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CONSTITUTIONAL REVISION—STATE AID TO PRIVATE ENTERPRISE IN NEW MEXICO

Article VIII, Section 6 of the proposed New Mexico Constitution prohibits aid to private enterprise :

Neither the state nor any political subdivision thereof, except as otherwise provided in this constitution, shall lend or pledge its credit, or make any donation either directly or indirectly to or in aid of any person, association, or public or private corporation. Nothing contained herein shall prohibit the state or its local subdivisions from making provision for the care and maintenance of sick and indigent persons.

The Constitutional Revision Commission has consolidated and shortened Article IX, Section 14 and Article IV, Section 31 of the existing constitution to form Section 6. They report that Article IX, Section 14 has proven of "extreme value in the past" and strongly recommend its retention in any new state constitution on the grounds that it prevents incursions upon state and local treasuries for non-governmental purposes.¹

The revision is substantively the same prohibition of aid to private enterprise as is found in the present constitution. So extensive a restriction on the legislature merits careful appraisal of 1) the value of the underlying policy expressed by the provision and 2) the consequence of giving constitutional weight to the policy.

A law designed to promote economic development in New Mexico had been approved March 16, 1967,² to become effective on passage of a constitutional amendment.³ It provided for the creation of a state economic development authority with power to make secured loans to local non-profit industrial and economic development agencies for the establishment of industrial or other enterprises.

The legislature has taken the position that economic insecurity and consequent indigency due to unemployment is a menace to the entire state. The state's investment in youth and training is a valuable resource which can only be preserved by creating employment opportunities. Increase in employment with coincident increase in homes, real property and corporate incomes will increase the tax base of the

1. Report of New Mexico Constitutional Revision Commission 118 (1967).

2. N.M. Laws 1967, ch. 89, § 2.

3. N.M. Const. art. IX, § 14 (Interim Supp. 1968). An amendment to Article IX, Section 14 was defeated November 7, 1967: 31,019 against and 22,353 in favor. The amendment provided that the state or any political subdivision would not be prohibited from creating new job opportunities, decreasing unemployment, or improving the state's economy with loans to encourage economic development.

state, permitting it to support education and other state services. These advantages are best secured by promoting commerce, industry, and other job producing enterprises.⁴ At the present time, the legislature is precluded by Article IX, Section 14, from promoting such economic development with state financial resources.⁵

The constitutional limitations on state industrial financing have roots in the railroad-bond debacle of the 19th Century. During the 1830's and 1840's burgeoning eastern business created a demand for development of railroads and canals, and as pressure mounted for longer railroads to penetrate more sparsely settled areas, private capital was not readily forthcoming. A demand for use of public credit developed. During the mid-19th Century, several states filled the financial vacuum by extending credit or borrowing in order to purchase railroad shares.⁶

The panic of 1873 resulted in eight states defaulting or repudiating debts of this type.⁷ This had a sobering effect on the public and gave rise to the adoption of state constitutional debt limitations.

Early state debt restrictions did not generally apply to political subdivisions. State legislatures remained free to encourage counties and municipalities to incur debt in aid of railroad construction. When many railroad lines were abandoned as unprofitable, the credit of the municipalities which had financed them was impaired. Constitutional amendments were then adopted to restrict the financial activities of political subdivisions. Provisions requiring electorate approval of borrowing and prohibitions against financial aid to private enterprise emerged as the principal constitutional limitations. Some states adopted additional prohibitions barring loans, donations or gifts of land.⁸

4. *Id.*

5. N.M. Const. art. IX, § 14.

Neither the state, nor the county, school district, or municipality, except as otherwise provided in this Constitution, shall directly or indirectly lend or pledge its credit, or make any donation to or in aid of any person, association or public or private corporation, or in aid of any private enterprise for the construction of any railroad; provided, nothing herein shall be construed to prohibit the state or any county or municipality from making provision for the care and maintenance of sick and indigent persons.

