they filled the continuing demand for public borrowing to fund private enterprise. At this point, local government became the primary borrower, a situation that continues to the present time.

Just as railroads were supplanting canals and turnpikes, many towns were competing for railroad lines. This effort usually entailed some sort of merging of public and private credit. Municipalities guaranteed railroad securities or issued municipal bonds and used the bond proceeds to purchase stock in a railroad company. During the 1830s, the City of Baltimore, for example, loaned more than $4 million to the Baltimore and Ohio Railroad, the Baltimore and Susquehanna Railroad, and the Susquehanna Canal, thereby increasing its outstanding debt from less than $1 million to more than $5 million.[14]

Citizen objections resulted in numerous court cases whose goal was to impose state-level restrictions on local governments. The legal opinions offered at that time have a familiar ring to today's student of municipal bonds and accountability. An Alabama court ruled in 1854 that tax-supported bond financing:

> Legitimately extends to the employment of all those means and appliances ordinarily adopted, or which may be calculated, to develop the resources of the state and add to the agrarian wealth and prosperity of the citizens; such, for example, as providing outlets for commerce, and opening up channels of intercommunication between different parts of the State.
>
> *Stein v. Mayor et al of Mobile,* 24 Ala. 591, 614 (1854)

In another case, the Tennessee Supreme Court approved support for conduit bonds based on the indirect benefits that enhance the commercial interest of a town. *Nichol v. Mayor etc. of Nashville, 9 Humphreys Tenn. 252 (1848)*

One nineteenth century court opinion clearly characterized these instruments. Justice Grier, writing for the Federal Circuit Court for the Western District of Pennsylvania in 1859, pointedly commented that municipal aid to railroads arose because the citizens had already restricted state support:

> The state being unwilling to involve herself in further debt, and risk a second insolvency, the scheme of city, county, and borough subscriptions was invented and put in practice.
>
> *Oelrich v. Pittsburgh*, Fed. Case No. 10442 (1859)

Localities, particularly in the Midwest, believed that their economic development would be severely constrained if they did not attract the railroad, and that their chances of doing so depended upon the provision of financial aid. Accordingly, jurisdictions often competed with each other to provide the "best deal," often issuing bonds in excess of what the existing tax base

Accordingly, jurisdictions often competed with each other to provide the "best deal," often issuing bonds in excess of what the existing tax base could reasonably support, but anticipating the availability of stock dividends and an increase in land values and tax base brought on by the arrival of the railroad. Unfortunately, bonds frequently were issued and stock purchased without the railroad ever coming to town.

The current situation is the result of counteractions taken by government officials and private sector bond interests to devise instruments that do not meet the definition of debt and to organize new quasi-governmental entities (e.g., industrial development authorities) which are legally separate from the local governments that create them, and hence theoretically independent of the debt restrictions placed on localities.

could reasonably support, but anticipating the availability of stock dividends and an increase in land values and tax base brought on by the arrival of the railroad.

Unfortunately, bonds frequently were issued and stock purchased without the railroad ever coming to town. In other cases, financial aid encouraged overbuilding of railroad lines, causing many of them to fail or merge. In the absence of the railroad and stock dividends, the value of a town's land and tax base often proved inadequate to pay the principal and interest on the bonds.[15]

Virginia's History

Virginia's experience during this era was typical. As early as May 1784, the General Assembly passed "an act for clearing and improving the navigation of James River." The James River Company was incorporated for that purpose and, under an act passed February 17, 1820, a compact was made between the Commonwealth and the company, under the terms of which the company acted as agents in trust for the Commonwealth. At the time it was contemplated that the Commonwealth, through the company, would improve the navigation of the James and Jackson's rivers from tide water to the mouth of Dunlap's Creek. Navigable canals and locks would be built where necessary, as would be a road extending to the great falls of the Kanawha River. Above the falls, work on the Kanawha River would render it navigable to the Ohio River.

However, changing times and serious fiscal and engineering difficulties caused the General Assembly to subsequently withdraw its support. In an act passed March 16, 1832, the General Assembly "for the purpose of connecting the tide water of James river with the navigable waters deemed it expedient to incorporate a joint stock company, to which the Commonwealth's interest in the James River Company was be transferred."

Stock sales were slow until the Common Council of the City of Richmond stepped forward and, with the permission of the General Assembly in the form of enabling legislation passed February 13, 1833, purchased the bulk of the company's stock. The legislation also expanded the city's authority, permitting it "to borrow from time to time, on behalf of said corporation, such sums of money as would be required" for its operations and "to levy, assess and collect such taxes…for the purpose of paying the interest and redeeming the principal of any loan which might be negotiated by virtue of this act."

Citizens objected to these arrangements just as vehemently as they did in other states, demanding accountability and oversight of commitments being made in their name and at their expense. The first citizen effort to win such accountability and oversight in Virginia was made through the courts by John Goddin who, in July 1836, filed a class action suit on behalf of himself and "owners of real property…who had not consented to the proceedings." The complaint alleged that the state government, restrained from further financial adventures of its own, did not have the authority to authorize such activities by the City of Richmond. *Goddin v. Crump*, 35 Va. 120, 1837 Va. LEXIS 12, 8 Leigh 120 March, (1837).

The suit, like its counterparts across the nation, was unsuccessful. Reflecting a national trend, however, Virginia's citizens continued to demand restrictions on local government activities and oversight provisions, which were subsequently enacted. These restrictions, again mirroring actions taken nationally, specify that local governments may not incur debt without citizen

approval. As we will see, the current situation is the result of counteractions taken by government officials and private sector bond interests to devise instruments that do not meet the definition of debt and to organize new quasi-governmental entities (e.g., industrial development authorities) which are legally separate from the local governments that create them, and hence theoretically independent of the debt restrictions placed on localities.

Though the depression of the 1840s caused taxpayers to demand constitutional and statutory restrictions on state borrowing power, the depression following the Panic of 1873, and the series of municipal bond defaults and repudiations that followed, made them aware of their exposure at the local level. These defaults were so widespread that they may have totaled as much as 20 percent of the outstanding municipal bonds at the time.[16]

The result was a move to impose restrictions on municipal borrowing, although not to the degree that state borrowing was restricted thirty years earlier. Typically, the limits imposed on municipal governments were based on some reference ratio, often debt as a percentage of property value in the jurisdiction. Virginia's constitution contains such provisions (i.e., art. 7, sec.10(a)), reflecting the national mood. Of these restrictions, more will be said later.

In the first overt attempt to evade the provisions designed to maintain accountability, local government debt was issued by "special assessment districts" on a massive scale.

