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THE PUBLIC PAYS, THE CORPORATION PROFITS: THE EMASCULATION OF THE PUBLIC PURPOSE DOCTRINE AND A NOT-FOR-PROFIT SOLUTION

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I. INTRODUCTION

Massive subsidies by state and local governments to private corporations[1] for the purpose of inducing such corporations to retain or locate facilities in their respective locales are attracting greater public scrutiny.[2] Commentators are beginning to question whether the public entity receives benefits anywhere near the value of the subsidy. In Virginia, where Governor George Allen proposed giving the Walt Disney Corporation $163 million in subsidies to establish a theme park, the public responded with bumper stickers that read "Virginia Pays—Disney Profits."[3]

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1. Unless otherwise noted, reference to private corporations will mean a "for profit" private corporation.

2. Subsidies take several forms, but unless otherwise stated, the term "subsidy" refers to government expenditures for the benefit of private corporations. This includes grants, public improvements that benefit a project, and low-interest loans financed by the sale of tax-exempt bonds.

3. Scott Bates, *Not so Fast, Mickey! Let's Deal Again*, ROANOKE TIMES & WORLD NEWS, Feb. 21, 1994, at A7. The Disney Corporation subsequently renounced interest in the proposal.

In Alabama, government officials made several trips to Germany for the privilege of expending $253 million[4] in subsidies to the Mercedes-Benz Corporation in exchange for the construction of an auto plant in Alabama.[5] The City of Chicago and the State of Illinois spent $150 million to retain the Chicago White Sox baseball team when the team threatened to move to Florida.[6] Finally, the City of Portland, Oregon gave millionaire Microsoft founder Paul Allen $35 million to build a new stadium for his Portland Trailblazers basketball team.[7]

What is the status of such subsidies in light of the Public Purpose Doctrine? The Public Purpose Doctrine states that public monies may only be spent for "public purposes." This doctrine is a judicially imposed constitutional limitation on the manner in which federal, state, and local governmental entities may spend public funds.[8] If a court determines that a subsidy is not for a public purpose, then such aid will be disallowed. Hence, the judicial interpretation of the Public Purpose Doctrine is of crucial importance to private sector corporations who seek government subsidies for their projects.

Currently, the substantial majority of courts have allowed aid to private corporations based on whether they confer a "public benefit" on the populace. For example, *Rural Water District No. 3 Pushmataha County v. Antlers Public Works Authority*[9] addressed whether a public works authority could extend a subsidy to a water district. The court ruled that the public purpose requirement was satisfied because of the inherent public benefit the arrangement conferred on its customers.[10] Other cases

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4. Bernard L. Weinstein, *Can Alabama Afford a Mercedes?*, ECON. TIMES, Oct. 1993, at 6. This subsidy is 2.3% of the state's tax base and averages $222,000 per job. *Id.*

5. Susan Haedden, *Dealing with Corporate Flight*, U.S. NEWS & WORLD REP., June 13, 1994, at 62. Ms. Haedden states: "Rarely consulted about economic development, voters are beginning to challenge the cost of corporate tax breaks—and they are deciding that the catch is often not worth the bait." *Id.*

6. Alexandria Biesada, *Gimme a Break: Your Tax Dollars at Work Enriching Wealthy Team Owners*, FIN. WORLD, July 9, 1991, at 40.

7. Newall Gilchrist, *Blazers Rip City*, PORTLAND FREE PRESS, Oct. 1993, at 1.

8. Breck P. McAllister, *Public Purpose in Taxation*, 18 CAL. L. REV. 137, 137 (1929) ("It was to curb government expenditures that the Doctrine of Public Purpose was first used in state court."). The doctrine was subsequently recognized by the United States Supreme Court in Loan Ass'n v. Topeka, 87 U.S. (20 Wall.) 655 (1874).

9. 866 P.2d 458 (Okla. Ct. App. 1993).

10. *Id.* at 461; *see also* City of Charlottesville v. Dehaan, 323 S.E.2d 131 (Va.

have stated that the legislative determination of public purpose will stand unless it is irrational or arbitrary. In *Associated General Contractors v. Schreiner*,[11] the court considered whether state government expenditures to promote the ethanol industry were taxes levied for a public purpose. "In making such decision [the legislature] is vested with a larger discretion with which the courts should not interfere unless its action is clearly evasive."[12] But as I shall demonstrate, if the phrase "public benefit" is currently the lexicon driving public purpose or if blind judicial obedience to legislative determinations of what constitutes a public purpose is the test, then no real limitations remain on the power of the government to tax its citizens for the purpose of extending aid to private corporations. This proposition is contrary to the great weight of judicial authority in the nineteenth century, which generally ruled that aid to private corporations doing business outside the internal improvement sector was not for a public purpose. Thus, judicial misuse of the Public Purpose Doctrine continues to buttress ill-advised aid to private corporations, resulting in ever-increasing debt to be paid by future generations of the unwitting public.[13]

It is my contention that an examination of the historical development of the Public Purpose Doctrine establishes that the proliferation of the kind of public subsidies referred to above (sometimes called public "give aways")[14] is unconstitutional.[15] This article will discuss several issues starting with the concept that the limitation on the power of government to tax is well-grounded in American jurisprudence. The article will then ad-

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1984). *But see* Button v. Day, 158 S.E.2d 735 (Va. 1968).

11. 492 N.W.2d 916 (S.D. 1992).

12. *Id.* at 923; *see also* State *ex rel.* Ohio County Comm. v. Samol, 275 S.E.2d 2 (W.Va. 1980).

13. Even though most states have constitutional limitations that prohibit any aid to private corporations, courts have created a "public purpose" exception to such provisions. *See* Dale F. Rubin, *Constitutional Aid Limitation Provisions and The Public Purpose Doctrine*, 12 ST. LOUIS U. PUB. L. REV. 143 (1993) (stating that judicial creation of such an exception is unwarranted).

14. Robert Guskind, *The Give Away Game Continues*, PLANNING, Feb. 1990, at 4.

15. Since this article will discuss the Public Purpose Doctrine in the context of state and local subsidies to private corporations, the term "unconstitutional" refers to both federal and state constitutions. All fifty states either have amended their constitutions to include the doctrine or the doctrine has received judicial sanction. *See, e.g.*, ALASKA CONST. art. IX, § 6; COLO. CONST. art. XI, § 1; ILL. CONST. art. VIII, § 1.

dress the following points: (1) the Public Purpose Doctrine is a judicially implied constitutional limitation on the legislative power to tax; (2) the crucial proposition to the judicial sanctioning of public aid to railroads was the fact that railroad construction was considered to be an obligation of the state, and therefore aid to railroad companies was *thought to be for a public purpose*; (3) the Public Purpose Doctrine is usually interpreted and applied in cases that arise in a setting of overburdened public debt, political corruption, and fraud; (4) the periods of economic chaos, caused in part by massive state and local railroad debt, gave rise to able and vigorous opposition to the judicial majority's application of the doctrine; (5) the Public Purpose Doctrine is a judicially created doctrine, therefore courts have the responsibility to interpret and apply the doctrine in appropriate cases; and (6) the judicial abdication of the doctrine to legislative determination amounts to an abdication of judicial responsibility.

Finally, this article posits that the constitutional limitation on the power of governmental entities to spend tax dollars for public purposes is more effective if such expenditures are channeled through the nonprofit sector of the economy. Public spending through a government-nonprofit paradigm would minimize the ills spawned by public corruption and private greed that characterized the evolutionary period of the Public Purpose Doctrine.

It is important to stress that this article will only discuss the Public Purpose Doctrine in the context of tax expenditures. The following discussion should be distinguished from other constitutional provisions regulating the power of government to tax.[16] Additionally, this article does not discuss subsidies to private corporations that do not involve expenditures,[17] although each situation involves similar issues.[18] In addition, this article will not concern itself with the interplay of the Public Purpose Doctrine and constitutional aid limitations pro-

16. Oregon's Constitution is typical. *See* OR. CONST. art. I, § 32, art. IV, § 1, art. XI, § 11 (all concerning taxation).

17. For example, tax abatements, tax holidays and land write-downs.

18. The possibility of corruption and fraud in the granting of subsidies not involving expenditures is the same if the subsidies do involve such expenditures.

visions[19] in which the courts have carved out a "public purpose" exception.[20]

II. FACTUAL CONTEXT IN WHICH THE PUBLIC PURPOSE DOCTRINE DEVELOPED

In spite of the longstanding rhetoric espousing self-reliant private enterprise, the quest for public subsidies by private enterprise is as old as the nation itself. Shortly after the signing of the Constitution, the State of New Jersey offered tax abatements to induce Alexander Hamilton to locate his manufacturing plant in that state.[21] This early instance of "public-private partnering," a term which has currently become fashionable, marked the beginning of an era characterized by substantial public aid to private corporations in the construction of a national transportation system. Starting with the construction of the Erie Canal in 1825 to which New York pledged its public credit,[22] state governments made tremendous outlays of public funds to private corporations to aid in the building of canals, roads and railways.

