Bond Financing and Economic Development:
The Arkansas Legacy of Default*

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Public administration theory suggests that infrastructure and other long-lived assets should be financed with bonds in order to enhance intergenerational equity. However, data from recent financial reports indicate that states more commonly finance their long-lived assets from current revenues. This paper explores why the theory of public finance for long-term assets differs from practice. As the only state in the United States to have defaulted on its bonds three times, Arkansas is used to illustrate the dangers of using bond financing to construct long-term assets. The paper will conclude with an assessment of potential problems with Arkansas Constitutional Amendment No. 82 passed in November of 2004.

This paper explores the divergence between public administration theory and practice in financing long-term assets. After reviewing the theory of debt financing by state governments, evidence will be presented that state governments are much more conservative in their use of long-term debt than would be recommended by administrative theory. A case study of Arkansas's three-time record of default on bonds issued for economic development will be used to illustrate the inherent risks in bond financing. These inherent risks may help explain state governments' very conservative use of debt and may suggest a need for revision in public administration theory concerning debt financing for long-term assets. The paper will conclude with a critique of Arkansas's 2004 Constitutional Amendment No. 82, which gives the legislature more flexibility in issuing bonds for economic development.

Theory of Debt Financing by State Governments

Public administration and economic theory have much to say about the appropriate amount of debt for federal government and for private businesses, but theoretical assessment of the appropriate level of state debt is scanty. Classic Keynesian economics suggests that it is appropriate for federal governments to save tax dollars during flush times, then spend those reserves and additional borrowed funds during economic downturns in order to the stimulate the economy (Keynes, 1936). The literature of business finance focuses heavily on determining the optimal capital structure, i.e., the mix of debt versus equity finance. In general, the business literature concludes that while there is considerable variability in the amount of debt

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used by corporations, as long as a firm earns a greater return than the cost of borrowing, debt financing will typically increase stockholder value compared to having no debt at all (Megginson and Smart, 2006). Still, the greater returns are accompanied by some additional risk of fiscal distress if the firm should fail to maintain interest payments in the long run.

Most state governments have balanced budget laws that preclude the types of deficit spending engaged in by the U.S. federal government and are often further constrained by debt limit rules based on a percentage of property values. Textbooks on financial analysis for public entities include some rules of thumb about when debt should be used, and the percentage of the budget that should be devoted to debt service payments (Granof, 2005; Mead, 2001), but they are largely devoid of an integrated theory of the appropriate level of debt finance.

Classic theory of fiscal administration in the public sector posits that intergenerational equity and full funding are the most important issues to consider in issuing debt. The concept of intergenerational equity is that those who receive the benefits from a public improvement should share in the cost. If a long-term debt is fully funded, this means a dedicated, predictable revenue source is in place to assure adequate coverage of future debt service requirements. Three arguments have been given as to why pay-as-you-go financing schemes are not appropriate for long-lived construction projects. First, pay-as–you-go will result in inappropriate assignment of costs due to population mobility. If a road construction project is financed entirely from current revenues, yet the road will last for forty years, current residents of the state will be assessed the entire cost even if they do not continue to live in the state beyond the current year. Conversely, those migrating into the state or those born after the road is constructed will receive benefits without paying their fair share. Second, total asset construction will be less than optimal with pay-as-you-go financing; if the state or local governments must save the entire cost of a major project prior to construction, the level of public building will be less than the amount citizens could afford on a debt service schedule. Third, tax rates will tend to be volatile since pay-as-you-go approaches tend to bunch greater costs and therefore greater tax payments in years when large construction projects are undertaken. If bonds are used instead of current tax sources, and if long-term assets are set up on an annuity-based payment schedule, tax payments would be constant or decline over time assuming a level or growing population base (Mikesell, 1991, p. 409).