"Specials" Allow Local Government to Evade Accountability

After a hiatus, local government debt issuance resumed at an accelerating pace from the turn of the century until the Great Depression. Again, defaults and repudiations ensued. The debt now issued differed slightly from the debt that was controlled legally. In the first overt attempt to evade the provisions designed to maintain accountability, local government debt was issued by "special assessment districts" on a massive scale. A tenuous legal distinction may be found between the old canal and railroad bonds and the millions of dollars of improvement bonds issued in ever increasing volume through the late 1920s. In the former case, the money generated directly aided private interests while in the latter the bonds legally and ostensibly were for public purposes (e.g., irrigation, roads). It was this distinction that avoided accountability requirements and allowed the issuance of "specials" over the objections of citizens. The real purpose, however, was to allow the real estate promoter to push new properties or sell "new" farm land.[17]

In a legal sense, these specials, as the bonds were called, were not considered a debt of the city or county in which the special district existed and by which the debt was created. Such legal distinction allowed debt to accumulate but did not always protect the taxpayer from getting stuck with the bill when defaults occurred. *Shapter et al v. City and County of San Francisco* 115 F. 1021, 1902 U.S. App. LEXIS 4296, 1902; *The State, John D. Norris, Prosecutor, v. The City Of Elizabeth* 51 N.J.L. 485, 18 A. 302, 1889 N.J. Super. LEXIS 32, 22 Vroom 485. When the economy turned sour, the debt burden the specials caused led to a significant number of defaults, perhaps amounting to as much as 10 percent of the total debt outstanding[18] and renewed pressure to increase accountability.[19]

Virginia was relatively free of local government defaults during the 1930s. It achieved this distinction in a unique way, which preserved the quality of its credits but not without costs being imposed on citizens. Faced with economic pressure on its own budget and pressure from local government bondholders to assume responsibility for their debts, the Virginia Legislature authorized in 1932 direct payments to bondholders to be deducted from state intergovernmental

aid appropriated from the offending local government body (except schools). This action satisfied bondholders, who now found a source for repayment through the State Controller's Office but left citizens holding the bag.[20]

The political process balances the push from constituents for public provision of more services against the pull of the taxpayers who must forego privately purchased goods and services to finance the public ones.

A Public Choice Analysis of Taxation vs. Borrowing

By David W. Kreutzer, Ph.D.

Most of us do not read our electric meter. Nor do most of us go to public utility commission rate hearings to keep track of electric rates. We are made aware of our electricity consumption when we pay the bill. When the bill gets higher than we expect or can afford we make adjustments such as being more careful to turn off lights or to keep the heating or air conditioning turned down. The bill comes due close enough to the actual time of consumption that we can reasonably adjust to changes in the price of electricity. We track our government finances in a similarly indirect, but timely, way. Few of us regularly scrutinize budget documents and tax code. We have an awareness of our tax burdens when we receive our tax bills—annually we pay our income taxes, once or twice per year we pay our personal-property and real-estate taxes, daily we are reminded of our sales-tax burden. When these bills seem to rise out of proportion to benefits or income, voters may demand an accounting from their representatives and appointed officials.

The political process balances the push from constituents for public provision of more services against the pull of the taxpayers who must forego privately purchased goods and services to finance the public ones. Though not perfect, this struggle for balance saves us from the extremes of either public parsimony or public profligacy.

Returning to our electric bill, imagine that instead of sending bills for the previous month, the electric company sent the bills out with a ten-year delay (with the interest added). By stretching the link between consumption and expenditure, awareness of price changes and adjustment to them becomes less effective. In a similar fashion, when a government finances its expenditures by borrowing, instead of taxing, taxpayers/voters do not get the same timely notice of their obligations and will offer less resistance to extractions from their private purses.

There is precious little incentive in the political arena to provide such notice, however. The politician who delivers benefits that can be readily seen gains support. The politician who extracts taxes that are noticeable loses support. The politician who provides visible benefits while successfully hiding the costs gains votes. The politician who exposes the true costs of benefits may gain some votes from taxpayers grateful for the information, but this same politician will lose some votes from those less likely to receive the benefits. The bias runs toward hiding costs. Deficit financing can be a tool for hiding these costs in the short run.

Taking our analogy one step further, imagine that not only is the electric bill delayed by ten years, but it also must be paid by the resident of the dwelling at the time

the bill is sent, and not necessarily by whoever consumed the electricity. The incentive to mind the lights and the air conditioning is considerably reduced. So, too, will the incentive to monitor the public purse be reduced when the obligation to pay is shifted to a vaguely defined, future set of taxpayers. In this instance, even if citizens are fully aware of the actual costs, they are happy to try and have some other group pay for them.

To this point we can see two reasons why borrowing tilts the scales toward more spending. The first is that borrowing can conceal the actual cost, and the second is that it creates the possibility of shifting the costs to those who are not part of the current political process. The political desire to conceal and shift costs is always present, whether revenue is raised via taxation or borrowing. However, deficit financing offers greater latitude for these abuses than does taxing.

Although debt can be a legitimate and important tool in public finance, deficit spending in democracy requires different checks and balances than does taxation. In recognition of the special concerns surrounding public borrowing, the Virginia Constitution imposes additional constraints. These constraints are designed to ensure that the public is more fully aware of the liabilities that are being incurred and that future taxpayers are not overly burdened by current expenditures. In particular, for general obligation bonds, limits are placed on the magnitude of borrowing, and requirements are stipulated for specific voter approval of the bonds. These are dual safeguards against the dual abuses mentioned above.

There are no sales commissions on taxation. There are certainly those who benefit from any government expenditure, and in fact we hope that many do benefit. It is the beneficiaries who create the political pressure for the expenditure in the first place. As we have noted, this pressure for expenditure is countered by taxpayers' reluctance to pay taxes. This counterweight to spending is diminished when the method of finance is borrowing. However, still another factor tilts the scales when it comes to deficit financing. Public borrowing is done through private intermediaries. These intermediaries—bond attorneys and bond underwriters—typically are compensated in proportion to the amount being borrowed, that is, the more money borrowed, the more their income.

Suppose someone suggests building a town recreation facility with a swimming pool and gymnasium and that it be financed by a meals tax. Those supporting the project will press the town council to vote in favor. Those who eat out and those who own or are employed in restaurants will be inclined to oppose the project. The magnitude of the expected benefits motivates the pressure exerted by the former, while the magnitude of the expected costs motivates the pressure exerted by the latter.

However, if this project is to be financed by issuing bonds (that is, by borrowing), there will be less opposition from taxpayers and more encouragement from those who stand to profit from underwriting the bonds. These profits are considerable. For the five years 1995-1999, over $8 billion dollars of bonds were issued by municipalities in Virginia. Using two percent as the estimate of issuing costs implies $165 million of revenues to underwriters and bond counsel.