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19. Colorado's provision is typical. COLO. CONST. art. XI, §§ 1, 2 provide the following:

> § 1. Pledging credit of state, county, city, town or school district forbidden.
>
> Neither the state, nor any county, city, town township or school district shall lend or pledge the credit or faith thereof, directly or indirectly, in any manner to, or in aid of, any person, company or corporation, public or private, for any amount, or for any purpose whatever; or become responsible for any debt, contract or liability of any person, company or corporation, public or private, in or out of the state.
>
> § 2. No aid to corporations—no joint ownership by state, county, city, or school district.
>
> Neither the state, nor any county, city, town, township, or school district shall make any donation or grant to, or in aid of, or become a subscriber to, or shareholder in any corporation or company or a joint owner with any person, company, or corporation, public or private, in or out of the state . . .

COLO. CONST. art. XI, §§ 1, 2.

20. *See* City of Aurora v. Public Util. Comm'n, 785 P.2d 1280 (Colo. 1990); *see also* Rubin, *supra* note 13, at 161-66.

21. Peter W. Bernstein, *States Are Going Down Industrial Policy Lane*, FORTUNE, Mar. 5, 1984, at 112.

22. Ellis L. Waldron, The Public Purpose Doctrine of Taxation 34-35 (1952) (unpublished Ph.D. dissertation at the University of Wisconsin on file with the University of Richmond Law Review).

Officials successfully collected tolls from patrons of the Erie Canal and thus relieved the state of further taxation and encouraged other states to increase their public investment in private undertakings. However, the success of the Erie Canal was not to be repeated. Excessive optimism encouraged by European investors eager to purchase state securities led to an overextension of credit which precipitated the panic of 1837.[23] State enterprises failed because tolls were not sufficient to service debt. As a result, states were virtually bankrupt. Shortly after 1837, state debts were estimated at $231 million and local improvement obligations at $27 million.[24] The annual interest charge on these obligations was close to $16 million, which created a severe tax burden on a national population of only seventeen million people. Since private capital was inadequate and foreign investors were unwilling to refund the debt, states liquidated the transportation facilities they owned by selling them to private corporations at drastically reduced prices.[25] Other states, responding to the political outcry about excessive debt, simply repudiated their obligations. By 1850, at least ten states, in reaction to widespread public dissatisfaction, enacted constitutional state debt limitations and/or constitutional prohibitions against lending of state credit or subscribing to stock in private enterprises.[26] By 1857, almost all state constitutions had been amended to include limitations on debt.[27]

However, such constitutional limitations applied only to states, not to municipalities. As economic confidence returned and attitudes toward the formation of private corporations be-

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23. The Panic of 1837 rendered states unable to pay their bonded indebtedness previously incurred for internal improvements. As a result, they began repudiating their debts. ALBERT M. HILLHOUSE, MUNICIPAL BONDS 34 (1936); *See* Horace Secrist, *An Economic Analysis of the Constitutional Restrictions Upon Public Indebtedness in the United States*, 8 BULL. OF THE UNIV. OF WISC. 1, 21 (Apr. 1914).

24. FREDERICK A. CLEVELAND & FRED W. POWELL, RAILROAD PROMOTION AND CAPITALIZATION IN THE UNITED STATES 113 (1909).

25. *Id.* at 103. For example, by 1844 Pennsylvania was more than $40 million in debt arising out of the operation of its canal and railway operations. The railway operations were eventually sold to the Pennsylvania Railroad in 1857 for $7,500,000. *Id.*

26. The ten states were: Rhode Island (1842); New Jersey (1844); Louisiana, Texas and Maine (1845); Iowa and New York (1846); Illinois (1847); Wisconsin (1848); and California (1849).

27. *See* Secrist, *supra* note 23, at 54.

came more liberal, municipalities began to incur debt for the construction of internal improvements in the settlement of the agricultural West. At this time, the emphasis on the construction of transportation facilities had shifted from canals to railroads. By 1853, the municipal railroad debt of seven cities alone—Wheeling, Baltimore, Pittsburgh, St. Louis, Louisville, New Orleans and Philadelphia—was more than $28 million. This represented a per capita debt ranging from $20 in Philadelphia to $55 in Wheeling.[28] By 1860, about $1,500,000,000,[29] more than a quarter of the total active capital of the nation, was invested in railroads controlled by private corporations. By 1870, state legislatures, responding to public outcry over municipal debt, passed constitutional amendments prohibiting both the state and the municipality from lending credit, taking stock subscriptions in, or giving aid to private corporations.[30]

Finally, there was the matter of corruption. Commentators have observed that public sentiment in favor of requiring, by constitutional amendment, states and local government to curtail their excessive propensities to incur debt and to spend tax monies, were in significant part based on the fraud by railroad promoters and the corruption by public officials in subsidizing the construction of railway systems. The Wisconsin experience was typical:

> Sober fear was expressed before Wisconsin accepted federal land grants in aid of railroad construction, that the state government would not have the strength to withstand the temptations to partiality or corruption that would be generated out of contests to win these prizes. A major scandal in 1856 over the disposition of the first railroad grant, amply confirmed these forebodings.[31]

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28. CLEVELAND & POWELL, *supra* note 24, at 206.

29. *Id.* at 83.

30. Secrist, *supra* note 23, at 59-60.

31. JAMES WILLARD HURST, LAW AND ECONOMIC GROWTH, THE LEGAL HISTORY OF THE LUMBER INDUSTRY IN WISCONSIN 1836-1915, at 55 (1964); *see also* Secrist, *supra* note 23, at 58:

> An equally objectionable thing, and one much more serious in its ultimate consequences, was the state of mind which the unbridled use of the credit system fostered. Taxes were allowed to go delinquent—in fact, direct taxes were frequently not levied,—borrowing was freely indulged in

Arthur T. Hadley[32] analyzed the most common complaints against railroads in the latter part of the nineteenth century, and he concluded that there had been an enormous waste of capital spent on unnecessary railroads. Hadley estimated that of the 30,000 miles of railroads built between 1880-1882, less than half were necessary to the development of the country. He concluded that railroads were constructed in a manner calculated to put money in the hands of builders, rather than to serve the interests of the public.[33]

Philadelphia was a case in point. "Excessive subscriptions of stock by the state and the incautious outlay of public funds . . . were the two mistakes which made fraud by private promoters possible."[34] The Directors of the Northwestern Railroad Company, after faking a large portion of the required private subscription in order to obtain funds from Philadelphia and other localities, distributed $22,000 to themselves as compensation and voted to release their treasurer from the responsibility for accounting for private funds which that had been collected but never invested.[35]

The public perception that governments' dealings with railroads was rife with corruption should not be ignored. Public outcry of this nature led to the adoption of state constitutional debt limitation and lending of credit provisions.[36] As early as 1850, A.F. Morrison, an Indiana State Representative, expressed strong objections to the "system of internal improve-

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> to pay the ordinary running expenses of the governments, and debts when due were pushed on into the future by the act of refunding. These practices opened the door for corruption among city officials . . . .

Id. (footnotes omitted); *See also* Waldron, *supra* note 22, at 41 ("Th[e] optimism [that the profits of railroads would be sufficient to retire the public debt was] unfounded in many instances. Some roads were never started; others were inadequately capitalized; in the speculative climate which prevailed, there was much mismanagement of funds, excessive cost of construction, and inadequate planning of roadbed, routes and markets.").

32. Mr. Hadley was the President of Yale University and the author of RAILROAD TRANSPORTATION: ITS HISTORY AND ITS LAWS (New York, G.P. Putnam's Sons 1885).

33. Arthur T. Hadley, *Railroad Abuses at Home and Abroad, in* THE NEW PRINCETON REV. 355-65 (New York, A.C. Armstrong & Son 1886).

34. William Smith, I HAZARDS REGISTER 410 (1828).

35. County of Lawrence v. North-Western R.R., 32 Pa. 144, 149-50 (1858).

36. *See* Rubin, *supra* note 13 at 156-61.

ments" that oppressed the populace with excessive taxes.[37] He refused to sanction the state as a partner with private enterprise. He stated that public involvement with private corporations usually resulted in a public detriment because "corporations always labor and scheme for their individual benefit which is always antagonistic to the interests of the people."[38]

It was against this historical backdrop of over-burdened state and local debt, widespread corruption, and fraud that the Public Purpose Doctrine was adopted. The doctrine was initially pronounced in *Sharpless v. Mayor of Philadelphia*[39] and became a dominant factor in limiting the power of the government to tax and spend.

