



A Summary of the History and Effects of Anti-Aid Provisions in State Constitutions

Matthew D. Mitchell, Robin Currie, and Nita Ghei

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Despite their popularity among policymakers, targeted economic development subsidies don't work as advertised. Indeed, the best evidence suggests that they actually undermine economic development, fiscal health, and good governance.¹ History indicates that subsidies can lead to corruption and even government fiscal crisis.

State constitutional framers have responded to these outcomes with anti-aid provisions. Properly structured, these constitutional prohibitions on subsidies do seem to have an effect on the size and scope of subsidies. However, the provisions have been repeatedly challenged and weakened over time, and some are stronger than others. They therefore must be periodically renewed and strengthened.

Mercatus Center at George Mason University scholars examine the history and effects of these constitutional provisions at length in a forthcoming Mercatus working paper. We offer a short review of that work in this policy brief.²

TARGETED SUBSIDIES—NOTHING NEW

In July 2017, Amazon announced plans for a second headquarters (HQ2), which set off a bidding war among state and local governments. Jurisdictions across the country competed with one another to offer economic development subsidies to attract Amazon. In the end the company chose Arlington, Virginia, as its HQ2 location.

In targeting Amazon for special privileges, policymakers were engaging in a long-established practice. As early as 1661, the *colony* of Virginia subsidized woolen cloth producers with bounties of

tobacco.³ And during George Washington’s administration, Treasury Secretary Alexander Hamilton famously called for the systematic promotion of manufacturing through tariffs and subsidies.⁴ His proposals would have transplanted the European policy of mercantilism—which called for subsidies, tax privileges, and regulatory protections to promote particular firms—to America.

America’s early policymakers, however, were ambivalent about mercantilism. Congress rejected Hamilton’s plan, and during the early decades of the republic, neither the states nor the federal government was very active in promoting particular firms or industries.

PUBLIC SPENDING ON PRIVATE VENTURES

This situation began to change in the 1820s as state governments sought to stimulate their economies with increasing levels of state spending on private ventures. Completion of the publicly funded Erie Canal inspired two decades of state-supported railroads, turnpikes, and canals nationwide. Policymakers believed that these ventures would benefit the public and attract other businesses.⁵

The political appetite for locally funded infrastructure may have been high, but the willingness to pay for it through taxes was not. State debt grew as a result. While most states had little or no debt at the beginning of the 1820s, by 1839 they had incurred higher levels than at any other time in their history.

As Columbia Law School’s Richard Briffault has put it, many of these infrastructure projects were marked “by waste, overbuilding, and mismanagement.”⁶ When the economy entered a deep recession in the late 1830s, these projects failed to generate expected revenues, and state tax collections plummeted. Eight states and one territory were soon in default.⁷ Out of these circumstances, the first wave of constitutional anti-aid state provisions was born.

RESTRAINING THE STATES

Their states’ debt burdens unsustainable, many state officials sought federal assumption of the debt. But a bailout was denied. Unable to shift responsibility onto federal taxpayers, states were left to clean up their own messes.

States adopted a number of constitutional measures designed to limit corruption, ensure impartial government, and encourage fiscal rectitude.⁸ And because the debt crisis had been brought on by government-granted privileges to private companies, a number of these reforms specifically targeted such privileges.

Known as “anti-aid provisions,” they generally took three forms.

1. A “credit clause” was the most common and forbade the government from loaning its credit to a private individual, association, or corporation.
2. A “stock clause” forbade the government from becoming a stockholder in any corporation.
3. A “gift clause” forbade the government from granting loans or donations to any individual, association, or corporation.

By the end of the 19th century, some form of public aid limitation had been adopted by a large majority of states. One Indiana state representative put the case for anti-aid provisions this way: “There is no justice in the principle that the property or the money of the people should be taken to make profits for corporations.”⁹

In the decades that followed, state aid to private corporations did not end altogether, but it was sharply curtailed.

RESTRAINING LOCALITIES

This first wave of anti-aid provisions did not always apply to localities, however. And as states reduced their direct support of private interests, localities ramped it up. In many cases, local governments began to take on the sorts of risks that the states had previously assumed.