The political desire to conceal and shift costs is always present, whether revenue is raised via taxation or borrowing. However, deficit financing offers greater latitude for these abuses than does taxing.

> Given these profits and given the political preference for deficit financing, it should not be surprising that constitutional constraints on borrowing prove inconvenient to some.

Current Era Defaults

Although they rarely make the evening news reports or appear in other media outlets, defaults continue to punctuate the municipal bond market. Further, they consistently arise from the use of instruments that reduce or eliminate the accountability of local government but not the liability of citizens. In the current era, default or threats of default are met by unified insistence by bond market actors that the legal fictions by which the obligations were created, the very fictions that reduced accountability, be swept aside to ensure repayment. Accommodating this demand routinely results in state, and sometimes federal, assumption of these debts.

In 1975, the Urban Development Corporation (UDC), a public authority created in the late 1960s by the New York State Legislature, achieved a dubious distinction: It became the first major issuer of municipal bonds since the Great Depression to default on its obligations. The results were catastrophic. Private capital markets shut the door on the state virtually overnight. New York City was thrown into a fiscal crisis, which resulted in bankruptcy and a state and federal bailout. The destructive effects can still be seen today, as the State of New York continues to underwrite UDC and NYC expenses. The fallout was not limited to New York State but spread to the entire nation because of the national nature of the municipal bond market.[21]

In 1975, the Urban Development Corporation (UDC), a public authority created in the late 1960s by the New York State Legislature, achieved a dubious distinction: It became the first major issuer of municipal bonds since the Great Depression to default on its obligations. The results were catastrophic. Private capital markets shut the door on the state virtually overnight. New York City was thrown into a fiscal crisis, which resulted in bankruptcy and a state and federal bailout.

In the summer of 1983, after years of deepening problems, the Washington Public Power Supply System (WPPSS), an association of local governments in Washington State, defaulted on interest payments due on $2.25 billion in outstanding bonds. WPPSS made it clear that it did not expect to make interest payments on those bonds in the future, and it did not expect to be able to pay back the principal to the tens of thousands of bondholders who had invested in Project 4 and 5 bonds. As a disruption of the national municipal bond market, the WPPSS default was unmatched by any event since the Great Depression. Of the five WPPSS nuclear plant projects for which over $8 billion has been borrowed, only one has begun limited operation; the rest have been terminated or indefinitely delayed.[22]

WPPSS ultimately repudiated the Project 4 and 5 bonds. The balance of the debt was, in effect, assumed by the Federal government via payments through the Bonneville Power Administration (BPA). Technically the BPA is only a conduit between the utilities and the bond trustee. However, utilities that do not make their WPPSS payments are not penalized and BPA prioritizes payments to the bond trustee over payments to the Treasury. In years in which BPA lacks sufficient funds, the Treasury is left unpaid, or even borrowed from, to ensure bond payments to the trustee.

In December 1994, Orange County stunned the markets by announcing that its investment pool had suffered a loss of $1.6 billion. This loss was the largest ever recorded by a local government investment pool and led to the bankruptcy of the county shortly thereafter. The county, fortunately, fared much better than had been feared. Disaster was narrowly avoided as

schools were paid back just enough to avoid default. Luck also played a role. The booming economy produced greater sales tax receipts. However, payments by the State of California were still required.

Since then, Orange County has filed a recovery plan centered on a sale of $800 million in thirty-year recovery certificates of participation (COP) in which creditors are to be repaid in full. Some county expenses were cut, or transferred to other agencies. Investors in the pool (i.e., cities, schools, agencies, and the county itself), however, are still facing a $800 million shortfall. It is unlikely the $1.6 billion loss will ever be recovered. So far, the county has settled a $2 billion lawsuit against Merrill Lynch, its principal broker, for $437 million. And so far, the county has recovered $650 million, a far cry from the $1.6 billion loss.[23] Further, the panic caused by the default caused a "run" on the TexPool investment pool, which cost Texas taxpayers at least $55 million.[24]

One feature ties all these incidents together: All the obligations involved were contracted without citizen approval and citizens had no effective redress. Yet, with the exception of incidents of outright repudiation, the taxpayer was stuck with the higher taxes and reduced services as a result. In each incident, the imposition of unwarranted and unwanted debt produced pressure for citizen oversight and control.

One feature ties all these incidents together: All the obligations involved were contracted without citizen approval and citizens had no effective redress. Yet, with the exception of incidents of outright repudiation, the taxpayer was stuck with the higher taxes and reduced services as a result.

Accountability Mechanisms: State and Local Restrictions on Debt Issuance

Before 1840 most state constitutions did not refer to state borrowing, and the states were not restricted on the matter. The tax increases, defaults, and repudiations of the 1840s, however, created widespread citizen demand for permanent restrictions on the borrowing power of state legislatures. Although Rhode Island was the first state to impose restrictions, the New Jersey restriction of 1844 became the one emulated by most other states.[25] The Virginia Constitution's language is an example of this emulation, reflecting the tenor of the times and the mood of the citizens.

> No debt shall be contracted by or in behalf of the Commonwealth except as provided herein.(a) Debts to meet emergencies and redeem previous debt obligations. The General Assembly may (1) contract debts to suppress insurrection, repel invasion, or defend the Commonwealth in time of war; (2) contract debts, or may authorize the Governor to contract debts, to meet casual deficits in the revenue or in anticipation of the collection of revenues of the Commonwealth for the then current fiscal year within the amount of authorized appropriations, provided that the total of such indebtedness shall not exceed thirty per centum of an amount equal to 1.15 times the average annual tax revenues of the Commonwealth derived from taxes on income and retail sales, as certified by the Auditor of Public Accounts, for the preceding fiscal year and that each such debt shall mature within twelve months from the date such debt is incurred; and (3) contract debts to redeem a previous debt obligation of the Commonwealth.
>
> *Virginia Constitution, art. 10, sec 9a*

All state constitutions now contain restrictions on state and local borrowing. One should not, however, be deceived by these restrictions, for they apply almost exclusively to the issuance of general obligation debt, that is, only those instruments backed by the full faith and credit of the issuing government.