While these arguments may be valid for local governments, they do not adequately explain why most states are so conservative in their level of long-term debt compared to the amount of long-term assets in use. Table 1 shows the amount of capital assets after accumulated depreciation compared to the level of debt financing for state governments in fiscal year 2002. Derived from Moore’s (2004) study of capital assets in state Comprehensive Annual Financial Reports (CAFRs), these data show that state governments clearly do not follow the classic theory in public administration texts, which states that long-term assets should be financed with debt of equal duration in time. Of the 47 states with CAFRs available at the time of the Moore study, only five states had 50 percent or more of the asset book values after depreciation financed by long-term debt. Other factors not explained by the normative intergenerational equity theory must be coming into play.

While balanced budget laws do not in and of themselves preclude the prudent issuance of debt, many other types of laws exist which tend to restrict full discretion by state governments in their issuance of debt. Most states have statutory debt maximums in place based on a percentage of the value of taxable real estate, but in most cases these ceilings are set so high and the laws are written so narrowly that they do not operate as stringent restraints on debt. Having an earmarked funding source is probably a more significant issue than debt limit in determining the actual amount of debt outstanding. Purchasers of bond investments are more assured of non-default when a specific tax, typically a new tax, is dedicated to the payment of bond interest. If state laws are written in such a way that either a vote of the public or a supermajority of the legislators is required to issue bonds, bond issues are restrained. Assessment of whether a vote of the people actually holds the level of capital assets below some theoretical optimal level of long-term assets might be informed by adopting a concept from the field of finance, namely the portfolio outlook, rather than the more typical project-by-project viewpoint, for purchases of long-term assets.

For city governments whose purchases of buildings or major public improvements are infrequent and irregular in timing, the pay-as-you-go approach will delay the purchase or construction of needed infrastructure or other long-term assets. State governments, on the other hand, by their very nature could be thought of as managers of a large portfolio of capital assets. Capital budgeting systems that project expected replacement of existing assets plus the desired level of new infrastructure for economic development and other needs should be established. As long as replacement of capital assets and needs for new types of capital assets are regularly distributed over time, the same needs can be met whether or not long-term financing is used. The budgeting system itself could be used to level out expenditures and tax rates over time, rather than forcing equalization of payments through bond indenture agreements.

Looking at capital asset management as a portfolio system, the pay-as-you go system dominant in state government is no more likely to decrease the overall level of benefits provided to citizens than would financing with bonds. The exception would be when a new type of infrastructure asset is needed that has such a large cost that it cannot be purchased without undue disruption to the replacement of existing capital assets. Further, the capital improvement should have such a large potential benefit from future economic development that earlier increases in revenues from income or sales taxes would be sufficient to offset the debt service costs for the long-term asset. Even then, the danger exists that promoters of new industry or infrastructure technology will overstate the expected benefits for self-interested purposes, and there is no way to assess whether some subsequent technology of even more benefit might be developed before the current bonds are repaid. These concepts show that there is room for the development of new theories of public finance for long-term assets. Development of theories that really work in practice will undoubtedly require consideration of both optimal economics and public attitudes toward long-term debt financing. The next section will consider Arkansas's history of bond default in order to highlight some specific risks of issuing bonds to finance economic development projects, which may cause conservative attitudes among the public on the use of bonds to finance economic development projects.

The Arkansas Legacy of Bond Default

The Bank Bond Crisis in Early Statehood

Prior to Arkansas's becoming a state in 1836, the costs of administering the Arkansas territory were born by the federal government. Some historians indicate that the application for statehood in Arkansas was premature because its population of roughly 50,000 was too small to justify the financial burden of administering its own government. Yet the timing of the application for statehood was driven in part by the need to balance slave and free states. Further, the wealthier farmers in the state were in favor of statehood in order to gain economic development benefits from having a state bank (Tucker, 1985, p. 19). An act to create a bank had been considered under the territorial government in 1835, but was abandoned because of doubts about the constitutional authority of a territory to establish a bank (Herndon, 1922, p. 480). One of the first actions in the new state's initial legislative session in 1836 was the creation of two banks: a commercial bank (the State Bank) and a real estate lending bank (the Real Estate Bank). Neither of these banks achieved a stable operating status before a major economic depression in 1837. Bad economic times coupled with improper management led to a quagmire not completely resolved until after Reconstruction.