6. A. Heins, *Constitutional Restrictions Against State Debt* 3 (1963).

7. *Id.* at 7, indicating default in the following order: Mississippi, Florida, Arkansas, Indiana, Illinois, Michigan, Maryland, Pennsylvania.

8. N.M. Const. art. IV, § 31.

No appropriation shall be made for charitable, educational or other benevolent purposes to any person, corporation, association, institution or community, not under the absolute control of the state, but the legislature may, in its discretion, make appropriation for the charitable institutions and hospitals, for the maintenance of which annual appropriations were made by the legislative assembly of 1909.

The two specific vices to which public aid limitations were addressed were the "lending of credit" and unsupervised private control of planning and development. The railroad aid schemes involved marketing state and municipal obligations which were delivered to the railroad as a donation or in exchange for shares. The corporation then disposed of them as it saw fit, often selling them at 65 to 70 cents on the dollar. Private corporate control was grossly inadequate to safeguard the public interest. For all practical purposes, there was no public control over the planning of the project or the expenditure of public funds. The end result was an enormous burden of public debt as the sole reminder of frustrated public purpose.⁹

This colorful chapter of American history records a total abdication of governmental responsibility. The public was left with little stomach for new adventures in financing economic progress. This was confirmed when the power to perpetrate such disasters was withdrawn from the legislature. Public aid limitations were designed to restrict government involvement in private ventures. Forty-five state constitutions impose limitations on lending of credit to private enterprise,¹⁰ and Article IX, Section 14 of the New Mexico Constitution is an illustration of the standard provisions.¹¹

New Mexico is faced with the problem of attracting industry to the state and, as in the railroad-bond era, private capital is not readily forthcoming. Increasing proportions of savings are going into institutional forms—life insurance, savings and loan associations, government bonds, pension funds and trusts. Legal and economic factors limit the power of these financial intermediaries to invest in long term obligations or in equities. State laws generally fix the maximum amount of loans that can be made by commercial banks so as to restrict the ability of many of them to make long term loans for plant construction.¹² Moreover, commercial banks must keep their loans quite liquid and are therefore limited to short or intermediate terms.

In New Mexico, state bank loans are limited to 20% of their capital and surplus to any one customer.¹³ As a practical matter, this

9. Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach*, 111 U. Pa. L. Rev. 265, 280 (1963).

10. Comment, *Constitutional Limitations on Public Industrial Financing*, 41 U. Colo. L. Rev. 135, 136 n.8 (1969).

11. N.M. Const. art. IX, § 14.

12. N.M. Stat. Ann. §§ 48-22-20 and -21 (Repl. 1966) cover reserves against deposits for state banks and loans of commercial banks.

13. Compliance with federal reserve requirements satisfies state requirements. N.M. Stat. Ann. § 48-2-28 (Repl. 1966). For state banks which do meet federal reserve requirements, the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811-1831 (1969), sets the ground rules.

limits many small New Mexico banks to \$50,000 or under. The large banks in northern New Mexico may, of course, make loans throughout the state or in connection with corresponding local banks. In the absence of corresponding banks, however, such loans are rarely made. The result is that capital for local economic development is exceedingly restricted.¹⁴

The problem common to all the states struggling to develop or redevelop diversified economies is curtailed availability of long-term capital for small business, particularly manufacturing units. New Mexico and all those states which have felt the need for public industrial financing have had to devise methods to raise required funds. To a greater or lesser extent, the solutions have been based on using public financial resources to subsidize private industry.

The diverse methods utilized by states in fostering economic development have been shaped as much by constitutional limitations as by specific regional problems. In some states, constitutional amendment has smoothed the way; in others, the courts have upheld legislative enactments attacked on constitutional grounds. The courts developed a "public purpose" doctrine to justify the state programs.¹⁵ Simply stated, the courts looked to the policy behind public aid limitations and if factors of 1) urgent necessity and 2) adequate public control to effectuate the public purpose were present, the financing legislation was upheld.