The economic and political conditions that gave rise to the public's mistrust of government expenditures resemble present day conditions. Currently, government is heavily burdened by

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37. DEBATES OF INDIANA CONVENTION 651-52 (1851).

38. *Id.* at 652. Morrison said:

> I will state to the Convention that they will generally find my votes and my voice given to sustain the interest of the people against any course of policy which will permit corporations to filch from the people their rights which they can never get back again . . . . Our people are to this day ground down by most oppressive taxes, which the system of internal improvements of that year have inflicted upon them;—Better called a system of oppression inflicted by the representatives of the people as they call themselves, in the Legislature, by means of a regular system of log rolling and now why should gentlemen wish to place a power so dangerous to the people again at the disposal of the legislature? . . .
>
> It is well known how these schemes are got along in the Legislature. Corporations are always well represented there, and the people have no knowledge of what is going on until they are entrapped by them. What right has the State of Indiana to become a partner with any speculation? She has no more right to do this, than she has a right to form a regular co-partnership with a merchant or manufacturer in any speculation looking to a profitable result . . . .
>
> I voted for the amendment of the gentleman from Tippecanoe because I think the same principle ought to extend to the counties which we are about establishing for the state. There is no justice in the principle that the property or the money of the people should be taken to make profits for corporations. I shall be found constantly voting against any proposition to connect the interests of the people with the interests of the corporations for the reason that corporations always labor and scheme for their individual benefit which is always antagonistic to the interest of the people.

DEBATES OF INDIANA CONVENTION 651-52 (1850-1851).

39. 21 Pa. 147 (1853).

debt and the public's confidence in our governmental officials is correspondingly low.

III. CONCEPTUAL ANTECEDENTS TO THE PUBLIC PURPOSE DOCTRINE

Before examining the courts' interpretation and application of the Public Purpose Doctrine as a limitation on the government's ability to appropriate tax dollars, it is important to describe earlier concepts proposing similar constraints on government spending. An examination of the early conceptual models demonstrates that limits must be imposed on the government's authority to disburse public funds.

It is axiomatic that in order for government to exist, it usually must extract some portion of the wealth of its people. This is the power of taxation. The people accord their government this right based on the assumption that the funds exacted will *only be spent for the benefit of the public.*[40] This idea was common among European philosophers in the seventeenth and eighteenth centuries.

Montesquieu said "[i]n order for these revenues to work one must consider the necessities of the state and the necessities of the citizens. One must not take from the real needs of the people for the imaginary needs of the state."[41]

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40. *See* Waldron, *supra* note 22, at 2 (emphasis added). "The objectives or purposes of taxation must be public, rather than the gratification of desires of any narrow privileged segment of the people." *Id.*

41. Montesquieu, *Of The Public Revenues*, *in* THE SPIRIT OF LAWS, Book 13, ch. I 213 (Anne M. Cohler Vattel et al. eds. & trans., 1989) Vattel reiterated Montesquieu's concerns:

> A sovereign who possesses the power of imposing taxes upon his people should be careful not to regard the revenues therefrom as his own private property. He should never lose sight of the end for which that power has been entrusted to him. The Nation desired to enable him to provide in his wisdom for the needs of the State. If he diverts those revenues to other uses, if he spends them to indulge himself in luxury and pleasures, or to satiate the greed of his mistresses and favorites, we make bold to assert to those sovereigns who can still grasp the truth that such a one is not less guilty, nay a thousand times more so, than an individual who uses another's property to satisfy his immoral passions. The fact that injustice may go unpunished does not make it the less shameful.

State constitutions in the colonies also expressed the principle that government was for the benefit of the entire community.[42] The motivating force behind this philosophy was the belief that it was necessary "to erect some barrier between the taxing authority and the private right to property."[43] Colonial America resolved this issue by creating a representative legislature which, at the time, was deemed to be sufficient protection of private property interests. Professor Waldron theorized that since legislatures were thought to be adequately representative, the American courts commonly ruled that the legislature had unmitigated taxing power in the absence of express constitutional provisions.[44] Thus, in *McCulloch v. Maryland*,[45] the United States Supreme Court stated:

> The people of a state, therefore, give to their government a right of taxing themselves and their property, and as the exigencies of government cannot be limited, they prescribe no limits to the exercise of this right, resting confidently on the interests of the legislator and on the influence of the constituent over their representative, to guard them against its abuse.[46]

By the middle of the nineteenth century, private property interests were subject to ever-increasing taxes to pay off massive public debt. It was at this time that judicial challenges to the legislature's authority to incur debt for other than public purposes began to be asserted.

THE LAW OF NATIONS 243 (Fenwick trans., 1758, Carnegie Institution Classics of Int'l Law ed., 1916).

42. *See* MD. CONST. art. I (1776); MASS. CONST. art. VII, § 1 (1780); N.J. CONST. pmbl. (1776); PA. CONST. art. V (1776); VT. CONST. pmbl. (1777); VA. CONST. § 3 (1776).

43. Waldron, *supra* note 22, at 4.

44. *Id.*

45. 17 U.S. (4 Wheat) 316 (1819).

46. *Id.* at 428.

IV. JUDICIAL ANTECEDENTS TO THE PUBLIC PURPOSE DOCTRINE

Even though the "first clear-cut statement of the [Public Purpose] Doctrine"[47] is usually attributed to Justice Jeremiah Black in the case of *Sharpless v. Mayor of Philadelphia*,[48] the tenor of the doctrine "had been performed by other verbal formulas and legal concepts" in earlier cases.[49] "The view that individuals possess some natural or inalienable right to private property; and that protection of this right is both the reason for, and a fundamental limitation upon organized government, was the central proposition advanced by those challenging particular exercises of taxation or spending by government."[50]

Giddings v. Brown,[51] decided in Massachusetts colony in 1657, almost two centuries prior to *Sharpless*, involved the seizure of pewter owned by taxpayer Giddings after he failed to pay a tax in support of a parsonage.[52] Giddings brought an action for damages, but the Salem general court found the tax valid for "necessary, publicke town charges, viz. honourable maintenance of the ministry, which the law requires in generall, but leaves to each towne to determine and apply in particular, suitable to their owne condition."[53] Even though judicial review of tax legislation was not common until the mid-nineteenth century, Professor Waldron asserts that *Giddings* "stands at the head of a line of litigation involving the scope of local fiscal powers with respect to . . . necessary charges [a concept] which explored many of the essential elements of the Public Purpose Doctrine."[54]

In 1692, Massachusetts provincial legislation, mirroring early colonial law, defined the authority of local government to assess inhabitants "for the maintenance and support of the ministry, schools, the poor, and for defraying other *necessary charges*

47. McAllister, *supra* note 8, at 141.
48. 21 Pa. 147 (1853).
49. Waldron, *supra* note 22, at 7.
50. *Id.* at 9.
51. *See* 2 THE HUTCHINSON PAPERS 1, 1-25 (Prince Society ed., 1865).
52. *Id.* at 2.
53. *Id.* at 22.
54. Waldron, *supra* note 22, at 11.

arising within said town."[55] The provision relating to necessary charges was reenacted in 1785.[56] Subsequent cases employed the term "necessary charges" as a limiting device with respect to the power of the local authority to tax. In *Bangs v. Snow*,[57] the Massachusetts Supreme Judicial Court held that a parish tax levy used to promote incorporation of the parish as a town was invalid because it was not a charge necessarily connected with granted local powers.[58] This construction of local authority "had been so uniformly holden in the judicial courts" that the court interrupted counsel's argument and awarded damages for trespass in a tax seizure.[59] In *Spaulding v. City of Lowell*,[60] the court had to determine the scope of "necessary charges" in connection with the legality of a town vote of funds and levy of a tax for construction of a public marketplace. Chief Justice Shaw stated that the court was "not at all prepared" to discover town authority "to raise and appropriate money for general objects" or to discover in the term "other necessary charges" any "new, substantive power of taxation."[61] To do this would be "letting in all the mischiefs, arising from an indefinite and arbitrary power of a majority to bind a minority, to an unlimited extent."[62] The court also recognized that custom and usage could be used as a guide in determining appropriate town expenditures. Appropriations based on usage "founded on the convenience and necessities of the inhabitants," and later recognized and confirmed by statute, would be allowed as a proper "prudential concern" of the town.[63]

In 1837, the town of Biddeford, Maine voted to distribute its shares of the 1836 federal treasury surplus "according to fami-

55. 1 ACTS AND RESOLVES OF THE PROVINCE OF THE MASSACHUSETTS BAY § 6 at 66 (2d sess. 1692) (emphasis added).