Table 2 gives a time line of the major events in the state's early banking crisis. One of the first Acts of the Legislature was authorization of the two banking systems with directors deriving mainly from planter class legislators. Though the bank legislation was widely supported, an early and notorious legislative scandal soon after the creation of the banks indicates that they were not entirely without opposition. When Representative J. J. Anthony from Randolph County made an off-hand slur or joke about the level of power wielded by the president of the Real Estate Bank, who was Speaker of the House John Wilson, Speaker Wilson told Anthony to sit down and, when he refused, stabbed and killed Anthony (Bolton, 1998, p. 177).

The banks were established using bonds which were intended to be repaid from their profits, but were guaranteed by the state in the event of default. Few controls were imposed on the bank directors. For example, no limit was placed on loans to directors. Real Estate Bank loans were supposed to be collateralized by cleared land suitable for crops, but this was interpreted liberally, resulting in large tracts of land being pledged for inflated market values even though only a small section of them had been cleared for crops. At the time the banks were organized in 1836, markets were experiencing constant growth in land values, and prices of commodities were good. With the depression of 1837 however, both land and commodity prices fell sharply. Farmer-Directors were unable to pay the interest on

Table 2: Time Line of the First Arkansas Banking Crisis

- **October 26, 1836:** Legislative approval given for Real Estate Bank.
- **November 2, 1836:** Legislative approval given for State Bank.
- **August 8, 1837:** State Bank opens; stock does not sell as well as predicted.
- **December 12,1838:** Real Estate Bank opens; loans exceed $1.5 M by Oct. 1839.
- **October 1839:** Arkansas Post branch of State Bank suspends specie payment.
- **November 1839:** Helena branch of Real Estate Bank suspends specie payment.
- **Mid-1840:** Bank notes selling for 30 cents on the dollar in New Orleans. Bank directors receive raises to offset decline in note value.
- **November 1840:** “Hypothecation of bonds” to New York-based North American Trust and Banking Company in order to meet the Jan. 1841 interest payment. Because it was Illegal to sell bonds below par, $500,000 of bonds were pledged in a separate loan of $121,000.
- **December 1840:** North American Trust and Banking Company sells the $500,000 of ‘collateral’ bonds to James Holford, a London banker, for $350,000 in ‘bad faith’ shortly before it declares bankruptcy.
- **May 1841:** Fayetteville bank branch’s books were stolen prior to examination. When recovered, key cash transaction pages were missing. Cashier admits financial condition was misstated in 1838 to prevent run.
- **April 1842:** State Bankers set up a trust run by themselves to handle the liquidation of the State Bank.
- **1842:** Gov. Yell tells the legislature he is willing to stand behind legal bank bonds, but not Holford’s.
- **1846:** Arkansas legislature adopts a constitutional amendment prohibiting any banks within the state.
- **1860:** Governor Drew acknowledges the justness of the liability of the bank bonds but notes the state cannot afford to pay.
- **1869:** Post Civil War reconstruction legislature issues new bonds replacing all the bank bonds including the Holford’s.

their real estate loans and were unwilling to foreclose against themselves. There would have been no market for the land even if they had foreclosed. By 1839 Arkansas had nine branches of the two banks serving a population of less than 100,000, and in less than two years of their initial authorization, the banks’ finances were in shambles (Blocher 1987 per Thompson, 1976, p. 174). Herndon (1922) suggests that suspension of specie payments in 1839 took place not because the banks were actually out of money, but because loan payments taken out on share purchases, mostly by members of the legislature, were due and the legislator/ directors of the banks were not willing to demand payment.