Once again, the precarious fiscal position of governments—this time, local governments—was laid bare by a national economic contraction. In 1873 a financial panic seized the country and gave way to a deep and lasting economic depression. Property values plummeted, and railroads began to default on their debts. This prompted a second wave of constitutional reforms, now extending anti-aid provisions to local governments.

THE EFFECTS OF ANTI-AID PROVISIONS

For the next half century, the courts actively reined in governments that overstepped the bounds of established anti-aid provisions. Significantly, they understood that the framers of these provisions intended them to limit public aid regardless of its purpose.

What was the result? While it is impossible to determine a causal relationship, the provisions did coincide with improved outcomes:

1. The financial footing of government grew stronger. By 1900, combined state and local debt stood at a smaller share of national income than at any point since the crisis of the early 1840s.
2. As their fiscal positions improved, municipalities found themselves facing lower borrowing costs.

3. As state and local governments curtailed their use of targeted economic development subsidies, the US economy entered a period of prolonged and robust economic expansion.

Over the past century or so, however, courts have weakened constitutional anti-aid provisions. They did so, in large measure, by performing a deft acrobatic feat. They turned the judicially created “Public Purpose Doctrine”—which should have complemented anti-aid provisions—on its head so that it came to undermine the effectiveness of these institutions.

WHEN PUBLIC MONEY SERVES PRIVATE INTERESTS

The Public Purpose Doctrine dates back to *Sharpless v. Mayor of Philadelphia*. In this 1853 case, a Philadelphia taxpayer brought suit when the Pennsylvania legislature authorized the city to use borrowed money to buy shares in two private railroads. He objected that public money should not serve private interests. The state’s supreme court agreed with the plaintiff, at least in principle. “It is said this is a taking of *private* property for *private* use,” the court concluded. “If this be so it is palpably unconstitutional.” It concluded that the legislature had no authority “to take one man’s property and give it to another.”¹⁰

Thus was born the Public Purpose Doctrine: the state may tax in order to fund only projects that are in the public interest. Public support of projects that benefit private interests is forbidden. In 1874 the US Supreme Court issued its first ruling on the Public Purpose Doctrine. It found that state legislatures may confer to municipalities the right to levy taxes, but only if those taxes serve a public purpose.¹¹ By 1917, the court had incorporated the doctrine into the Fourteenth Amendment.¹²

On its face, the Public Purpose Doctrine would seem to complement state constitutional anti-aid provisions. In practice, however, it has come to thwart them. There are two reasons: First, from the beginning, courts have shown an extraordinary tendency to construe “public purpose” in as broad a light as possible. Second, courts came to view it as an *exception* to anti-aid provisions, citing it as a reason to permit public aid to private firms—even in the presence of public aid provisions—so long as some public or quasipublic purpose for the aid could be furnished.

State legislatures took note. They were careful to include the words “public purpose” in their subsidy legislation.

THE MODERN ERA OF TARGETED ECONOMIC DEVELOPMENT SUBSIDIES

This new practice by legislators began with Mississippi’s famous 1936 Balance Agriculture with Industry Program (BAWI). Under this program, local governments were allowed to issue bonds to finance the purchase of land and even to build factories for private manufacturers.¹³ The words “general welfare” and “public purpose” were included in its preamble. “By invoking those magic

words,” says economist James Bennett, “this act, which plainly violated the state charter of the Magnolia State, became kosher.”¹⁴

When BAWI came before the Mississippi Supreme Court, a majority of justices found that it did not violate the state’s anti-aid provision. In his dissent, Justice W. D. Anderson said that the decision “drove a steam shovel through our constitution.”¹⁵ But the US Supreme Court agreed with the Mississippi Supreme Court majority and dismissed an appeal of the case.

Thereafter, the evolution of anti-aid provisions in many states progressed in similar fashion, from (1) strict enforcement of the provision after it was first adopted to (2) subsequent approval of certain subsidies (for example, for low-income housing or “slum clearance” programs and other support for the poor), and then to (3) approval of industrial manufacturing projects, and finally to (4) all manner of economic development schemes.