56. MASS. GEN. L. ch. 75, § 7 (1785). Both these acts also used the term "Prudential Affairs" which was also construed as limiting the authority of local government to expend tax dollars.

57. 1 Mass. 181 (1804).

58. *Id.* at 187-90.

59. *Id.* at 190; *see also* Stetson v. Kempton, 13 Mass. 272 (1816) (stating that "necessary charges" under a 1785 statute did not include payment of additional wages to town militia).

60. 40 Mass. (23 Pick.) 71 (1839).

61. *Id.* at 76.

62. *Id.*

63. *Id.* at 77-78.

lies."[64] The Maine Supreme Judicial Court, interpreting a statute identical to the 1785 Massachusetts statute, denied an assumpsit for a share of the distribution, finding that the distribution was "entirely unauthorized by the language of any statute [and would violate the] principles of moral justice."[65]

> For if the right to assess and collect money is without limit, it would not be difficult to continue the process of collection and division until the whole property held by the citizens of the town had passed into, and out of the treasury . . . . Such a construction would be destructive of the security and safety of individual property; and subversive of individual industry and exertion.[66]

The aforementioned statutes and cases clearly speak the language of public purpose. Substituting the term "public purpose" for either "prudential concerns" or "necessary charges" would not have altered the context in which the limitation of the power of government to tax was discussed. These conceptual precedents to the Public Purpose Doctrine also support the proposition that current government expenditures should be carefully scrutinized to insure they fulfill public purposes.

V. INTERNAL IMPROVEMENT LITIGATION AND THE PUBLIC PURPOSE DOCTRINE

A. *The Law at Mid-Century (1850)*

By 1850, three years before *Sharpless v. Mayor of Philadelphia*,[67] internal improvement litigation was common. Many of the cases concerned the power of the governmental entity to provide railroad subsidies. The subsidies usually took the form of subscription of stock in railroad corporations. In reaction to the panic of 1837 and subsequent dramatic increases in state and local debt, constitutional debt limitation provisions were passed in several states by 1850.[68] Yet, there was no higher

64. Hooper v. Emory, 14 Me. 375, 375 (1837).
65. *Id.* at 379-80.
66. *Id.* at 380.
67. 21 Pa. 147 (1853).
68. *See supra* note 26 and accompanying text.

court decision prior to 1853 which held it unconstitutional for the state to delegate to local entities the power to tax to subscribe to stock in companies constructing internal improvements. Also, privately owned and operated canals and turnpikes were readily analogized to roads and therefore entitled to public financial support.[69] Generally, attorneys who argued that there was an implied constitutional limitation to the legislative power to tax were rebuffed by justices who demanded that such limitations be explicit.[70]

B. *The* Sharpless *Case*

As mentioned previously, the *Sharpless* case is the most significant case in the public purpose era, initially pronouncing the doctrine in the context of limiting the government's spending power.[71]

On May 9, 1853, the Pennsylvania Legislature authorized the City of Philadelphia to subscribe to 10,000 shares of stock in the Hempfield Railroad Company. It also gave the city the authority to borrow and provide for repayment of principal and interest.[72] Oddly enough, the nearest point of the line to Philadelphia was to be more than three hundred miles away. The city had previously subscribed to four million dollars of stock in the Pennsylvania Railroad and had determined that the Hempfield feeder line would establish a valuable connection into the Ohio River Valley.[73] William Sharpless sought an injunction against the subscription from the state supreme court. The importance of this case was illustrated by the fact that both sides were represented by prominent members of the Pennsylvania Bar.[74]

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69. Waldron, *supra* note 22, at 61-62.

70. *See, e.g.*, Bridgeport v. Housantonuc R.R., 15 Conn. 475 (1843).

71. Sharpless v. Mayor of Philadelphia, 21 Pa. 147 (1853).

72. The pertinent section of the act is reprinted in the *Sharpless* opinion. *Id.* at 150.

73. *Id.*

74. Mr. Sharpless was represented by Benjamin Brewster, Garrick Mallery and Thomas Williams. Brewster had been the Attorney General of Pennsylvania just after the Civil War and gained his greatest prominence as President Arthur's Attorney General and Prosecutor of the Star Route Postal Frauds in 1881-1884. 2 DICTIONARY OF AMERICAN BIOGRAPHY 26 (A. Johnson & D. Malone eds., 1958). Garrick Mallery had just been admitted to the Bar. However, he subsequently abandoned the law for a military and scientific career and became a leading authority on Indian pictography.

The presiding judge, Chief Justice Jeremiah S. Black of the Pennsylvania Supreme Court, had been elected to the court in 1857 and was subsequently appointed Attorney General of the United States by President Buchanan.[75] Black began his opinion by focusing on the economic effect the granting of the injunction sought by Sharpless would have on the current bondholders who were counting on the completion of the railway and on the economy of Pennsylvania:

> We cannot award the injunction asked for, without declaring that all such bonds are as destitute of legal validity as so much blank parchment. Besides the deadly blow it would give to our improvements, and the disastrous effect of it on the private fortunes of many honest men, at home and abroad, it would seriously wound the credit and character of the state, and do much to lessen the influence of our institutions on the public mind of the world.[76]

Justice Black, however, also acknowledged that the power of government to incur debt in order to subscribe in railroad stock would bring injury to the people at large.[77] Nevertheless, Jus-

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6 DICTIONARY OF AMERICAN BIOGRAPHY 222 (A. Johnson & D. Malone eds., 1961). Thomas Williams was a prominent Pittsburgh attorney who voluntarily presented argument against the constitutionality of the acts. He also was a founder of the Republican Party in Pennsylvania, a Congressman, and a House manager of the Impeachment of President Johnson. Waldron, *supra* note 22, at 69.

The city was represented by John Meredith Reed and George Mifflin Dallas. Reed had been a United States District Judge and was elected to the Pennsylvania Supreme Court in 1858. 8 DICTIONARY OF AMERICAN BIOGRAPHY 427-28 (A. Johnson & D. Malone eds., 1963). George Mifflin Dallas had been Vice President of the United States during President Polk's administration. He had served as Ambassador to Russia and Great Britain. 3 DICTIONARY OF AMERICAN BIOGRAPHY 38 (A. Johnson & D. Malone eds., 1959).

75. *See* WILLIAM N. BRIGANCE, JEREMIAH SULLIVAN BLACK, A DEFENDER OF THE CONSTITUTION AND THE TEN COMMANDMENTS (1934). After returning to private life Black had an illustrious career as counsel in *Ex Parte Mulligan*, 71 U.S. (4 Wall.) 1 (1866) where he argued for civilian rights against military rule and justice. He also appeared opposite John Archibald Campbell in reargument of the *Slaughterhouse Cases*, 83 U.S. (16 Wall.) 36 (1873).

76. 21 Pa. 147, 158-59 (1853).

77. *Id.* at 159.

> If the power exists, it will continue to be exerted, and generally it will be used under the influence of those who are personally interested, and who do not see or care for the ultimate injury it may bring upon the people at large. Men feel acutely what affects themselves as individuals, and are but slightly influenced by public considerations. What each per-

tice Black concluded that the court "can declare an Act of Assembly void, only when it violates the constitution *clearly*, *palpably*, *plainly*; and in such manner as to leave *no doubt* or hesitation on our minds."[78] Since no constitutional language "expressly or by clear implication forbids the legislature to authorize subscriptions by a city to the capital stock of a company incorporated for the purpose of making a railroad," the petitioner's action failed.[79]

Ironically, Justice Black did not end the opinion with his constitutionally interpretive observation. Instead, he introduced the reservation that formed the basis of the Public Purpose Doctrine: "I do not mean to assert that every act which the legislature may choose to call a tax law is constitutional."[80]

He continued, and in express terms set forth the Public Purpose Doctrine:

> Neither has the legislature any constitutional right to create a public debt, or to lay a tax, or to authorize any municipal corporation to do it, in order to raise funds for a mere *private* purpose. No such authority passed to the Assembly by the general grant of legislative power. This would not be legislation. Taxation is a mode of raising reve-

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> son wins by his enterprise, is all his own; the public losses are shared by thousands. The selfish passion is intensified by the prospect of immediate gain; private speculation becomes ardent, energetic, and daring, while public spirit—cold and timid at the best—grows feebler still when the danger is remote. Under these circumstances it is easy to see where this ultra-enterprising spirit will end. It carried the state to the verge of financial ruin; it has produced revulsions of trade and currency in every commercial country; it is tending now, and here, to the bankruptcy of cities and counties.

Id.

78. *Id.* at 164.

79. *Id.*

80. *Id.* at 168.

> The whole of a public burden cannot be thrown on a single individual, under pretence of taxing him, nor can one country be taxed to pay the debt of another, nor one portion of the state to pay the debts of the whole state. These things are not excepted from the powers of the legislature, because they did not pass to the Assembly by the general grant of legislative power. A prohibition was not necessary. An Act of Assembly, commanding or authorizing them to be done, would not be a law, but an attempt to pronounce a judicial sentence, order or decree.