By the time of the Civil War, nineteen states had adopted constitutional restrictions on the amount and purpose of state borrowing. Additional states in the South adopted restrictions during Reconstruction, and all states admitted to the Union since the Civil War have had some sort of constitutional restriction of this general type.[26]

Following the financial collapse of 1873, the angry reaction of the outraged citizenry produced constitutional and statutory restrictions on local government borrowing. These restrictions usually entailed some combination of prohibitions against lending to private individuals or corporations, requirements to hold referenda before issuing bonds, and caps on the ratio of outstanding debt to assessed valuation. Again, the Virginia Constitution's language is typical:

> (1)(a) No city or town shall issue any bonds or other interest-bearing obligations which, including existing indebtedness, shall at any time exceed ten per centum of the assessed valuation of the real estate in the city or town subject to taxation, as shown by the last preceding assessment for taxes.
>
> (2) Bonds pledging the full faith and credit of such city or town authorized by an ordinance enacted in accordance with Section 7, and approved by the affirmative vote of the qualified voters of the city or town voting upon the question of their issuance.
>
> *Virginia Constitution, art. 6, sec. 10*

All state constitutions now contain restrictions on state and local borrowing.[27] One should not, however, be deceived by these restrictions, for they apply almost exclusively to the issuance of general obligation debt, that is, only those instruments backed by the full faith and credit of the issuing government. However, as a noted authority in the field, points out:

> [t]he intention of the people in adopting the debt limitations ... seems quite clear. These limitations were intended either to prohibit state borrowing for public improvements or to require public approval of this type of borrowing.[28]

Devices to Avoid Debt Limitations

Others see the problem quite differently.

> [T]he evasions of debt limitations seem to indicate a recognition that the capital needs of government have to be met, and that the debt limit legacy of the 19th century would prohibit governments from meeting these needs if the restrictions were not circumvented.[29]

This recognition means that, rather than incur the "costs" of a public campaign to alter

the constitutional debt limits or seek citizen approval, local government officials have chosen to create quasi-governmental political subdivisions to act as conduit borrowers, which—as they do not constitute a *locality*—operate outside the statutory and constitutional limitations on debt. Alternatively, local government officials have created whole new classes of debt which evade constitutional limitations solely because they do not meet an artificially narrow legal definition of debt. Whatever the subterfuge, these attempts, if left unchecked, are no less than a subversion of the clear intent of the law with regard to citizen oversight. The implications of recent instruments that circumvent accountability are clear. They have "almost completely undermined the restrictive ability of constitutional debt limitations."[30]

Upon adoption of debt limitations, purchasers of new issues required assurance that the debt was being issued in compliance with these limitations. Public officials thus began to hire specialized attorneys to assist them in issuing debt within the letter of the new laws. According to the National Association of Bond Lawyers (1988), "Such attorneys provided an opinion that, notwithstanding the limitations imposed upon debt, the particular debt in question was valid and enforceable."

These attorneys are the forerunners of today's bond counsel. "Over the years, bond counsel and public officials, with the acquiescence of the court system, have developed several institutions and devices to evade the intent of these debt limitations."[31] It is these devices that, in a repetition of history, create unreasonable debt loads and threaten to precipitate a new round of defaults and their attendant fallout.[32] This fallout includes rising debt loads, increased borrowing costs, decreased citizen trust in government, falling voter participation, and a resurgence of interest in reasserting citizen oversight and accountability.

Much of the current problem stems from instruments that narrowly skirt the legal definition of debt but which are binding obligations despite the legal subterfuge that eliminates citizen oversight and government accountability.

The Current Period 1960–2000

Overall, municipal debt is again on the increase, at rates that outstrip growth measures and other legitimate economic drivers.[33] Much of the current problem stems from instruments that narrowly skirt the legal definition of debt but which are binding obligations despite the legal subterfuge that eliminates citizen oversight and government accountability. In a repeat of the historical cycle outlined above, the instruments being used evade the clear intent of constitutional provisions and statutes designed to ensure accountability. Like the local funding of railroads when the states had been constrained and the "specials" used in the 1920s, these instruments increase the overall burden on the public fisc, creating a situation in which budgetary flexibility is reduced and threats to fiscal stability arising from changes in economic conditions are magnified. Excessive encumbrance of public resources is a house of cards. The new instruments are no better in this regard. The first of these instruments introduced in the modern period was the "moral obligation" bond.

Moral Obligation Bonds

Moral obligations attempt to create a distinction between a local government's "moral obligation" to appropriate the necessary funds to cover a default of various agencies and authorities and the legal obligation to do so. If a government making a moral obligation pledge fails to appropriate adequate funds to repay bond investors, it is not in technical default, according to the bond industry that promotes these transactions. Rather, the government has simply broken a nonbinding promise. Thus the moral obligation does not constitute "debt" under technical

legal definitions and avoids the oversight provisions in the law.

This type of debt was issued extensively by the State of New York and other states to finance public housing and other projects during the 1960s and 1970s.[34] John Mitchell came up with the idea while serving as bond counsel to New York's Governor Nelson Rockefeller in the 1960s. In an effort to get around the voter approval process, Mitchell attached language to the offerings, which indicated the state's intent to meet bond payments even though it was not obligated to do so.[35] Over twenty years later Marlin and Mysak (1991) quote Mitchell in an interview in the *Bond Buyer* about his role in creating this innovation. After being asked to respond to the concerns of some that moral obligations represent a "form of political elitism that bypasses the voter's right to a referendum or an initiative," Mitchell responded laconically, "That's exactly the purpose of them."[36]

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Moral obligations are treated differently by different rating agencies. The Public Securities Association notes that Standard and Poor's usually assigns a lower rating to a moral obligation bond than it would assign to a full faith and credit bond of the same guarantor, unless the project can be rated better on its own. Moody's simply ignores the moral obligation and rates the issue on its own pledged revenue support.[37]

The 1975 UDC debacle, referenced above, was caused by moral obligation bonds. The State of New York was forced to "make good" on the short falls.[38] Again, citizens demanded action. Moral obligation bonds were outlawed in New York State in 1976 [39] and they have fallen out of favor nationally.

Lease-Revenue Bonds

This new instrument of choice combines the "advantages" of the moral obligation (avoids plebiscite requirements and debt limits because it is not technically debt of a government entity) with the ability to avoid some tax and expenditure limits. It does so because the lease-revenue bond appears to be like a genuine revenue bond.

Legitimate revenue bonds depend upon a specific revenue source, usually a fee, for repayment and typically are used by government enterprise fund activities. For example, genuine revenue bonds often are used to finance wastewater treatment capital investments. User fees, apportioned on the basis of usage, are the sole source of the funds to retire the issue. Therefore, the issue is rated and purchased based solely on the reliability of this discrete revenue source.

The lease-revenue bond deviates from this respected practice in that the stream of lease payments comes not from fees or dedicated taxes (e.g., improvement districts) but from the annual appropriation of general tax revenue in the form of "lease payments." The contracts associated with lease-revenue bonds specifically recognize this difference.[40] However, lease-revenue bonds technically are not a debt of the government and rely on annual (or biennial) budget decision processes. As we will see, they represent a fixed, long-term commitment and are functionally identical to a GO bond used for the same purpose.