The hard times in the aftermath of the 1837 depression led the directors of the banks to use some extreme measures to increase their balance sheets and generate cash. The exploits of the Fayetteville branch of the State Bank were the most notable. The Fayetteville bank reasoned that since Arkansas bonds were being quoted in New York for 13 to 17 cents on the dollar, they could increase their net assets and report a gain by buying back their own debt. For example, at 20 cents on the dollar, if $10,000 were used to purchase $50,000 of bonds the accounting entry would be as follows:

Notes Payable (Decrease in a liability)	50,000
Cash (Decrease in an asset)	10,000
Gain (Reported on income statement)	40,000

Satisfying a $50,000 debt for $10,000 would increase the reported net assets on the balance sheet by $40,000 and cause a $40,000 gain in the income statement. Unfortunately, the disreputable New York bankers whom they trusted for the transaction stole their money without re-purchasing any of their bonds (Thompson, 1976, p. 178). When Governor Yell called for an investigation of the banks, the Fayetteville branch books were stolen in May 1941. The records were later found, but with pages showing key cash transactions torn out and missing (Blocher 1876, per Thompson, 1976, p.177).

In late 1840 the central Real Estate Bank sought to avoid default on interest due in January of 1841 by getting a loan from the New York-based North American Trust and Banking. According to the original bank charters established by the 1836 Act of the Arkansas legislature, it was illegal to sell state guaranteed bonds for less than face value. Therefore, under the market conditions of late 1840, there was no direct market for the bonds. Instead the Real Estate Bank engaged in a transaction called "hypothecation of the bonds." They received cash of approximately $121,000 on a separate loan, but pledged $500,000 of unissued state guaranteed bonds as collateral in the case of default on the separate note, thus in effect disguising the sale of the guaranteed bonds at a discount. The unissued bonds were physically transferred to North American Trust and Banking. The North American Trust and Banking company had financial problems of their own and soon sold those bonds to a London banker, James Holford, for approximately $350,000 shortly before it declared bankruptcy (Blocher 1876 per Thompson, 1976, p. 180). Holford argued that he had no way of knowing from the language on the bonds that these were illegally sold to him. In correspondence with Governor Yell, he indicated that he had every reason to believe they were good bonds since North American Trust and Banking had previously been the agent selling Arkansas Real Estate Bank bonds when the banks were first opened (Hempstead, 1899, p. 277).

When the Real Estate Bank defaulted on its interest payment of $91,000, bondholders looked to the state for repayment. Since interest payment was more than half the annual state budget, Arkansas also defaulted. The Real Estate Bank turned its assets and management over to a receiver of its own choosing in 1842, which effectively protected the original planters and bank personnel from any attempt at recovering principal and interest. The legislature was unable to regain control from those receivers until 1855 (Dougan, 1993, p. 92).

Legal action on the status of the apparently illegal Holford bond portion of the debt continued even after the Civil War by representatives of Holford's estate. Legislative sessions continually discussed but repeatedly failed to resolve the Holford bond situation. The bank bonds, including the illegally issued Holford bonds, were finally replaced with new bonds at the order of the Arkansas legislature in 1869. However, full repayment of the bonds came into question once again as a result of the Reconstruction rail building bond crisis covered in the next section.

The Railroad Bond Crisis

In the aftermath of the banking crisis just described, the authors of the 1868 Arkansas Constitution included a provision that the credit of the State or counties shall never be loaned for any purpose without the consent of the people thereof, expressed through the ballot box. Further, no act of the legislature could become effective until ninety days after the adjournment of the legislative session during which the Act had been passed.