Id.

> nue for *public* purposes. When it is prostituted to objects in no way connected with the public interests or welfare, it ceases to be taxation, and becomes plunder.[81]

Having established that the taxing power of the legislature is limited to public purposes, Justice Black applied the doctrine to the facts of the case. Although acknowledging that the proceeds from the sale of the shares would end up in the hands of a private corporation, he stated that it was "not on the nature or character of the person or corporation" who is employed to achieve a public purpose.[82] Rather, it is the "ultimate use, purpose and object for which the fund is raised" that determines public purpose.[83] Accordingly, the ultimate object of the expenditure determined public purpose, not the means used to achieve that object.

Black then concluded that the construction of a railway was for a public purpose. "A Railroad is a public highway for the public benefit, and the right of a corporation to exact a uniform, reasonable, stipulated toll from those who pass over it, does not make its main use a private one."[84] Black stated that the state's duty does not stop with the establishment of those institutions necessary for the existence of government: "To aid, encourage, and stimulate commerce . . . is [also] a duty of the sovereign . . . ."[85]

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81. *Id.* at 168-69.
82. *Id.* at 169.
83. *Id.*
84. *Id.*
85. *Id.* at 169-70.

> It is a grave error to suppose that the duty of a state stops with the establishment of those institutions which are necessary to the existence of government; such as those for the administration of justice, the preservation of the peace, and the protection of the country from foreign enemies; schools, colleges and institutions, for the promotion of the arts and sciences, which are not absolutely necessary, but highly useful, are also entitled to a public patronage enforced by law. To aid, encourage, and stimulate commerce, domestic and foreign, is a duty of the sovereign, as plain and as universally recognized as any other . . . . Canals, bridges, roads, and other artificial means of passage and transportation from one part of the country to the other, have been made by the sovereign power, and at the public expense, in every civilized state of ancient and modern times.

Id.

There can be no question that *Sharpless* provided significant judicial support for governmental expenditures in aid of private enterprise constructing internal improvements. However, the impact of *Sharpless* must be tempered by the consideration that its scope was confined to aid to corporations operating in one particular sector of the economy. As a result, *Sharpless* provided scant precedent for courts considering public aid to private corporations doing business outside the internal improvement area.

It should be noted that judiciaries in three states registered spirited dissents to the overwhelming number of rulings in other states validating municipal stock subscription in railroads. The dissenters were led by such imminent jurists as John F. Dillon of Iowa and Thomas M. Cooley of Michigan.[86]

In an 1859 Iowa case, *Stokes v. County of Scott*,[87] petitioners challenged local subscriptions to railroads under a code section that courts had previously employed to sustain such subscriptions.[88] The court stated that irrespective of how much railroads might develop resources and increase general prosperity, the railroads are similar to mills and manufacturing establishments for which "it would scarcely be claimed that a county has the inherent right, in its corporate capacity, to tax the people."[89] This view was buttressed by Chief Justice John F. Dillon in *Hanson v. Vernon*[90] where the court was called upon to decide the constitutionality of legislation enacted specifically to allow localities to tax for railroad aid.[91] In striking down the legislation as unconstitutional, Justice Dillon relied on several propositions: (1) the legislature has no right to tax citizens and hand the money over to a private, for-profit organization;[92]

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86. THOMAS M. COOLEY, CONSTITUTIONAL LIMITATIONS (1871) was a milestone in American Constitutional Law. JOHN F. DILLON, MUNICIPAL CORPORATIONS (1881) was a pioneer legal treatise.

87. 10 Iowa 166 (1859).

88. *Id.*

89. *Id.* at 172-73; *see also* State *ex rel.* Burlington & Missouri R.R. v. County of Wapello, 13 Iowa 388, 405 (1862) (stating that railroads are essentially private, not public and that "county revenue must go to the county treasurer where it would be under control of a county's agents").

90. 27 Iowa 28 (1869).

91. *Id.*

92. *Id.* at 40-41.

(2) the *Sharpless* decision, allowing such aid, had been reached under the influence of fourteen million dollars in debts previously subscribed and under the influence of Chief Justice Gibson, whose "extreme notions" of the extent of legislative power would "practically invest the legislature with despotic power";[93] (3) the legislative enactment was "in fact, a coercive contribution in favor of private railway corporations and violative [of the due process provisions of the federal constitution]";[94] (4) taxes are contributions demanded for the use of government and not for private uses;[95] and (5) whatever "material prosperity" that results from the railroad construction would be "a mere incident of the business [which was organized] solely to make money for . . . stockholders."[96] Finally, Justice Dillon put forth the proposition that future courts would cite as precedent in striking down aid to private corporations in other sectors of the economy. Dillon stated that sanctioning such legislation "because of the incidental advantage to the community" would "unsettle the foundation of private rights."[97] He reasoned that if the citizen and his property might be taxed for "incidental advantage to the community, "*who, indeed, could define the logical boundaries to this doctrine*? . . . . [A]griculture, commerce, the mechanic arts, [indeed] . . . every department of labor and every industrial pursuit" would be involved since they all advance the "public prosperity."[98]

In Michigan, two years after publication of his treatise *Constitutional Limitations*, Justice Thomas M. Cooley led the majority in opposing public financing of railroads in refusing to grant mandamus to compel the issue of township bonds as a loan to the railroad.[99] While echoing many of Chief Justice Dillon's themes, Justice Cooley also stated that an indirect and incidental benefit to the public through the enhancement of values could not sustain taxation because such "incidental benefit which any enterprise may bring to the public, has never

93. *Id.* at 44-45.
94. *Id.* at 45.
95. *Id.* at 48.
96. *Id.* at 53.
97. *Id.*
98. *Id.* at 58-59 (emphasis added).
99. People *ex rel.* Detroit & Howell R.R. v. Township Bd., 20 Mich. 452 (1870).

been recognized as sufficient of itself to bring the object within the sphere of taxation."[100]

Justice Cooley also attacked the prevalent proposition that because railroads enjoyed eminent domain powers for public use, they must therefore be public objects to sustain taxation for their benefit. He stated that the grant of eminent domain powers to railroads was a "considerable modification" of common law principles, and a mere "convenient fiction" the courts had adopted from "overriding public necessity."[101] The law in the case of railroads had considered need rather than means of accomplishment. But if an analogy existed between eminent domain and another power, "it is much nearer akin to that of the public police than to that of taxation."[102]

Finally, in a statement that present day judges would do well to observe, Justice Cooley, in response to the assertion that his decision was contrary to the weight of authority in other states, opined that mere repetition of decisions added little to the authority of the first case in the line.[103] Furthermore, the Michigan Court was unembarrassed by prior decision and could settle the matter on principle.[104]

VI. PUBLIC AID TO PRIVATE ENTERPRISE

How does public aid to such private corporations as Mercedes Benz, the Chicago White Sox, and the Portland Trailblazers fit within the context of the previous discussion of public purpose? The answer is that court rulings regarding the Public Purpose Doctrine in the context of internal improvement litigation were radically different than the conclusion drawn by the courts regarding aid to private corporations operating in other sectors of the economy. As illustrated below, with the exception of the ambivalence of the courts concerning aid to agriculture, the courts overwhelmingly concluded that aid to private enterprise

100. *Id.* at 488.
101. *Id.*
102. *Id.*
103. *Id.* at 492.
104. *Id.* at 493.

doing business outside the internal improvement sector was prohibited.

It is important to reiterate that the foundation of the intense debate over aid to railroads was whether they, as private corporations, were the proper entities to perform what was almost unanimously considered a public purpose: the construction of internal improvements, specifically railways. The construction of internal improvements[105] was historically considered a public duty, so there was no question that the object of the expenditure of tax dollars was for a public purpose.

But the operations engaged in by many other types of industry were not impressed with the imprimatur of public purpose. Furthermore, in light of the disastrous experience with railroads, public attitudes changed from generally encouraging government subsidies to encouraging private enterprise and personal initiative: "General disillusionment with the fruits of governmental enterprise in the earlier part of the [nineteenth] century undoubtedly played a part in the development of this attitude. And the excesses of railroad finance had borne bitter fruit in public bankruptcy and debt repudiation."[106]

Professor Waldron has asserted that "[t]he proposition that private interests might not enjoy public largesse was a major corollary implicit in the commonly accepted argument that railroads might benefit from public funds because they furthered public purposes."[107] In 1871, the Supreme Judicial Court of Maine expressly adopted this proposition in *Opinion of the Justices*.[108] This work is deemed to be the first widely recognized judicial pronouncement on the subject regarding aid to private corporations operating outside the internal improvement area.[109] The Maine House of Representatives asked the court whether it might enable towns to "assist individuals or corporations to establish or carry on manufacturing of various kinds"

105. Prior to railroad construction, the term "internal improvements" involved, *inter alia*, the construction of schools, jails, and libraries. *See* Charles F. Chamberlayne, *The Sugar Bounties*, 5 HARV. L. REV. 320, 324 (1891-92).