The key to the exclusion of lease revenues from the legal definition of debt lies in the nonappropriation clause found in all such contracts. The typical nonappropriation clause provides that the obligation of a governmental unit to make payments under a lease-revenue agreement is contingent upon sufficient appropriation of funds to make the payments. The purpose of such a clause is to prevent future-year lease-revenue payment obligations from being classified as debt under state or local laws. If the obligations are debt, they are subject to state limitations and procedures for incurring debt.[41]

Orange County will pay interest only for the first twenty years. When principal payments come due, today's public servants will be safely in retirement, and voters will be stuck with the tab.

The nonappropriation clause theoretically permits a local government lessee to cancel an agreement without penalty or default at the end of any year or fiscal period if funds are not appropriated to make the payments due under the agreement in the next year or fiscal period. The essential effect of putting a nonappropriation clause in a lease contract is that payments in any year are due only as the money to make them is appropriated. Future years' payments are not due until they are appropriated and, thus, in most states they are not debt in a legal sense; rather, they are current expenses.[42]

Four parties are involved in lease debt. The first is the authority or agency issuing the bonds. This party acts as a lessor, leasing some facility or property to a lessee. The second party is the lessee, generally the local government that authorizes payments to the authority or lessor for use of the funded facility; these latter payments are used to pay the principal and interest on the debt. The third party is the investor, who buys the lease-revenue bonds and is paid back by the lessor from the lease payments. The fourth party consists of the local taxpayers, who are not only denied the right to vote on the need for the leased facility, but who are taxed, along with their children, to pay for a debt they never agreed to incur. The lease payments may even be secured by the full faith and credit pledge and tax authority of a local government.

Among the "advantages" of lease-revenue bonds is the ability to borrow outside of the general obligation debt limit. Another potential "advantage" is that this type of security typically avoids the voter approval associated with general obligation debt.[43] Higher interest rates, often necessary credit enhancement premiums (bond insurance), and the added underwriting/ legal costs to circumvent the debt limitation provisions constitute the primary disadvantages.[44] In addition to the increased costs, such financing may raise concerns with the electorate about circumventing their approval authority in making debt equivalent commitments. Such concerns undermine citizen trust in government and leave the door open to excessive debt burdens.

Certificates of Participation: Common Example of Lease-Backed Financing

Certificates of Participation (COP) typically are used to purchase or improve real property or equipment. COP are one of the most common forms of lease-backed financing. Instead of buying bonds, investors purchase certificates entitling them to a share of the lease payments associated with a specific endeavor. The proceeds of the lease payments, less operations expenses and reserve payments, are paid to investors through a trustee, who issues the certificates, monitors the project, and distributes the money back to certificate holders.[45]

With several notable exceptions, courts across the nation have held that lease-revenue instruments do not constitute debt. Virginia's opinions are typical of the legal opinions issued. They rely upon an artificially narrow interpretation of the statutes and contracts, tending to ignore legislative intent and market realities.

To avoid classification as debt, the issue normally must be structured to avoid unqualified government liability. As discussed above, this objective is accomplished through legal language that qualifies the government's promise of repayment subject to the presence of sufficient appropriations and the absence of catastrophic events, and that establishes an agreement similar to a renewable lease. Investors typically are protected by insurance and covenants against catastrophic loss. Many municipalities in states with citizen accountability requirements for general obligations rely on COP, as they are not considered debt.

Interestingly, it was $800 million in COP that Orange County finally sold to "solve" its bankruptcy problem. The structure of the payments is illustrative of the intent of those who forged this deal behind the voters' backs and over their vehement objections. Orange County will pay interest only for the first twenty years. When principal payments come due, today's public servants will be safely in retirement, and voters will be stuck with the tab. Of course, such an arrangement will cost a great deal since only interest is being paid and the principal is not being reduced—even more so when one considers the high interest rates of nonguaranteed debt. However, the citizens of Orange County who have already suffered service cuts are impotent. Their votes counted for nothing because courts have consistently held that such "lease" arrangements technically are not debt and, therefore, not subject to debt limitations or plebiscite requirements. Virginia court decisions parallel those in the rest of the nation.

Lease Financing Constructively Debt

With several notable exceptions, courts across the nation have held that lease-revenue instruments do not constitute debt. Virginia's opinions are typical of the legal opinions issued. They rely upon an artificially narrow interpretation of the statutes and contracts, tending to ignore legislative intent and market realities. Virginia courts have recognized the intentions of the restrictions:

> It was clearly intended to afford municipalities protection against undue extravagance by their governing bodies and, at the same time, give them power, with the approval of the electors, to exceed the limitations for the purpose of financing self-liquidating capital improvements.
>
> *Town of South Hill v. Allen*, 177 Va. 154, 12 S.E.2d 770 (1941); *Button v. Day*, 205 Va. 629, 139 S.E.2d 91 (1964)
>
> Yet Virginia's courts feel compelled to make their judgments based on black letter law:
>
> Whether an indebtedness assumed by a city is subject to this section must be determined by the language and terms of the contract creating the obligation, and not by a legislative interpretation, however well meant.
>
> *Button v. Day,* 205 Va. 629, 139 S.E.2d 91 (1964)

Therefore, lease-revenue obligations, sometimes considered subject to appropriation financing because of their structure as discussed above, are not legally "debt":

> "Subject to appropriation" financing does not create constitutionally cognizable debt because it does not impose any enforceable duty or liability on the county. Expectations of bondholders, county officials, or bond rating agencies do not create county "debt" any more than the expectations of the railway for continued appropriations by the state created state debt.
>
> *Dykes v. Northern Va. Transp. Dist. Comm'n,* 242 Va. 357, 411 S.E.2d 1 (1991), cert. denied, 504 U.S. 941, 112 S. Ct. 2275, 119 L. Ed. 2d 201, 504 U.S. 941, 112 S. Ct. 2277, 119 L. Ed. 2d 203 (1992)

As we can see, the courts rely upon the black letter law of the constitutionally and statutorily imposed restrictions on local governments. Moreover, as the brief history set out above shows this situation has arisen before. Accountability mechanisms are evaded and more sophisticated language becomes necessary to reassert meaningful citizen oversight.

Specifically, Virginia's courts find that (1) lease-revenue obligations do not constitute a debt within the "current" definition, and (2) the expectations of "bondholders, county officials, or bond rating agencies" do not have an impact on the decision's legal basis. The definition of "current," however, is something of a moving target among activist judges and the bond industry. This definition shifts constantly, always keeping just ahead of public demands for oversight.

Though the former is a legal opinion, the latter is an empirical question. The reality is somewhat different from what the courts seem to believe. In fact, lease-revenue obligations directly undermine some of a citizen's most basic rights. The most direct attack is on the rights of the citizen with respect to representation in taxation. As we will see, what the courts dismiss as mere "expectations" are, in fact, powerful legal, intergovernmental, and market forces, which strip citizens of a meaningful role in their government and, in effect, impose tax burdens without their consent.