One of the great debates of Arkansas history is why the state has consistently fallen short in the area of economic development. In addition to the effects of the early banking crisis, historians also contend that the 1841 and other Federal land grants which were intended to be sold for schools, internal improvements, and economic development were largely squandered with no meaningful public school system put in place before the Civil War (Thompson, 1976, p.188; Bolton, 1998, p. 176). Arkansas began to pin its hopes on railroads as a means of economic and population development in the 1850s, but the Civil War postponed the bulk of railroad construction until the Reconstruction era. In his history of the reconstruction era, Thompson describes the complexities of early railroad and levee projects and their underlying finance. Arguments over the physical routes of the railroads reflected their importance to local and regional development. If railroads were primarily for transportation in a southeast direction from the northwest corner of the state, New Orleans would gain, while rail tracks running primarily northeast to southwest would allow connections with the St. Louis markets. This issue was settled in favor of the St. Louis markets when the ten-year Federal land grant of 1853 given to the Cairo and Fulton railroad company was granted for a track from the Mississippi river extending diagonally across the state in a southwestern direction (Thompson, 1976).

The population of the state in the 1850s was insufficient to provide adequate revenues for the railroad builders. Therefore, the railroad companies were eager to get as much construction financing from the Arkansas public coffers as possible. The railroad companies were able to get some bond financing from the state and some land grant money from the Federal government, but with the requirement that moneys could only be received after a sufficient number of rail miles had been completed. New York capital markets were not eager to loan money to the railroads for Arkansas construction after their prior experience with the Arkansas banks. The Railroad-Aid-Bill of 1867, which pledged bond money to support railroads, was vetoed by Governor Murphy because it was written in such a way as to favor only one railroad, the Memphis and Little Rock line, and because the faith and credit of the state on the bank bonds had still not been redeemed. Governor Murphy's veto was overridden by the legislature, but the railroads would not to receive any money until after the completion of a 40 mile section of track. The railroad received the pledge of bond money with the intention that the railroads would repay principal and interest over time. In order to protect the public credit, the State was to receive a first mortgage against railroad property. These provisions meant that rail builders received minimal funds on the front end, but nevertheless had to build as quickly as possible in order to receive any state and federal money, and to avoid losing the land grants, which had now been extended until 1873. The builders were in a constant cash flow crisis for money to pay suppliers and workers, many of whom had relocated from the Chicago area at their own expense. The railroads were only able to secure financing from Eastern investors by lobbying for more favorable bond conditions in the Railroad Bill of 1868, in that money could now be received after completion of only 10 miles, and the provision of a first mortgage lien to the state was replaced a provision that the state would not have the right to seize railroad property for non-payment of interest on the bonds (Thompson, 1976, p. 200). Although the bonds included in this bill were passed by overwhelming support in a vote of the people, it was much later argued that the required full 90 days had not passed between the end of the legislative session and the November election. The railroad industry was also clouded by an investigation into a minor shortfall in cash and by constant in fighting between local- versus investor-run boards. On April 28, 1870, the Little Rock and Fort Smith Railroad company received $1,500,000 in state bonds, but was in default for non-payment of interest by November 1871 (Thompson, 1976, p. 218). By 1873 all the railroads which had received state bond funding were in default (Scott, 1969).

The total debt of the State of Arkansas as of July 1, 1874 was $16 Million. Of this, $6M was undisputed State Bank, Real Estate Bank, and various other debts, including $200,000 of War Bonds. The remaining $10M was composed of approximately $1.5M of the disputed Holford bonds, $6M of railroad bonds, and $2.5 M of levee bonds which had been issued for various flood control projects (Thompson, 1976, p. 235). Many of these levees had been washed out by subsequent floods and were in various states of disrepair after the Civil War. Scott (1969, p. 123) reports that state property taxes at this time consisted of 3 mills for general purposes, 3 mills for debt, and 2 mills for school purposes, but the total amount collected was less than what was needed for full payment of interest.