106. Waldron, *supra* note 22, at 234.

107. *Id.*

108. 58 Me. 590 (1871).

109. Waldron, *supra* note 22, at 235.

by donations or loans of public funds.[110] Justice Appleton answered in the negative, responding that taxation must be for a public purpose and that the proposed legislation is "limited by and embrace[s] what is special and private, thereby excluding what is municipal, governmental or public.[111] Justice Appleton also discussed whether benefit to the community resulting from the operations of the manufacturer satisfied the public purpose requirements:

> The general benefit to the community resulting from every description of well-directed labor is of the same character, whatever may be the branch of industry upon which it is expended. All useful laborers, no matter what the field of labor, serve the State by increasing the aggregate of its products,—its wealth. There is nothing of a public nature any more entitling the manufacturer to public gifts than the sailor, the mechanic, the lumberman, or the farmer.[112]

Justice Dickerson was even more explicit in his opposition to such legislation. Taking a slightly different approach than Justice Appleton, he began with the proposition that the legislature has the authority to enact laws which are for the "benefit of the people of the state."[113]

Acknowledging that the term "benefit to the people" was "broad and comprehensive," he stated:

> Such are the laws providing for the survey of lumber . . . the establishment of local tribunals, sanitary and police regulations, public parks and public libraries . . . . It is not the purpose of these laws to confer pecuniary benefit upon private individuals, or increase the value of private property, or furnish employment for the people, in a particular district, but it is to subserve the public convenience and promote the general welfare.[114]

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110. 58 Me. at 590 (1871).

111. *Id.* at 592. Justice Appleton recast the question as follows: "It is true the inquiry is, whether the legislature can authorize a town by a major or any vote to give away the property of an unwilling minority to an individual or manufacturing corporation whom or which such majority may select as donees." *Id.* at 592-93.

112. *Id.* at 593.

113. *Id.* at 601.

114. *Id.* at 602.

Regarding the proposed legislation, he stated that its "direct purpose [is] private in its character; it is to increase the means and improve the property of some, and furnish employment to some, while the benefit, if any, to the public is only reflective, incidental or secondary."[115]

Responding to the argument that if aid were not extended, certain enterprises either could not continue to operate or would not settle in the state, Dickerson responded with the rhetorical inquiry: "But does the inability of A., to carry on or establish manufacturing, afford any *constitutional ground* for taxing B. to help A do so?"[116]

Finally, in answer to the contention that manufacturers were no different from railroads, Dickerson stated "[r]ailroads are manifestly the great public convenience and necessary not on the ground that they incidentally [benefit the country or] increase the local value of private property, . . . [but because their] primary purpose is . . . a public one [: to foster the] intercommunication between remote sections of the country as public highways."[117]

The *Opinion of the Justices* set forth the parameters on how aid to private corporations operating outside the internal improvement sector would be viewed. Such private corporations were not deemed to be carrying on business for a public purpose. Whether their business operations might result in some incidental benefit to the public was irrelevant, as such benefit did not provide a constitutional authority for public aid. In addition, employing "benefit to the public" as a judicial standard effectively eliminated the impact of the Public Purpose Doctrine as a limitation on the spending power. Finally, com-

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115. *Id.* at 603.

116. *Id.* at 603 (emphasis added).

117. *Id.* at 605.

> Not only is the public character of railroad corporations established by their office, as public highways, and by the grant of the right of eminent domain to them, but it further appears from the various legislative enactments in regard to the construction of these roads, the provisions for the safety of the public, the constant supervision to be exercised over their management by the railroad commissioners of the State, and the penalties imposed for their neglect or violation of these regulations.

Id.

paring manufacturers with railroads in the context of public aid proved futile because the great weight of judicial authority had considered railroads to be performing a public function.[118]

A somewhat startling example of how the attitude of the justices in Maine was reflected in other states is the case of *Lowell v. Boston*.[119] In 1862, a fire destroyed a part of Boston, and in response, the state legislature authorized the city to borrow $20 million for reconstruction loans to affected property owners. The Massachusetts Supreme Judicial Court enjoined the bond issue as being beyond the taxing power of the legislature because the issue did not concern the public welfare:

> The promotion of the interests of individuals, either in respect of property or business, although it may result incidentally in the advancement of the public welfare, is, in its essential character, a private and not a public object. However certain and great the resulting good to the general public, it does not, by reason of its comparative importance, cease to be incidental.[120]

Additionally, the United States Supreme Court examined the Public Purpose Doctrine in the case of *Loan Association v. Topeka*.[121] This case involved legislation authorizing Kansas cities and counties to issue bonds, the proceeds of which would be donated to private corporations to build bridges and to aid railroads, water power development, and other internal improvements. The Court stated that there could "be no lawful tax which is not laid for *a public purpose*."[122] In reviewing the Kansas legislation, the Court had "no difficulty in holding that . . . [the proposed aid] is not [for] such a public purpose as we have been considering."[123] The Court also dismissed the

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118. *Opinion of the Justices* was followed by the case of *Allen v. Jay*, in which the Supreme Court of Maine struck down a proposed bond issue, the proceeds of which were to be loaned to a private firm. Allen v. Jay, 60 Me. 124 (1872). Professor Waldron has characterized the 1871 and 1872 opinions as "the most ingenious in the whole case literature of public purpose, in their invocation of economic considerations." Waldron *supra* note 22, at 241.

119. 111 Mass. 454 (1873).

120. *Id.* at 461.

121. 87 U.S. (20 Wall.) 655 (1874).

122. *Id.* at 664 (emphasis in original).

123. *Id.* at 665.

public benefit assertion by ruling that employing such criteria would remove any limitation on the power to tax.[124]

Loan Association has been characterized as the first case in which the United States Supreme Court recognized the Public Purpose Doctrine.[125] "It has been ranked with Cooley's *Salem* opinion, his treatises and the *Lowell* and *Sharpless* cases as a definitive proclamation of the Doctrine."[126]

VII. SUMMARY

Contrasting the current application of the Public Purpose Doctrine with its original intent, it is apparent that the rule is an ineffective means of limiting a legislature's spending power. Judicial inability to fashion consistent guidelines concerning the application of the doctrine has contributed to its ineffectiveness. Perhaps the problem is with the conceptual dilemmas of the rule. Over a century ago, Justice Ladd of the New Hampshire Supreme Court recognized some of the difficulties in applying the doctrine. He stated that the courts, in determining the public purpose of tax legislation, "pass upon the same question as that decided by the legislature . . . and they must determine it in the same way [that] the legislature ha[s] done, simply by

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124. *Id.*

> If it be said that a benefit results to the local public of a town by establishing manufactures, the same may be said of any other business or pursuit which employs capital or labor. The merchant, the mechanic, the innkeeper, the banker, the builder, the steamboat owner are equally promoters of the public good, and equally deserving the aid of the citizens by forced contributions. No line can be drawn in favor of the manufacturer which would not open the coffers of the public treasury to the importunities of two-thirds of the business men of the city or town.

Id.

125. *See* McAllister, *supra* note 8, at 147.

126. Waldron, *supra* note 22, at 251. Prohibition of aid to private enterprise was also applicable to mixed public and private enterprises. *See* Opinion of the Justices, 91 N.E. 405 (Mass. 1910) (invoking the *Lowell* decision against a municipal plan for development of the Boston Harbor area and stating that management and use of the project "to promote the interests of the merchants or traders who might occupy it, and to furnish better facilities for doing business and making profits" would not be for a public purpose); Coates v. Campbell, 35 N.W. 366 (Minn. 1887) (enjoining village construction of a power dam across the Mississippi River); Attorney v. Eau Claire, 37 Wis. 400 (1875) (enjoining construction of a dam and water power facilities by a city).

the exercise of reason and judgment."[127] Ladd also stated very few expenditures were per se public or private because that determination rested in social, political and economic experience and was "essentially a conclusion of fact and public policy."[128]

Since it is difficult to devise a coherent judicial framework within which the Public Purpose Doctrine can be applied to limit government expenditures, it is necessary to look to other means of achieving this goal. One alternative is to require that in situations where goods and services are provided to the public, all government expenditures must be channelled through nonprofit entities. That is, unless the government decides to provide the good or service itself, the entity providing funding should be nonprofit.