A survey of the various methods of state industrial financing is useful to a critical study of the New Mexico solution. It should be clearly understood at the outset that the New Mexico solution was achieved by the broadest possible interpretation of the present constitutional limitations.

The Mississippi plan was the beginning of modern state industrial financing. It began in 1936 with the enactment of a plan to meet immediate and long term problems.¹⁶ The impact of the depression was severe on the basically agricultural economy, and unemployment was acute. Per capita income was a disheartening 41% of the national average.¹⁷ The plan authorized municipalities to issue general obligation bonds on approval of the general electorate. Issuance was permitted on approval of a state agency based on findings of sufficient natural resources and labor to support the proposed industry, and evidence that the project would in fact promote the

14. Pinsky, *supra* note 9, at 273.

15. Note, *The "Public Purpose" of Municipal Financing for Industrial Development*, 70 Yale L.J. 789 (1961).

16. Miss. Code Ann. §§ 8936-05, 8938-08 (1957, Supp. 1968).

17. Pinsky, *supra* note 9, at 267, quoting from Survey of Current Business at 15 (Aug. 1949).

objectives of the act. Thus financed, the municipality could construct and equip a plant, then effect a long term lease to private industry. Initially, nominal rentals made this plan an outright subsidy. At present, the objective is to fix rentals to amortize the bonded indebtedness within the primary term of the lease. The Supreme Court of Mississippi upheld the statute in 1938 in the landmark case of *Albritton v. City of Winona*, 181 Miss. 75, 178 So. 799, *appeal dismissed*, 303 U.S. 627 (1938). The public purpose doctrine enunciated by the court operated as a counterweight to the constitutional limitation. Related decisions have split on *Albritton*. Courts have also split on the validity of revenue bond plans. It is significant that of the five states in which industrial financing legislation was invalidated, all had per capita income levels of 80% of the average national rate or better.¹⁸ The constitutional relevance of economic factors is felt by the courts even though it is not stated.

The revenue bond plan is the approach used by New Mexico. Municipalities are authorized to finance the construction and equipping of industrial plants by the issuance of revenue bonds. Although modeled on the Mississippi plan, it is different in that the bonds are payable only from income produced by the facility rather than from general taxes. Although the revenue bonds do not rest entirely upon the credit of the municipality, they offer many features to the investor as attractive as general obligation bonds. The land and facility are generally exempt from property taxes, the interest rate is lower than many small enterprises could ordinarily obtain, and the interest is exempt from federal income taxes. Many states make revenue bonds authorized investments for savings banks and insurance companies.¹⁹

The Pennsylvania plan is intended to meet problems significantly different from those of New Mexico. Its efforts are bent toward reorganizing and redeveloping industry in areas which suffer a labor surplus as a consequence of severe decline of sectors of the state's economy. The Pennsylvania Industrial Development Authority is given authority to make second mortgage loans from appropriations out of current revenues for industrial plan construction in areas of the state which have a substantial labor surplus as defined in the act.²⁰

18. *Id.* at 326, Table I.

19. N.M. Laws 1955, ch. 234, created an industrial revenue bond plan for New Mexico. This statute was held constitutional by the New Mexico supreme court in an opinion which showed a clear awareness of the economic factors involved. *Village of Deming v. Hosdreg*, 62 N.M. 18, 303 P.2d 920 (1956). For general coverage of the New Mexico solution see Armstrong, *Municipal Inducements—The New Mexico Commercial and Industrial Project Revenue Bond*, 48 Cal. L. Rev. 58 (1960).

20. Pa. Stat. Ann. tit. 73, § 301 (1960).

The loans are made to local non-profit industrial development corporations which in turn lease the factories to private enterprises.