In June 1877, the Arkansas Supreme Court ruled that the Railroad Bonds passed in the November 1868 election were not valid because the legislative session was technically not over until April 10, 1869. In 1878, outstanding levee bonds were also found to be unconstitutional due to a technicality in the way the vote was recorded in the legislature (Scott, 1969, p.126). While subsequent research showed that by and large the railroad moneys in Arkansas were spent on construction of rails as intended (Goodrich, 1956, p. 426; Dougan, 1993, p. 250), the post-Reconstructionist political rhetoric held that not only were the Holford bonds an unjust debt, but all the railroad bonds were unjust as well. Though he was unsuccessful, John Adams worked to effect a compromise on paying the bonds, arguing that it was inappropriate for the legislature to be voting a tax cut at the same time it was repudiating its debt on a technicality (Thompson, 1976, p. 237). Governor Clayton’s past service as Chairman of the Board of Railroad Administrators, coupled with the fact that Northwest Arkansas benefited less from the rail industry than the Delta farm area, gave ammunition for the false but widely held public sentiment that all of the railroad bonds were a carpetbagger scam that should be repudiated.

In 1879, William M. Fishback sponsored a constitutional amendment prohibiting the Arkansas legislature from levying any tax or making any payments on the Holford bonds, the railroad bonds, or the levee bonds even though technically the railroad and levee issues had already been settled in court. While this amendment was narrowly defeated in the 1880 election, it reappeared on the 1884 ballot and won handily. Fishback was elected Governor in 1892. While the people of Arkansas avoided a tax increase, New York banks were not allowed to handle any Arkansas state securities until as late as 1917 (Evans, 1930, p. 374). The frontier homesteader’s mentality of free land for the taking had extended itself to the concept of free economic development. While Arkansans enjoyed the benefits of rail transportation, the vote against the railroad bonds, held largely by Eastern investors, was a means of expressing resentment against the Northern capitalists who had won the war.

The Highway Bond Crisis

National and state economic development efforts near the beginning of the 20th century glamorized rural life with a focus on the modernization and mechanization of agriculture. Still, Tucker (1985) notes that while bankers and equipment sellers alike urged farmers to purchase tractors and modern implements, automobiles caught on faster than tractors. Local governments were initially limited in their ability to construct roads by their high cost and by the state constitution’s prohibition against borrowing by county governments to finance public improvements. However, they soon discovered that they could set up special taxing districts similar to those previously used in eastern Arkansas for drainage improvements. These soon proliferated into more than 200 special districts, which were popular as long as farmers were getting high prices for cotton during the first World War. When a depression hit in 1921, farmers claimed they could not afford to pay their road taxes and threatened violence. Road commissioners in Craighead County were forced to resign and Governor McRae was quoted in the March 20-29 *New York Times* as saying, "This road business has turned out to be the greatest disaster that has ever befallen the people of Arkansas" (per Tucker 1985, p. 72). Although the opposition to road taxes diminished somewhat the next year as cotton prices improved, the initial crisis prompted a power struggle over local versus state control of the road system. Though local control was firmly entrenched, the federal government cut off financial aid for Arkansas roads in 1923 until the state assumed control of the major highways and approved a four-cent gas tax for their support under a special session called by Governor McRae (Donovan, et al., 1995, p. 163). The state had finally re-established New York credit lines under Governor Brough in 1917, and with the number of automobiles up to 210,000 by 1926, Arkansas was ready to borrow for highway development. Highway construction legislation under Governor Martineau (1927-1928) called for the state to assume $50 million of the debt from local road districts with a reduction in local taxes, and allowed borrowing of another $1 million per year for bridge and highway construction. Unfortunately, as Tucker puts it, the legislature subsequently became "intoxicated" with easy bond money, as the legislature borrowed another $3 million to provide Confederate veterans and widows the best pension in the South. Borrowing for highway construction rapidly accelerated so that by 1932 highway and bridge debt was $150 million out of a total state indebtedness of $160 million. When the state defaulted on its interest payments in 1932, the state had the fourth largest debt in the country, exceeded only by New York, Illinois, and Louisiana. On a per capita basis, this 1932 debt of $75 per person compared to that year's per capita income level of $212 per person (Tucker, 1985, p. 75).