VIII. A NOT-FOR-PROFIT SOLUTION

A. *Preliminary Comments*

Why propose a not-for-profit solution? The answer is simple: attempts to limit government spending by use of the Public Purpose Doctrine have created problems concerning judicial application and have fostered a climate of greed, political payoffs, and runaway public debt.[129] The probability that such a climate would exist in a not-for-profit context is minimal. The elimination of the profit motive would substantially reduce the incentive to use money to influence political decisionmaking.

For example, the current craze by the states to attract gambling has resulted in gaming interests making large campaign contributions to legislators. In Texas, casino companies spent between an estimated $1 million and $1.8 million during the 1993 legislative session in lobbying for riverboat casino gambling. These amounts include a $100,000 contribution by a major investor in United Gaming to Governor George Bush, Jr., and a $105,000 contribution by a Dallas developer to former

127. Perry v. Keene, 56 N.H. 514, 532 (1876).

128. *Id.* at 533.

129. The Public Purpose Doctrine has been used as a tool to expand government spending when courts employ it as an exemption from state constitutional provisions prohibiting aid to private corporations. *See* Rubin, *supra* note 13, at 161-66.

Governor Ann Richards.[130] It is inconceivable that such large campaign contributions would not influence a legislator's decision that public subsidies to gaming interests serve a public purpose.

Let us also examine the conceptual dilemma in which Gale Norton, the Attorney General of Colorado, found herself responding to questions presented by the President of the State Senate regarding a proposal to give United Airlines massive tax breaks as an incentive to locate an aircraft maintenance facility in Colorado.[131] The proposal would grant United Airlines as much as $609 million in tax credits over a thirty-year period.

In determining whether such a subsidy served a public purpose, the opinion stated that a distinction should be made between two judicial philosophies: (1) a "judicial activist" approach, which "utilizes current practical realities to interpret the constitution with modern needs and understandings,"[132] thereby allowing virtually any aid to a private corporation as long as a public purpose is stated in the legislation; and (2) a "strict construction" view that the state constitution, which contains provisions prohibiting such aid,[133] is the "overriding document" which, in the Attorney General's opinion, creates a structure of fairness and objectivity.[134] The Attorney General also stated that adherence to constitutional mandates prevents "favoritism and whim."[135] In spite of these strong admonitions, Attorney General Norton concluded:

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130. R.G. Ratcliffe, *Politicians Winning Big Over Casinos; Gambling Firms Seek to Influence Officials*, HOUS. CHRON., Aug. 8, 1994, at A1.

131. Letter to the Honorable Ted Strickland, President of the Senate, from Gale Norton, Attorney General of Colorado (June 13, 1991) (on file with the Attorney General, *A.G. File N.ORL*).

132. *Id.*

133. For example, the Colorado Constitution provides:

> Neither the state, nor any county, city, town, township, or school district shall make any donation or grant to, or in aid of, or become a subscriber to, or shareholder in any corporation or company or a joint owner with any person, company, or corporation, public or private, in or out of the state, except as to such ownership as may accrue to the state by escheat, or by forfeiture, by operation or provision of law.

COLO. CONST. art. XI, § 2.

134. Letter, *supra* note 131, at 10.

135. *Id.*

> The proposed legislation provides aid to a private corporation that would not pass muster under the Colorado Constitution as originally intended . . . . Nevertheless, in advising the General Assembly, I cannot ignore the vast divergence between the original intent of the Constitution and modern judicial interpretation. Given the historical trends, public purposes such as those set forth in the proposed legislation will almost certainly pass judicial muster.[136]

The expansion of the Public Purpose Doctrine by the Attorney General, in spite of her admonitory language, is the likely result of the political pressures both she and other public officials feel when they attempt to restrict the power of their peers to spend tax dollars in subsidizing large corporations. Thus, efforts by the government in response to political pressures exerted by private entities to enlarge the scope of what is a public purpose renders the doctrine ineffective as a limitation on the spending authority of the legislature.

B. *A Specific Not-For-Profit Proposal*

Initially, it should be understood that my proposal would significantly restrict the power of public entities to subsidize private activities. In fact, this proposal would prohibit the expenditure of tax dollars to subsidize private activities unless they are conducted by nonprofit entities. Such a government-nonprofit framework would also have serious repercussions on the ability of private entities to finance their activities using public funds. These are matters with which economists and politicians must grapple.

The types of nonprofit entities to which I refer for the delivery of public goods and services[137] are what have been described as "true" nonprofits, i.e., firms formally organized as either nonprofit corporations or charitable trusts. These organizations are characterized by the fact that they are subject to a "nondistribution constraint" that prohibits the distribution of residual earnings to individuals who exercise control over the

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136. *Id.*

137. What is classified as a "public" good or service is a matter of legislative discretion.

firm. A nonprofit firm offers consumers the advantage that those who control the organization are constrained in their ability to benefit personally from providing low-quality services; thus, they have less incentive to take advantage of their customers than do managers of a for-profit firm:[138]

> The emphasis . . . here is on the role of the nondistribution constraint as a direct bar on opportunistic conduct on the part of nonprofit's managers. The nondistribution constraint might also, however, serve the same function through indirect means by screening for managers who place an unusually low value on pecuniary compensation and an unusually high value on having the organization they run produce large quantities of services or services that are of especially high quality.[139]

Prior to examining in detail a nonprofit paradigm, it is important to understand that there are several nonprofit alternatives through which the delivery of public goods and services can be achieved.

Initially, to appreciate the significance of the nonprofit sector, it should be noted that in 1980, nonprofits[140] purchased $142.2 billion in goods and services and employed 15.3% of the service sector workers in such fields as health care, education, research and social services.[141] At that time, the nonprofit sec-

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138. Henry Hansmann, *Economic Theories of Non-Profit Organizations*, *in* THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 27 (Walter W. Powell ed., 1987). Burton Wisebrod describes such firms as "public," "collective," and "trust" type nonprofits. BURTON A. WISEBROD, THE NON-PROFIT ECONOMY 9-10 (1988). A "collective" nonprofit provides services that generate sizeable, "external" benefits to those who do not help to finance the organization's activities. This includes medical research, museums, wildlife sanctuaries, environmental protection, and aid to the poor. Activities of collective nonprofits are virtually indistinguishable from those of governmental agencies. A public-type "trust goods" nonprofit is exemplified by services rendered by nursing homes, daycare centers, and blood banks. They sell their services, just as proprietary firms do, but the services they sell are of the kind about which consumers are often poorly informed. Some consumers may prefer to deal with a nonprofit organization with the belief that it will take less advantage of a consumer's informational handi cap than a for-profit seller would. *See* WISEBROD, *supra* at 10.

139. Hansmann, *supra* note 138, at 29 n.5.

140. The types of nonprofit organizations vary widely. Such entities as Common Cause, March of Dimes, American Automobile Association, National Geographic Society, hospitals, nursing homes, and trade associations can all qualify to operate as nonprofit entities.

141. Gabriel Rudney, *The Scope and Dimensions of Nonprofit Activities*, *in* THE

tor was the third largest sector of the United States economy.[142] In 1993, the nonprofit sector measured $389 billion in total expenditures.[143]

In considering the delivery of public goods and services through the nonprofit sector, one must concentrate on three major areas: (1) the type of nonprofit organization that will provide the goods and services; (2) what goods and services should be provided; and (3) the most efficient method for providing such goods and services.

Nonprofit organizations take the following forms: (1) independent entities that perform traditional governmental functions (i.e., school and community college districts, hospital districts, transits districts, state colleges and housing authorities); (2) nongovernmental public corporations (i.e., the Red Cross or industrial accident insurance corporations); and (3) private nonprofit entities (i.e., private colleges, museums, orchestras, and public broadcast stations). All of these private nonprofit entities are tax exempt and often receive public subsidies.

Additionally, the kinds of goods and services that government purchases or provides either directly or through subsidies are those that are (1) considered essential to the operation of government itself; (2) deemed essential "public services" such as utilities, transportation, housing, health care and prisons; and (3) described as bestowing general benefits on the community (i.e., various subsidized economic development projects).

Finally, in deciding what is the most economically efficient method of delivering such goods and services, one must consider choices ranging from (1) simple governmental purchase of such goods and services in the marketplace (with no subsidy in price) to (2) above-market payments as a form of support for the providing entity, (3) tax breaks, (4) credit support (loans, industrial development bonds, guarantees), (5) use of public facilities at reduced costs, and/or (6) direct financial subsidies from public funds to private individuals for payment to nonprofit providers, as is the case in the medicare system.

NONPROFIT SECTOR: A RESEARCH HANDBOOK 55, 56-57 (Walter W. Powell ed., 1987).

142. *Id.* at 56.