In short, the courts forgot (or chose to ignore) the initial aim of the provisions—namely, as one court put it, “to prevent governmental bodies from depleting the public treasures by giving advantages to special interests or by engaging in non-public enterprises.”¹⁶

AN ONGOING CHALLENGE

Anti-aid provisions are as needed today as ever, especially in the context of prolific public aid to businesses for the so-called public purpose of economic development. This aid amounts to about \$50 billion annually in recent years, and as a share of GDP it has tripled since the 1990s.¹⁷

In some cases, courts appeal to extra-constitutional considerations such as interstate competition as a rationale for upholding subsidies. But as North Carolina’s Justice Robert Orr states in a dissent, the judicial philosophy in these cases seems to boil down to this: “everybody’s doing it.”¹⁸

By the end of the 20th century, says Briffault, “virtually every state supreme court had upheld at least some economic development programs that involved direct assistance—including cash grants, low-interest loans, and tax breaks—to individual firms.”¹⁹

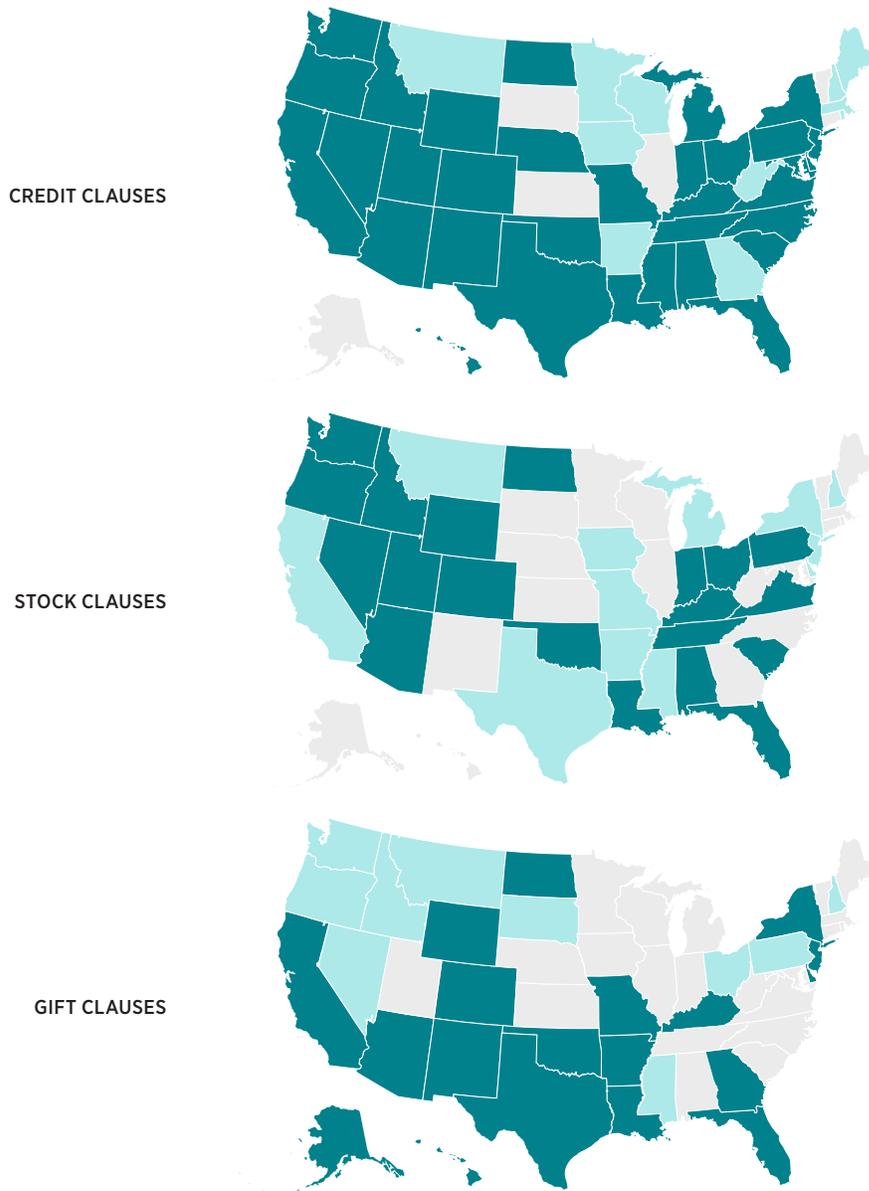
There remains some variation in the strength of anti-aid provisions, however, as well as in the extent to which they are honored. (It is because of this variation that economists have been able to estimate the effects of these provisions.) Moreover, recent legal developments suggest that some courts may be beginning to take the provisions seriously again.