Assessment of Amendment 82

In November 2004, Arkansans were asked to consider a constitutional amendment allowing the Arkansas legislature to issue general obligation bonds without a direct vote of the people. The text of the amendment appears in Table 3. This amendment was supported by the legislature, the governor, the state's former Economic Development Chief Jim Pickens, Associated Industries of Arkansas/State Chamber of Commerce, plus various Arkansas state agencies and city councils. Its supporters claimed that the time required for a direct popular vote was an unreasonable burden on the state's efforts to attract large industrial projects. The amendment attracted no major opposition, although the Arkansas Libertarian Party was officially on record as opposed to it. Advertisements in favor of the amendment used the slogan "Increase jobs. Not taxes." The legislative proposal passed with 63.4 percent of the vote and has become Amendment 82 to the Arkansas Constitution.

Table 3: Text of Bond Finance Amendment 82

AN AMENDMENT TO ALLOW THE GENERAL ASSEMBLY TO APPROVE THE ISSUANCE OF GENERAL OBLIGATION BONDS FOR ANY ECONOMIC DEVELOPMENT PROJECT THAT PLANS TO INVEST MORE THAN $500 MILLION IN CAPITAL EXPENDITURES AND TO HIRE MORE THAN 500 NEW EMPLOYEES

SECTION 1.

(a) In order for the State of Arkansas to effectively compete for large economic development projects, the Arkansas General Assembly, meeting in special or regular session, may authorize the Arkansas Development Finance Authority to issue general obligation bonds to finance infrastructure or other needs to attract large economic development projects.

(b) Bonds may be issued for an amount up to five percent (5 percent) of state general revenues collected during the most recent fiscal year.

(c) Infrastructure needs may include, but are not limited to:

(1) Land acquisition;
(2) Site preparation;
(3) Road and highway improvements;
(4) Rail spur construction; water service;
(5) Wastewater treatment;
(6) Employee training which may include equipment for such purpose;
(7) Environmental mitigation; and
(8) Training and research facilities and the necessary equipment.

Therefore

(d) In order for the General Assembly to authorize the issuance of bonds bearing the full faith and credit of the State of Arkansas, the prospective employer must be planning an economic development project that will invest more than five hundred million dollars ($500,000,000) in capital expenditures and plan on hiring over five hundred (500) new employees.

(e) The bonds shall be paid for in full by general or special revenues appropriated by the General Assembly until the bonds have been retired and all obligations associated with the issuance of the bonds have been met.

(f) Bonds may be issued under this amendment pursuant to an act of the General Assembly without voter approval.

SECTION 2.

This amendment becomes effective on January 1, 2005.

Prior to the November election, some journalists in the state cautioned that the language of the amendment was vague (*Arkansas Times*, October 21, 2004; Oakley, August 6, 2004). Overall, little information was available in the media about the rationale behind the Arkansas constitution's prior requirements for a vote of the public on all bond issues, though just after the election the *Arkansas Democrat-Gazette* did briefly mention the history of bond defaults in Arkansas (Bleed, November 3, 2004). Since the reasons for the restrictive approach to bond financing in Arkansas stem from issues that first arose shortly after statehood in 1836 and again after the civil war and during the great depression, the average Arkansas voter went to the polls with little understanding of the potential ramifications of issuing economic development bonds without strong controls by the public to assure that the bonds achieve legitimate means and are backed by adequate taxes or other public revenues. Voters may have also been influenced by the slogan of increased jobs without increased taxes, which failed to mention that increased taxes or reduced revenue allocations to other budget areas would be needed at a later date should bonds actually be issued.

Conclusion

The promise of economic development for free has been an alluring, but dangerous, aspect of Arkansas history. Arkansas has the dubious distinction of being the only American state to have defaulted on its bonds three times (Ratchford, 1941). Each default involved bonds issued for economic development. The first bond crisis involved banking and agricultural development, the second default was for bonds issued for railroad and levee development, and the third default resulted from the overly aggressive roads and highway bond program in the 1920s.