The New England plan meets problems similar to those in Pennsylvania. Maine, Rhode Island and Vermont created agencies with power to insure long-term first mortgage loans by pledging the credit of the state.²¹ They may be insured in amounts as high as 90% of the project cost. The mortgagor must be a non-profit development corporation which intends to sell or lease the property to private manufacturers. Both the Pennsylvania and New England plans encourage the maximum possible financing from private investment sources. Both plans use a statewide tax base in contrast to the Mississippi plan. State and federal tax exemptions play a minor role in these plans, again in contrast to the Mississippi plan.

Oklahoma, pursuant to constitutional amendment, adopted legislation creating a state authority with the power to make second mortgage loans to local development corporations financing industrial development. Funds are obtained by issuing general obligation bonds, not to exceed 25% of the total value of the property and not to exceed in the aggregate \$10,000,000.²²

New Mexico attempted to follow the last three plans. The New Mexico Economic Development Authority²³ may be viewed as an attempt to attract private investment capital. The proposed Authority was to contract secured loans not in excess of 30% of the estimated cost of the project, provided that the development agency holds not less than 20% of the estimated cost of the project in funds or property and has obtained from independent sources a firm commitment for all other funds above the loan of the Authority. This represents a very moderate extension of state credit compared to Mississippi, which has the authority to extend 100% of the estimated cost, and the New England plan which guarantees 90% of the private investment in the project.

Accepting for purposes of discussion the need in New Mexico for economic development, we must also accept the fact that the state

21. Maine found constitutional amendment necessary to make way for appropriate legislation. Me. Const. art. IX, § 14-A; Me. Rev. Stat. Ann. tit. 10, §§ 701-03, 751-53 (1964, Supp. 1968). Rhode Island was able to comply with the constitutional restrictions in passing legislation. R.I. Gen. Laws Ann. §§ 42-34-1 to -18 (Supp. 1967). Vermont was happily spared these time-consuming problems, its constitution having no public aid restrictions. Vt. Stat. Ann. tit. 10, §§ 201-15 (Supp. 1968).

22. Okla. Const. art. X, § 34; Okla. Stat. Ann. tit. 74, §§ 851-61 (1965, Supp. 1968). Section 34 permits the legislature to raise the limit to \$20,000,000 after three years from the date of amendment. This has been done. Okla. Stat. Ann. tit. 74, § 876 (Supp. 1968).

23. N.M. Laws 1967, ch. 89, § 2. This law was contingent on the amendment of Article IX, Section 14 of the New Mexico Constitution. The amendment failed and the New Mexico Economic Development Authority was stillborn.

will be expected to take affirmative action to supply the need. This is consonant with current service-oriented concepts of government. Even in its restriction on aid to private enterprise, the constitution openly recognizes that the needs of the state are the ultimate responsibility of the state. The existing constitution makes an exception in its limitation for the sick and the indigent, which Section 6 retains.

The scope for legislative irresponsibility is as vast in underwriting the non-productive sectors of society as it would be in underwriting the productive members. Even so, the public obligation to aid the sick and indigent is not hampered by constitutional restrictions on legislative action.

Following the logic of balancing risk of abuse against necessity for action, another exception could be grafted to Section 6, *e.g.*, aid to economically undeveloped areas as a function of aid to the indigent. This limited change would have merit if constitutional amendment were the issue. However, the Convention has an obligation to clearly express governmental policies which are not inconsistent with growth. If the state constitution is not written for all time, it should at least be written for a long time.²⁴

Over the past 30 years a respectable number of states, including New Mexico, have attempted to foster economic development.²⁵ The

24. *See generally*, National Municipal League, *Salient Issues of Constitutional Revision* (J. Wheeler ed. 1961).

25. States which have grappled with their economic problems by legislation incidentally express a modern view of the purpose of state government.

It is the duty of government to promote the public welfare by fostering commercial growth and developing the personal and material resources of the state. In order to provide resources for the support of education, the administration of justice and the service of government and to promote and develop the education and commercial interests, the material resources and general prosperity of a free people, there is a state-wide need for increased employment opportunity. [Vt. Stat. Ann. tit. 10, § 201 (Supp. 1968).]