CURRENT ANTI-AID PROVISIONS IN THE STATES

Forty-five states currently have constitutional anti-aid provisions.²⁰ Figure 1 shows the current status. These provisions prohibit public financing of private entities in the form of (1) loans and credit (“credit clauses”), (2) stock subscriptions and joint ownership (“stock clauses”), or (3) appropriations, donations, grants, gifts, subsidies, or some combination thereof (“gift clauses”).²¹

Figure 1. The Current State of Anti-Aid Provisions

● none ● either state or local level ● both state and local levels



Source: Individual state constitutions.

Forty-four states currently have some variety of credit clause, prohibiting government bodies from lending money or credit for nonpublic uses. Thirty-two states currently have a stock clause prohibiting stock subscription in and joint ownership of private ventures. And twenty-nine states have a gift clause, prohibiting the government from disbursing public funds without consideration. Some states apply these provisions to the state government, others to local governments, and others to both.

Nine state constitutions expressly prohibit both state and local levels of government from aiding private entities in any of the three forms.²² Arizona has one of the more stringent anti-aid measures in place. It applies to both levels of government, prohibits all three forms of aid, and allows only two exceptions, both related to legitimate government functions.²³ Anti-aid provisions that contain fewer textual exceptions, apply to each of the three varieties of aid, and apply to both levels of government tend to be stronger.

Many states, however, have public-purpose exceptions to their anti-aid provisions. These permit aid to private individuals or entities so long as the legislature declares that aid to be in the public's interest. The future efficacy of antisubsidy provisions appears least promising in states that have such public-purpose exceptions.

TOWARD A MODEL ANTISUBSIDY CLAUSE

In recent years, there has been a revival in the strength of anti-aid provisions. Arizona's seminal gift clause case, *Turken v. Gordon*, clarified that public purpose alone cannot justify an expenditure of public money that benefits private interests; instead, the government has to receive something sufficiently valuable in return for the expenditure. In other words, the state must obtain what in contract law is called "consideration." Moreover, the court found that *indirect* benefits—such as anticipated tax revenue and employment opportunities for city residents—are not valid consideration.²⁴ Other states with effective anti-aid provisions also require that government bodies receive a fair return for an expenditure of public funds.

Over the years, state courts have developed a number of tests that, when applied, tend to strengthen anti-aid provisions. These tests have not been adopted by all state courts, and in cases where they have not been adopted, state legislators can strengthen their anti-aid clauses by requiring them.

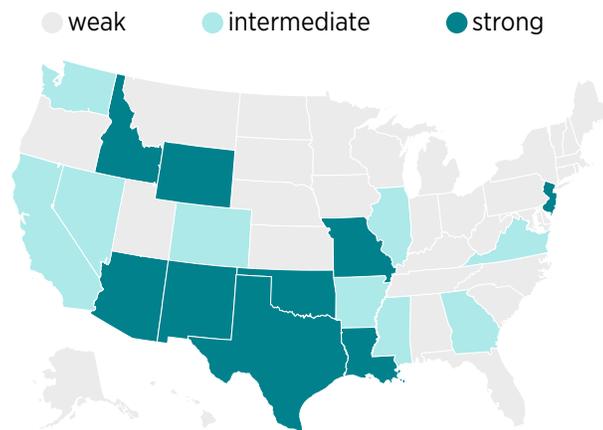
These tests can be summarized as follows:

1. Public expenditures should be primarily for a public purpose. This means that they must benefit the community as a whole, that they must constitute a legitimate function of government, and that they must entail a direct benefit to the public and not some indirect or speculative benefit.