143. VIRGINIA A. HODGKINSON ET AL., NONPROFIT ALMANAC 1992-93: DIMENSIONS OF THE INDEPENDENT SECTOR 5 (1992).

In light of the foregoing, it is obvious that much more work needs to be undertaken to determine the optimum relationship between the aforementioned alternatives. Nevertheless, the type of government-nonprofit association that would reduce the undesirable economic and political behavior described earlier involves either direct financial dealings between nonprofit organizations and particular governmental agencies or nonprofits that receive government subsidies. The key to making this type of government-nonprofit partnership work is encapsulated in the word "accountability." The governmental entity must maintain sufficient control over the nonprofit organization to hold it accountable. The ability of government to require accountability is greatest where the form of assistance to the nonprofit is a direct contract, loan, or grant. "It is weakest where the assistance is provided to [entities] who are then free to purchase services from providers of their choice in the market."[144]

The case of *Kromko v. Arizona Board of Regents*[145] illustrates the type of relationship between government and the nonprofit entity which fulfills public purposes and reduces the possibility of corruption. *Kromko* involved a challenge to the legality of a lease transaction between a state university and a nonprofit corporation that operated the university hospital. The petitioner claimed that the hospital, which received an annual appropriation from the general fund of the state, was the recipient of a subsidy in violation of the Arizona Constitution provision prohibiting government aid to corporations.[146] The court ruled that the expenditure did not violate the constitution. It also stated that public funds are to be expended only for public purposes. The court, in examining the legislative intent supporting the enactment of Article 9, Section 7 and the rationale for the Public Purpose Doctrine in Arizona, focused on the level of control the state retained with respect to the hospital operation. The court noted that the Arizona Board of Re-

144. Lester M. Salamon, *Partners in Public Service: The Scope and Theory of Government Nonprofit Relations*, *in* NONPROFIT SECTOR: A RESEARCH HANDBOOK 99, 106 (Walter W. Powell ed., 1987).

145. 718 P.2d 478 (Ariz. 1986).

146. The Arizona Constitution states: "Neither the State, nor any county, city, town, municipality or other subdivision of the State shall ever give or loan its credit in the aid of, or make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation . . . ." ARIZ. CONST. art. IX, § 7.

gents, a quasi-public body selected by the state legislature, decides who serves on the board of directors and retains the right of approval of any business transaction of the nonprofit that could adversely affect the interests of the state.[147] The nonprofit was also required to make semi-annual progress reports on its financial status to the regents. No earnings of the nonprofit corporation other than the reasonable compensation for services could be distributed to its members, directors, or officers.

> In other words, [the nonprofit corporation] is an independent corporation, free to operate in a competitive market without the normal constraints usually placed on the state. Nevertheless, its operations are still subject to the control and supervision of public officials. *Hence, we believe the fear of private gain or exploitation of public funds envisioned by the drafters of our constitution is absent . . . .*[148]

Thus, in order for the government-nonprofit partnering to be effective, government must maintain some reasonable control over the operation of the nonprofit entity.

There are, however, other issues that must be resolved in the government-nonprofit paradigm. While government should strive to make its subsidized nonprofit entity accountable and efficient, the nonprofit entity must resist the temptation to engage in what Professor Salamon refers to as "philanthropic insufficiency, philanthropic particularism and philanthropic paternalism,"[149] all of which cause the nonprofit to place emphasis on its wealthy nongovernmental donors to the exclusion of its less fortunate clients. Additionally, government's interest in account-

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147. *Kromko*, 718 P.2d at 480.

148. *Id.* (emphasis added).

149. Professor Salamon describes "philanthropic insufficiency" as: "[t]he central failing of the voluntary system as a provider of collective goods has been its inability to generate resources on a scale that is both adequate and reliable enough to cope with the human service problems of an advanced industrial society." Salamon, *supra* note 143, at 111. He defines philanthropic particularism as "the tendency of voluntary organizations and their benefactors to focus on particular subgroups of the population." *Id.* This idea is characteristic of Catholic or Jewish relief agencies. Philanthropic paternalism is defined as an approach that "inevitably invests most of the influence over the definition of community needs in the hands of those in command of the greatest resources." *Id.*, at 112. This concept encompasses foundations and wealthy owners.

ability must be tempered by the nonprofit's need for a measure of self-determination and independence.

Referring again to the nondistribution constraint, Hansmann asserts that although nonprofits are subject to only minimum policing, abuses involving managers enriching themselves at the expense of the entity or its clients appear to be the exception rather than the rule: "Such broad compliance with a poorly policed constraint is presumably due to adherence to social norms that reinforce the legal restraints on profiteering by conditioning individual behavior even when the legal constraints are unlikely to be enforced."[150] In addition, nonprofits are viewed as more trustworthy by the consumer because the presence of the nondistribution constraint reduces the probability that management will make sacrifices in the quality of services to increase financial returns.[151]

With respect to the ability of nonprofit managers to preside over the economic and efficient delivery of public goods and services, it has been observed that entrepreneurial activity in the nonprofit sector is no different from that in the for-profit area:

> The thrust of the theory is that entrepreneurs of different motivations and styles sort themselves out by industries and economic sectors in a way that matches the preferences of these entrepreneurs for wealth, power, and intellectual or moral purposes, and other goals with the opportunities for achieving these goals in different parts of the economy. Once screened, such entrepreneurial agents are assumed to be largely responsible for giving each sector its particular behavioral flavor and performance characteristics.[152]

In response to the suggestion that the only motivation for entrepreneurial activity is economic gain, Vroom states: "The evidence concerning noneconomic incentives to work is not restricted to people's reports of their motivations. The existence of 'dollar-a-year men,' who work with only token economic rewards

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150. Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 875 (1980).

151. Hansmann, *supra* note 138, at 29.

152. DENNIS R. YOUNG, IF NOT FOR PROFIT, FOR WHAT?: A BEHAVIORAL THEORY OF THE NONPROFIT SECTION BASED ON ENTREPRENEURSHIP 3 (1983).

and entrepreneurs who continue to work after having amassed tremendous fortunes, is well known."[153]

A nonprofit can also represent a politically desirable alternative to achieve public purposes if its board of directors, staff and volunteers have roots in the constituency it serves. As a result, it will have at least "nominal sensitivity" to political questions exerted by its constituency.[154]

Finally, two more observations are worth noting. First, there is nothing novel in the suggestion of government-nonprofit partnering. Government support of voluntary nonprofit organizations "has deep roots in American history."[155] Before the American Revolution, colonial governments established a tradition of assistance to private educational institutions such as Harvard and Yale.[156]

Second, the delivery of public goods and services through the nonprofit sector resolves "the conflict that has long existed in American political thinking between the desire for public services and hostility to the government apparatus that provides them."[157] This is because the government performs a managerial function but leaves a substantial degree of discretion to its non-governmental partner. "Thus, where existing institutions are available to carry out a function, whether it be extending loans, providing better health care, delivering social services—they therefore have a presumptive claim and a meaningful role in whatever public program might be established."[158] Therefore, "[i]n the final analysis, the level of greed and corruption is dictated not by the nature of the entity providing the

153. VICTOR H. VROOM, WORK AND MOTIVATION 31 (1964); *see also* E.B. KNAUFT, ET AL., PROFILES OF EXCELLENCE—ACHIEVING SUCCESS IN THE NONPROFIT SECTOR (1991) (examining the superior leadership qualities of the managers of ten nonprofit entities around the country).

154. Young, *supra* note 152, at 95.

155. Salamon, *supra* note 144, at 116.

156. *Id.*

157. *Id.* at 110.

158. *Id.* In order to judge the effectiveness of nonprofit firms, performance measures must be developed that take into account multiple constituencies and building measures around them. *See* Rosabeth M. Kanter & David V. Summers, *Doing Well While Doing Good, in* THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 154 (Walter W. Powell, ed., 1987).

goods and service[s], but by the integrity of the individuals under whose direction the entity does business."[159]

IX. CONCLUSION

The development of the Public Purpose Doctrine in the nineteenth century clearly exhibits the desire of both the populace and the courts to place some limit on government spending. Because of the disastrous effect public aid to railroads had on public treasuries, the courts, reacting to the public outcry, refused to sanction aid to private corporations outside the internal improvement sector of the economy. Yet, the significance of that historical development and the evils that gave rise to it have been lost on present judiciaries who find a public purpose in almost any proposed government expenditure. Thus, outlandish public debt and the public's perception of unethical political behavior is the norm in this area of governmental expenditure. Consequently, a solution is needed that will do much to soften such a perception and remove the incentive to deliver goods and services of a lesser quality than what the public needs or deserves. Governmental-nonprofit partnering is one answer.

159. Telephone Interview with Janet Krupsaw, Former Service Coordinator for the Health—Impaired Elderly of Cook County, Ill. (August 1, 1994).