What are these forces and how do they function? First, it must be understood that the municipal bond market is dominated by a few private entities. Of all the underwriters, the top ten account for 63 percent of the dollar volume of issuances in 1998; of all the bond counselors, the top ten national firms do 37 percent of the business, and only six companies provide bond insurance. The consensus of this relatively small group of private sector professionals is extremely important to municipal issuers. In many ways, it determines their access to capital markets and ties their actions together in a national web of consequences.

For instance, the Richmond, California, school district, faced with bankruptcy in 1991, adopted a financial recovery plan that envisioned making no payments on its outstanding COP for ten years. Their decision to seek deferrals of principal and interest payments roiled the national market and excluded local governments across the nation from the capital market. From 1991 to 1992, new-money lease issues and COP plunged 40 percent: from $11.8 to $7.1 billion. Analysts attributed much of the national decline to the Richmond situation, which "weighed on the market for all of last year."[46]

The legal distinction between bonds and lease securities gets blurred in the marketplace, where leases are often sold as "bond substitutes" and are graded using many of the same standards applied to GO bonds.[47] As one bond lawyer puts it, failure to appropriate, for whatever

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reason, is the same as defaulting on a bond, "[i]t's a question of whether they are competent to run their business."[48]

Though the pledge of a locality's full faith and credit does not ensure repayment of an obligation, continuation of essential local governmental functions is pledged.

The National Federation of Municipal Analysts believes so strongly that lease-backed securities are the equivalent of debt they suggest issuers disclose *all* defaults on lease-backed securities in their official statements for *any offering.*[49]

Finally, the Internal Revenue Service recognizes that these "leases" are municipal bonds by extending the exclusion from taxable income to the interest paid on them. Even though the nonappropriation clause in a lease-revenue agreement makes future payment obligations conditional under state law or for credit rating purposes, the obligation is not conditional for federal income tax purposes. This position has been formalized in IRS private letter rulings 8042143 and 7821068.[50]

We might expect public employees to have a view of the public interest that is substantially the same as that of the citizens. However, the incentives faced by these officials encourage larger budgets and conformance with professional standards that may be inconsistent with democratic accountability.[51] Research in New York State concludes that these incentives directly affect the appetite for borrowing and the preference for instruments that avoid citizen oversight.[52]

Further, lease agreements make specific demands on these public servants and raise significant conflict-of-interest concerns. Most lessors modify the nonappropriation clause by incorporating language into a lease that requires the lessee to exert "best efforts" to seek funding. The concept of best efforts requires the executive officers of a governmental unit to request the appropriation of funds from its governing board to make the lease-revenue payments called for in each fiscal period under an agreement or to "exert best efforts" to cause such appropriation to be made. The general wording leaves doubt about what best efforts mean, but there is little doubt in the minds of public officers as to who is to make them and what is required, as we will discuss below.

A nonsubstitution clause is also usually placed in lease-revenue contracts to further inhibit exercise of the nonappropriation clause. There are at least two variations of the nonsubstitution clause, one or both of which may appear in a lease-revenue contract. The first provides that, if the lessee cancels a lease-revenue agreement through nonappropriation, the lessee may not replace the property that was being leased under the agreement with property that performs the same or similar functions. The second version is broader, providing that the lessee, upon nonappropriation of funds to make payments under the contract, may not acquire by another contract, or provide with its own workforce and property, the service or function for which the leased property was being used.[53] Though the pledge of a locality's full faith and credit does not ensure repayment of an obligation, continuation of essential local governmental functions is pledged.

Furthermore, lessors commonly make sure that the lessee needs the property for an "essential" function and require the local government to sign a certificate to this effect. The theory is that, if the governmental lessee must continue to provide a function or service, it probably will continue to make the payments for the property and not cancel the agreement through nonappropriation.[54]

A recent survey clearly demonstrates the power of the legal, intergovernmental, and market forces described. A review of 78,176 deals with a total volume of $12.73 billion revealed that 0.03 percent of lease transactions reported resulted in non-appropriations, while only 0.01 percent resulted in defaults.[55]

To gain more insight into the coercive power of certain forces and how they operate to undermine accountability, consider the case of Brevard County, Florida. The county used lease financing to construct a government center citizens had voted against funding. Citizens exercised their sovereign rights at the next election, electing new officials who promised a referendum on the deal—not repudiation, just a referendum. The decision to hold the referendum was made immediately after the election, in November 1992, and was scheduled for the following March.[56]

In the interim, the sky fell in on Brevard County. First, rating agencies notified all issuing entities, including the State of Florida, that *their* credit ratings were under review for possible downgrading as a result of Brevard County's action. Underwriters advised all issuing entities that their bonds would either be unmarketable or carry unacceptably high interest rates. Bond counsel for Brevard County and their financial advisor berated the decision in the media and offered dire predictions of doom. Bond insurers warned issuers that bond issuance could become unavailable in Florida. *The Bond Buyer*, the national newspaper of record for the municipal bond market, carried front-page stories detailing the progress of the campaign between November and March.

The concerted actions of bond market actors caused the State of Florida and other jurisdictions to bring significant pressure on Brevard County. One commissioner, citing the personal and professional pressure, resigned from office. An extensive, and expensive, campaign to explain the wide-ranging negative impacts of a "no" vote was presented to the citizens, funded by private and public sector interests. The fates of the City of Richmond, California, and the State of California frequently were featured in campaign materials and advertisements.

On election day, despite their objections to the facility and the decision process, the citizens of Brevard County capitulated, voting to continue to pay the obligation for a government center they did not want. Still, they were punished for their temerity with a lowered rating in a subsequent genuine revenue bond issue, which caused the withdrawal of the proposed issue.[57]

Brevard County's experience validates a widely held belief among government finance officers. Of 1,200 members of the Government Finance Officers Association questioned in a 1993 survey, 95 percent of officials who have used certificates of participation or lease-revenue bonds said they view their duty to repay them "the same as for long-term debt."[58] We must recall that these people are the senior staff that local elected officials rely upon for expert advice and counsel in these matters.

Their opinion is buttressed by the accounting standards set by the Governmental Accounting Standards Board (GASB) for local governments. Following generally accepted criteria, GASB classifies leases into two groups: "operating" and "capital." The latter represents the typical lease-revenue bond. In which case, "substantially all of the benefits and risks of ownership should be accounted for as the acquisition of the asset and the incurrence of an obligation by the lessee…." Applying the standards set forth with regard to the Loudoun County

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government center, which citizens so vehemently opposed, Professor James Peters (1997) concluded that a lease-revenue bond "is in fact a purchase with a debt commitment."[59] GASB standards bind auditors of local government financial reports and are the legal standard for accounting practices and definitions.