2. The government must maintain sufficient control over expenditures to ensure that their public purpose is accomplished.
3. The public must receive valid consideration for all public outlays. Valid consideration is direct, ascertainable, contractually obligatory, and proportional.

In figure 2, we use this case law to show the viability of a legal challenge to government subsidies in each state.

Figure 2. The Viability of Legal Challenges under Anti-Aid Provisions



Source: Relevant case law. For details, see Matthew D. Mitchell et al., “Outlawing Favoritism: The Economics, History, and Law of Anti-Aid Provisions in State Constitutions” (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, forthcoming).

CONCLUSION

The long history of targeted economic development subsidies suggests that these government-granted privileges do not work as advertised. They are unlikely to spur economic development and may even depress it. Moreover, they can lead to fiscal waste and poor governance. In the vast majority of states, constitutional framers have attempted to outlaw subsidies through constitutional constraints known as anti-aid clauses. These constraints have been weakened over the decades, and history shows that they need to be renewed and strengthened from time to time.

If properly structured, however, these provisions can constrain the size and character of subsidies. But the details matter. The most effective anti-aid provisions encompass all varieties of aid, apply to both the state government and political subdivisions, and are as widely applicable as possible by applying to revenue bonds, industrial development bonds, and special districts. Moreover, the most effective provisions are supported by legal tests that require expenditures to serve a public purpose, to be under government control, and to be supported by valid consideration.

For more details on these provisions, their history, and their future prospects, see “Outlawing Favoritism: The Economics, History, and Law of Anti-Aid Provisions in State Constitutions,” by Matthew D. Mitchell, Jonathan Riches, Veronica Thorsen, and Anne Philpot.

ABOUT THE AUTHORS

Matthew D. Mitchell is a senior research fellow and director of the Equity Initiative at the Mercatus Center at George Mason University. He is also an adjunct professor of economics at George Mason University. In his writing and research, he specializes in public choice economics and the economics of government favoritism toward particular businesses, industries, and occupations.

Nita Ghei is the director of Policy Editing for the Mercatus Center at George Mason University. Before coming to Mercatus, Nita Ghei was at the Cato Institute. Previously, she was on the faculty of George Mason University School of Law and Northwestern University Law School, following a clerkship at the Maryland Court of Appeals (the state’s highest court). Before going to law school, Nita was a member of the editorial board at the *Economics Times* in New Delhi, after working at the World Bank in Washington, DC.

Robin Currie is a senior writer at the Mercatus Center at George Mason University. A graduate of Queen’s University Belfast (economics) and King’s College London (strategic studies), he is a former editor at Time Life Books. Prior to joining Mercatus, he worked for seven years at the American Enterprise Institute and five years at the Koch Seminar Network.

NOTES

1. For a review of these issues, see Matthew D. Mitchell et al., “The Economics of a Targeted Economic Development Subsidy” (Mercatus Special Study, Mercatus Center at George Mason University, Arlington, VA, November 2019).
2. Matthew D. Mitchell et al., “Outlawing Favoritism: The Economics, History, and Law of Anti-Aid Provisions in State Constitutions” (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, forthcoming).
3. David E. Pinsky, “State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach,” *University of Pennsylvania Law Review* 111, no. 3 (1963): 266.
4. Arthur Harrison Cole, ed., *Industrial and Commercial Correspondence of Alexander Hamilton, Anticipating His Report on Manufactures* (Chicago, A. W. Shaw Company, 1928).
5. Nicholas J. Houpt, “Shopping for State Constitutions: Gift Clauses as Obstacles to State Encouragement of Carbon Sequestration,” *Columbia Journal of Environmental Law* 36, no. 2 (2011): 381; Matthew Schaefer, “State Investment Attraction Subsidy Wars Resulting from a Prisoner’s Dilemma: The Inadequacy of State Constitutional Solutions and the Appropriateness of a Federal Legislative Response,” *New Mexico Law Review* 28, no. 2 (1998): 342.
6. Richard Briffault, “Disfavored Constitution, State Fiscal Limits and State Constitutional Law,” *Rutgers Law Journal* 34, no. 4 (2003): 911.
7. Benjamin Ulysses Ratchford, *American State Debts* (Durham, NC: Duke University Press, 1941), 114. As Joshua Bates, the umpire of the Anglo-American claims convention of 1853 put it, “It is to be hoped that sooner or later the people