The historical sections provide an important context for understanding prior Arkansas constitutional amendments that precluded issuance of bonds without a vote of the people. One hopes that current lawmakers will use more common sense and restraint in the issuance of the newly authorized economic development bonds than their predecessors, who were responsible for these bond defaults. On the other hand, the aspects of human nature which drive politics have not changed. Historically, Arkansas has shown itself to be so enamored by promises of economic development from various projects that it has been willing to "bet the wind." While it might not have been possible to foresee the economic depression of 1837, it should have been possible to foresee the dangers from self-dealing between the banks and members of the legislature who were in control of bank operations. Likewise, it should have been possible to foresee that the railroads would have trouble earning sufficient revenues from the small population base in Arkansas to repay the bond principal and interest on a timely basis. The repudiation of the Holford and railway debts on the part of the Arkansas citizens at the same time they were getting a tax cut, coupled with the legislature's gluttonous issuance of debt after World War I, clearly speaks to the potential dangers of long-term debt as opposed to pay-as-you-go financing.

The vague language of the new economic development bond funding amendment is likely to require judicial interpretation if the legislature attempts to issue the maximum amount of bonds allowed, since the 5 percent limit based on revenues does not specify whether this means gross or net revenue. Further, the amendment describing the economic development bonds does not name a single source of funding. While the citizens of Arkansas were assured that a vote for the bond amendment would not raise their taxes, the money will have to come either from undesignated sources of future revenue growth or by cutting back on existing budget allocations. It is not clear whether bond investment brokers will consider these bonds a safe buy at a reasonable interest rate from a state that is under considerable pressure to spend for public school building improvements, health, and prisons. The most troubling part of the amendment is that the bonds can be issued to fund infrastructure and other improvements on behalf of firms that are just considering whether to relocate to the state. While legislators certainly would not enhance their own reputations if they issued bonds on behalf of a corporation that did not subsequently relocate to Arkansas, the legislature can issue bonds for economic development purposes even more dubious than the historical banking and railroad interests of a nearly forgotten historic era.

The earlier discussion of public administration theory indicated that some theorists believe that bond financing can enhance intergenerational equity in state and local finance. This should have been true with railroad finance. The railroads were an expensive, new technology with the potential to eventually increase the economic status of the state. Accelerating the rate of development of the rail industry should have had widespread benefits to citizens in the state. The new constitutional amendment is targeted toward infrastructure and other development activities potentially on behalf of a large super project. This type of project may eventually increase the state coffers through increased income for Arkansas citizens and through sales taxes derived from increased personal income. But while there will be some benefits throughout the state, direct economic benefits are likely to be more localized than they were for the Reconstruction railroad projects and therefore less likely to benefit the citizens as a whole even though they may share equally in the tax burden. Another aspect to consider is that if one adopts the portfolio perspective on funding purchases of long-term assets, the 5 percent limit on the amount of bonds suggests that there is no valid reason why funding for projects of this size could not be funded from current reserves without issuing bonds if the legislature chooses to do so.

As of mid-2005, the legislature still had not made any attempt to issue any economic development bonds as allowed by Amendment 82. Given that many types of economic aid for corporations locating large projects in Arkansas are already available without the use of bonds, the primary benefit of Constitutional Amendment 82 to date has been the national media attention gained shortly after the 2004 election promoting Arkansas as a business-friendly state. The long-term benefit of

Amendment 82 depends on whether Arkansas can select and attract candidates for the economic bonds that will really provide long-term, quality jobs for Arkansas citizens. According to the popular cliché, “if we build it, they will come.” The worst case scenario of Amendment 82 would be for the state to finance and build economic infrastructure, and then have a corporation renege on establishing the promised jobs. The public embarrassment from financing such a failed economic development with bonds voted by the legislature would be much more palpable than from using revenue provided by current funding sources. Even in a term-limited political environment, one would hope that the potential for negative political fallout would serve to constrain the legislature to issue bonds only for the most circumspect of corporate projects.

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