. . . It is also declared that it is in the interest of the public welfare and purpose to promote the expansion and diversification of industry, to increase employment and to provide a larger taxable base for the economy of the state. . . . [R.I. Gen. Laws. Ann. § 42-34-2 (Supp. 1967).]

The Pennsylvania Industrial Authority was created to

. . . operate for the public purpose of alleviating unemployment with its resulting spread of indigency and economic stagnation by the promotion and development of industry and manufacturing enterprises. . . . [Pa. Stat. Ann. tit. 73, § 302 (Supp. 1969).]

Of particular interest is the further finding and declaration of policy *after* the Pennsylvania Industrial Authority had been in operation.

That as a result of the activity of the Pennsylvania Development Authority in making available financial assistance to local industrial development agencies and as a result of the recent high level of the national economy, unemployment has been greatly reduced . . . the rate of migration from the Commonwealth has been slowed and the general welfare of the people of the Commonwealth has been improved. [Pa. Stat. Ann. tit. 73, § 302.1(a) (Supp. 1969).]

question facing the Convention is whether such attempts are an appropriate exercise of governmental power. It is not enough to maintain constitutional barriers against spending government funds for non-governmental purposes as is recommended by the Constitutional Revision Commission. A decision must be reached as to what are, in fact, governmental purposes.

In reaching a decision on this fundamental concept, the Convention may profitably consider the position taken by the Alaska Constitutional Convention. They declared that their purpose was to produce a constitution which would:

- 1) Allow for the great changes the future might bring to the state; and
- 2) Provide for a government that is energetic in fostering the growth and development of the whole state and the welfare of all the people.²⁶

Such a purpose is consistent with the view of the New Mexico supreme court in its rejection of a constitutional attack on municipal revenue bonds:

The effort to bolster the sagging economy in and around some of our cities and towns over the state is, of course, entirely commendable. The closing of the coal mines in Colfax County, the drought in other sections of the state, as well as untoward economic factors elsewhere, all have been the cause of deep, statewide concern. Any movement reasonably calculated to improve the economic welfare of the people as a whole through furnishing employment, promoting industry and trade, and inspiring new hope, seems well worthwhile. Whether the present enactment will achieve these aims, none can tell. Only trial, effort and actual experience can give the answer.²⁷

The position is certainly persuasive, but it is not adequately reflected in either the present or the proposed New Mexico constitution.

The judiciary has gone as far as it can go in freeing the legislature from constitutional obstruction in this area.²⁸ The Constitutional

26. National Municipal League, *supra* note 24, at 170, quoting from A Report to the People of Alaska from the Alaska Constitutional Convention (College, Alaska, the Convention, Feb. 1956).

27. Village of Deming v. Hosdreg, 62 N.M. 18, 35, 303 P.2d 920, 931 (1956).

28. *Id.* at 26, 303 P.2d at 925. The New Mexico supreme court held that revenue bond plans do not violate the credit clause because no "debt" or pecuniary liability is incurred within the meaning of the constitutional restriction. This is because the general credit of the municipality is not pledged. By implication the opinion also holds that the public purpose is sufficiently compelling to make the plan an appropriate exercise of municipal power.

Convention has a rare opportunity to build anew; it is not limited to patchwork. Section 6 should be drafted to provide:

No tax shall be levied or appropriation of public money made or property transferred nor shall public credit be used except for a public purpose.²⁹

Such a provision may not usher in the golden age of industrial prosperity, but it will no longer constrict legislative power to foster economic growth if it seems feasible to do so. Moreover, public protection would not be sacrificed. Any legislative plan would be subject to scrutiny in terms of threatened abuses and intended benefits. Ultimately the courts have authority to give meaning to "public purpose." This provision would enable the judiciary to make a decision based on an economic understanding of the times without doing violence to either the letter or the spirit of the constitution.

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29. Alaska Const. art IX, § 6.