of Florida will discover that honesty is the best policy; and that no State can be called respectable that does not honorably fulfill its engagements.” Ratchford, *American State Debts*, 111.

8. These measures included debt limits, curbs on government-created monopolies, general incorporation clauses (forbidding special incorporation of firms by legislatures), and equality guarantees.
9. H. Fowler, *Report of the Debates and Progress of the Convention for the Revision of the Constitution of the State of Indiana* (Indianapolis, IN: A. H. Brown, 1850), 651–52.
10. *Sharpless v. Mayor of Philadelphia*, 21 Pa. 147 (1853), 167.
11. *Loan Association v. Topeka*, 87 U.S. (20 Wall.) (1874).
12. *Jones v. City of Portland*, 245 U.S. 217 (1917).
13. Peter K. Eisinger, *Rise of the Entrepreneurial State (La Follette Public Policy Series): State and Local Economic Development Policy in the United States* (Madison, WI: University of Wisconsin Press, 1989).
14. James T. Bennett, *Corporate Welfare: Crony Capitalism That Enriches the Rich* (New Brunswick, NJ: Transaction Publishers, 2015), 83.
15. *Albritton v. City of Winona*, 178 So. 799 (Miss. 1938).
16. *Wistuber v. Paradise Valley Unified Sch. Dist.*, 141 Ariz. 346, 349 (1984); *Bannon v. Port of Palm Beach District*, 246 So. 2d 737, 741 (Fla. 1971) (to “protect public funds and resources from being exploited in assisting or promoting private ventures when the public would be at most only incidentally benefited”); *Idaho Falls Consolidated Hospitals v. Bingham County Board of Commissioners*, 102 Idaho 838 (1982) (apparent that framers “were primarily concerned about private interests gaining advantage at the expense of the taxpayer”); *Lawrence v. Schellstede*, 348 P.2d 1078, 1081–82 (Okla. 1960) (to prevent the investment of public funds in private enterprises).
17. Timothy Bartik estimates that state and local business incentives totaled \$45 billion in 2015. Assuming that this figure has not grown in real terms over the past four years, it equals \$48.95 billion in 2019 dollars. Timothy J. Bartik, *A New Panel Database on Business Incentives for Economic Development Offered by State and Local Governments in the United States* (Kalamazoo, MI: W.E. Upjohn Institute, March 2017).
18. *Maready v. City of Winston-Salem*, 467 S.E.2d 615 (N.C. 1996).
19. Briffault, “Disfavored Constitution,” 913.
20. The exceptions are Alaska, Connecticut, Illinois, Kansas, and Vermont. South Dakota has a state credit clause, but it permits lending of credit with a supermajority of the legislature.
21. David E. Pinsky uses the term “current appropriations clause” rather than “gift clause” to describe this category of anti-aid provisions. David E. Pinsky, “State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach,” *University of Pennsylvania Law Review* 111, no. 3 (1963): 280. While the former is more accurate because it encompasses states that prohibit “appropriating money” or “raising money” for private entities in addition to those that prohibit donations, grants, gifts, and subsidies, this paper uses the latter term.
22. Arizona, Colorado, Florida, Kentucky, Louisiana, Montana, North Dakota, Oklahoma, and Wyoming.
23. However, Arizona amended its constitution in 1940 to exempt “[i]rrigation, power, electrical, agricultural improvement, drainage, and flood control districts, and tax levying public improvement districts” from the anti-aid provision. Ariz. Const. art. XIII, § 7.
24. *Turken v. Gordon*, 223 Ariz. 342, 348 (2010).