Agency-issued lease-revenue bonds, which Virginia local governments now increasingly rely on, included forty-two defaults between 1990 and 1999. The pattern of defaults, which increase in number and dollar volume over the ten years examined, parallels the pattern of increased reliance on lease-revenue bonds by Virginia's local governments over the same period.

One can do no better in conclusion that to quote Virginia Supreme Court Justice Stephenson in his learned dissent from *Dykes*. In his dissent, he urges his colleagues to look beyond the narrow view of the black letter law to the intent of the Virginia Constitution and the foundations of representative democracy. The Justice finds these lease arrangements are "a shocking, patent attempt to circumvent and nullify the requirement of voter approval contained in sec 10(b)" of the Virginia Constitution.

These instruments impose long-term obligations on citizens without their consent and not subject to their review by any currently available means, including wholesale replacement of their elected representatives. In the Justice's words, "no government should employ such a scheme."

In default, these instruments call forth market forces that require state action or assumption of obligations. Again the learned Justice is on point:

> Is anyone so naive that they truly believe that the County, in reality, is not compelled to make annual appropriations until the bonds are retired? What are some of the consequences if the County ceases to make the appropriations? Obviously, the bondholders would have no recourse, and their bonds would be worthless. Quite obviously, also, the County's credit would be seriously impaired, if not destroyed.

Such a situation strikes at the heart of representative democracy and governmental accountability in Virginia. Counties "now are at liberty to create bond indebtedness, payable from their general revenues, without submitting the matter to their voters." *Dykes v. Northern Va. Transp. Dist.*

Virginia Today

Today the preferred method of government financing for local governments in Virginia is lease-revenue bonds issued by authorities. This has, predictably, led to egregious overspending by local governments and an increasing number of defaults. Agency-issued lease-revenue bonds, which Virginia local governments now increasingly rely on, included forty-two defaults between 1990 and 1999.[60] The pattern of defaults, which increase in number and dollar volume over the ten years examined, parallels the pattern of increased reliance on lease-revenue bonds by Virginia's local governments over the same period.[61]

Citizens who attempt to reassert control over the fiscal actions of local government are being thwarted. In a series of actions that mirror the history of this struggle nationally and in Virginia, government officials have reacted harshly.

In 1990, citizens in Fairfax County, in reaction to skyrocketing real estate tax bills, attempted to assert oversight over a proposed $330 million bond sale to finance construction of the Fairfax County Parkway. The "revenue bonds" were actually sold by the Northern Virginia Transportation Commission, an authority acting on behalf of the county. The revenue with which the bonds were to be paid off was business tax money diverted from the county's general fund.[62] Outraged citizens took the matter to court, initially were defeated, and subsequently appealed to the Virginia Supreme Court. Turning sharply from the County Circuit Court, the Virginia Supreme Court in *Dykes* got the facts right:

> [t]he financing proposal is a contract which provides that the Commission will issue the bonds and the County will fund the annual principal and interest payments and other listed expenses of the bond issue. The repayment funds will come from the County's general revenues, but under the terms of the contract, the County's obligation to make the payments to the Commission is subject to and contingent upon the annual appropriation by the County of moneys for such purpose"

but, in an almost unprecedented move following changes in the court's membership, decided to rehear the case.

On rehearing, the court missed, perhaps deliberately, the salient point concluding, as courts in other states and at other times had, that the "[d]ebt incurred by legislatively created, independent political subdivisions is not the debt of the Commonwealth or of any other governmental unit. Therefore, the debt incurred by the Commission in issuing the bonds is not subject to the provisions of the Virginia Constitution, art. 7, sec. 10(b)" (the requirement for a referendum on debt).

Reversal of the previous decision opened the way for wholesale evasion of the public oversight provisions of the Virginia Constitution. Once the dam burst, local governments scrambled to use the new tactics to increase spending and debt without citizen approval or oversight. In a particularly egregious example, the Supervisors of Loudoun County used multiple devices to over-rule their citizens. In 1993 a ballot question seeking approval for $35.5 million in bonds to finance a new county government center was soundly defeated. Undeterred, the county government used certificates of participation, sold by a private nonprofit corporation created for the purpose, to finance the center over citizen objections and in the face of their legally expressed directive. The arrogance of government officials is captured in the words of one Loudoun County supervisor who maintains that the vote of the public "was not a vote on the policy issue of whether or not to proceed with the project;" weighty decisions like that are reserved for the ruling elite. For this politician and sadly many others throughout the Commonwealth, citizens have no say in what government does and their vote does not affect the decision process. When asked about the propriety of the reaction by government officials to the results of the referendum, the supervisor responded, "...if they say no, then you look for another means of financing."[64]

Recalling that COP financing is perhaps the most expensive of the devices used to avoid citizen oversight, we can understand why the county would seek to refinance such uneconomical debt. It attempted to do so in 1997 with lease-revenue bonds issued by the Loudoun County Industrial Development Authority. To clear up any doubt over the legality of the deal, the Loudoun Board of Supervisors sued their own taxpayers and citizens.

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Again, the only "revenue" involved was the county general fund appropriations—appropriations of money collected under the taxing authority, which, by virtue of the non-substitution language in the lease agreements, constituted a constructive debt for the county. When citizens objected, arguing that the initial lease was illegal because the bonds—and the government center project—had been rejected by voters, in an attack on its own citizens, the county filed suit against them at the behest of bond counsel and other private interests. The suit was to validate the bonds issued by the authority, making them equivalent to bonds issued by the county itself. This maneuver is termed a "bond validation" suit.

The county has the authority to name taxpayers, property owners, and residents as defendants under Virginia's Public Finance Act of 1991(VA Code §15.2-2600 et seq.). The purpose of such a suit, in general, is to obtain a court ruling prior to the issuance of bonds, which provides the cover of law and increases investor confidence, because it effectively precludes subsequent legal action by citizens to block the transaction or flow of payments.

The suit was joined by the proposed conduit issuer, the IDA of Loudoun County, an appointed body with no accountability to the people. In an interesting twist, the plaintiffs were thwarted when a circuit court judge presiding over the hearing ruled that the county lawsuit implicated the fundamental protection of due process and issued an order seeking to appoint either the Virginia Attorney General or some other competent counsel to defend county voters from their elected representatives.

Local politicians initiate bond validation actions against their taxpayers in questionable bond deals with surprising frequency. Because taxpayers need only be given notice in the legal section of the newspaper of record of the locality, and because the hearings usually are scheduled for weekday mornings, most taxpayers are never even aware they have been made a party defendant by their elected representatives in an effort to incur questionable debt.

One might ask what compelling public purpose calls forth such an array of government might directed against its own citizens. In Henrico County, Virginia, the Community Development Authority initiated an action asking the court to validate its plan to issue $22 million in bonds for the developers of the proposed Short Pump Town Center, a shopping mall. The bond proceeds were to subsidize the development by publicly funding the necessary infrastructure, including water and sewer lines, roads, parking, lighting, and landscaping. The lawsuit was filed to preempt legal challenges to the bonds because such challenges usually delay, if not prevent, their issuance. In the words of an attorney representing Henrico County against its citizens, government officials are "not going to allow any last-minute roadblocks" to interfere with their plans to provide public funds for private commercial development.[64]

Combined with the provisions of the Industrial Development and Revenue Bond Act, which broadened the scope of action for industrial development agencies , lease-revenue bonds have caused a major increase in local government debt in Virginia. As public-choice economists would predict, Virginia counties are coming to rely on IDA "revenue" bonds to pay for schools. There are many ways to finance school construction in Virginia, all of them less expensive than lease-revenue bonds. The least expensive way is by GO bonds approved by the voters. As an alternative, state law allows low-income localities to apply for state bonds issued through the Literacy Fund or through the Virginia Public School Authority. Though no referendum is necessary for these latter two mechanisms, a statutory requirement does mandate that school

construction costs be capped. But spending caps are no obstacle for local politicians prepared to sue the very citizens who elected them to office.

Pursuant to a 1995 Attorney General's Opinion, "voter approval is not required to fund school construction through county bonds sold to the [Virginia Public School] Authority, through bonds sold to the [Literacy] Fund, or through bonds issued by an IDA that leases the schools to the county." *1995 Op. Va. Att'y Gen 44, January 13, 1995, 1995 Va. AG LEXIS 28.* The resulting lack of oversight, as always, results in dramatic increases in overall debt burdens. Since 1990, lease-revenue bonds have been used in forty-three school projects creating $260 million of new debt.[65] Although in Virginia an opinion of the Attorney General does not create a precedent in courts, it does represent a significant barrier to legal challenges initiated and financed by voters/citizens.

The situation in Montgomery County, Virginia, highlights this practice and its deleterious impacts. Despite the urgings of a former state legislator, a former superintendent of schools, and several local citizens, the Montgomery Board of Supervisors authorized the county's Industrial Development Authority to borrow $22 million on the county's behalf by issuing "revenue bonds" to fund a new middle school. Of course, public schools don't generate any revenue, making a transparent hoax of the narrow legalisms used to justify and perpetuate such abuses. Any concerns are glossed over by bond underwriters and counsel, whose fees from bond sales run into tens of millions of dollars every year, and by local government officials eager to spend other people's money.

In a truly Orwellian interpretation of state law, local government officials argue that good schools lure industries, therefore financing school construction is part of the IDA legal mandate. Supporters also hide behind the interests of school children asserting, without support, that industrial development bonds allow school construction to begin more quickly than general obligation issues, which require a referendum. They also assert that industrial revenue bonds pose "less risk" than voter-approved debt, suggesting that the collective voice of Virginia voters is a risk that must be minimized by proactive governmental means. Anyone familiar with capital planning must necessarily conclude that those running the school system are either (1) incompetent, or (2) contemptuous of Virginia voters. Given their own testimony, the latter seems to be the case.

The real motivations of these people and the contempt for the public they serve have not attenuated since John Mitchell's dismissive comments on citizen oversight. In Virginia they appear to have gotten worse. In a recent interview, one local government official came clean on her rationale for using the higher cost IDA revenue bonds, explaining that with "general-obligation bonds, you have to have a referendum; with the IDA, you don't have to do that. If you have a referendum, how many people are going to say, `Yeah, raise my taxes to pay for it?' You can understand why IDA bonds are so popular."[66]

In a recent interview, one local government official came clean on her rationale for using the higher cost IDA revenue bonds, explaining that with "general-obligation bonds, you have to have a referendum; with the IDA, you don't have to do that. If you have a referendum, how many people are going to say, `Yeah, raise my taxes to pay for it?' You can understand why IDA bonds are so popular."

A more objective view paints a much different picture, one of a caring, generous, and responsible citizenry exercising sound fiscal judgment and restraint. In Virginia elections held in November 1998, Fairfax County voters approved two bond referendums totaling $186 million for public safety and parks. On that same election day, Arlington County residents passed four bond referendums by an average margin of approximately three to one, authorizing $99 million of debt for schools, streets, parks, and libraries. Meanwhile, voters in Loudoun County backed

Virginia must update the language of its public finance statutes and provisions of the Industrial Development Revenue Bond Act to close the loopholes self-serving politicians and special interests have created.

$68 million in bonds for school improvements, an emergency communications system, and an animal shelter. Contrary to the self-serving characterizations of citizen attitudes and motivations made by those whose interests and profligate spending habits are threatened by legitimate citizen oversight, these are not the actions of an uninformed, shortsighted, penny-pinching citizenry.

This perspective is borne out strongly in the case of three constitutional amendments proposed that same year and widely supported by the bond industry, local governments, and developers. Two amendments designed to make it easier for Virginia local jurisdictions to cooperate in issuing bonds without voter approval—purportedly for economic development—were defeated while another amendment that allows cities to exempt businesses from certain taxes was approved. Again, the balance and restraint of the electorate are evident. In the best democratic tradition, the citizens voted to maintain oversight and provide government with carefully designed and controlled tools for economic development.

Conclusion

In conclusion, it seems fair to say, that lease-revenue bonds, like the "specials" and "moral obligation" bonds before them, constitute a debt of the county government by any but the most narrow legal definition. Most important, they are instruments by which long-term obligations can be placed on citizens without their consent, review, or revocation by any currently available means, including wholesale replacement of their elected representatives. In default, these instruments call forth market forces that require state action or assumption of the obligation.

The hubris of local government officials, as has been true in the past, results in overextension of local government, which threatens the political stability and economic competitiveness of Virginia. Further, the use of these instruments unnecessarily increases the cost of public capital, placing unnecessary stress on government resources and decreasing government efficiency. Most important, the current situation strikes at the heart of representative democracy. Restoration of the crucial balance, which can only be established and maintained by citizen oversight, is part of a recurrent historical cycle. Virginia must update the language of its public finance statutes (VA Code §15.2-2600 et seq.) and provisions of the Industrial Development Revenue Bond Act (§15.2-4900 et seq.) to close the loopholes self-serving politicians and special interests have created. The job of government is hard work. It doesn't get any easier when politicians manipulated by special interests seek to marginalize the people who put them in office, and when politicians cannot be trusted to decide if a new county administration building or other public infrastructure truly is needed. In the state that gave us Washington, Jefferson, and Madison, "Government of the people, by the people and for the people," must not be allowed to become government despite the people. When the ruling elite can ignore a vote on debt, what is the next election they will choose to ignore?

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