A MACKINAC CENTER REPORT

PATRICK WRIGHT

FROM PROHIBITED TO PERMITTED

A Legal History of Corporate Handouts in Michigan

MACKINAC CENTER
FOR PUBLIC POLICY

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By Patrick Wright

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Executive Summary

Elected officials today regularly try to woo large companies into locating to their state or city by offering them special tax treatment or subsidizing them in some way. States and cities compete with each other in this regard — Michigan is no exception — and this competition makes national headlines when well-known companies choose to relocate or expand. With this in mind, one might reasonably assume that publicly funded economic development is a long-standing, firmly established practice. But that's not the case in Michigan.

This report chronicles the history of Michigan Supreme Court decisions on this issue. It is not a formal legal review of the case law, but rather a historical account of important cases, spanning from Michigan's earliest days as a new state to the ratification of the current constitution in 1963. The narrative that unfolds will surprise those not familiar with Michigan's experience with taxpayer-funded corporate handouts.

For almost all of its first hundred years as a state, which was a time of steady population and economic growth, corporate handouts were strictly prohibited by Michigan's constitution. The Michigan Supreme Court repeatedly ruled that it was unconstitutional to use public resources to benefit a private interests, and voters repeatedly rejected proposals to eliminate this prohibition.

Over decades, multiple challenges were posed to this constitutional prohibition. A wide variety of private interests tested it, each arguing that its case was so unusual and special that it deserved to be exempt. But one after another, these pleas — for subsidies for railroads, streetcars, sugar manufacturers, corn farmers and private museums — were denied by the state's highest court.

This continued until 1941 when the Michigan Supreme Court, in a surprising opinion, allowed public funds to be used to benefit a private interest. Even though previous courts had ruled against corporate handouts in nearly identical cases, this court allowed taxes to be used to subsidize the marketing of apples. The court reasoned simply that selling more apples would be good for the state's economy and therefore permitted it.

But even after the long-standing precedent against subsidies to private companies was overturned in the courts, the people reaffirmed the constitutional prohibition against such spending. In the early 1960s, voters rejected a proposed constitutional amendment to allow the Legislature to spend money on corporate handouts. Then, while developing a new constitution, convention delegates carefully considered whether public funds should be used to subsidize private interests and preserved language they thought would continue to prohibit it. Voters ratified this new constitution in 1963 and it remains this state's current law.

Despite Michigan currently devoting millions of dollars per year on taxpayer-funded economic development programs, the main takeaway from this historical review is that these programs may rest on a weak legal foundation. The language meant to prohibit corporate handouts remains unchanged in the state's constitution, yet these programs proliferate. In light of the full view of Michigan's history with corporate handouts, it may be past time for the courts to review the constitutionality of economic development programs.

Introduction

It is common today for states, counties and municipalities to give special tax treatment to certain business or industries. These favors often come in the form of tax credits or tax deductions, loans or loan guarantees, or just plain cash subsidies. The total value of these tax incentives is difficult to pin down, but national estimates suggest they amount to tens of billions of dollars annually.[1] Michigan has its fair share of similar programs that effectively hand out hundreds of millions of dollars each year to select companies and thus reduce state revenues.

Proponents of these type of incentive programs — or corporate handouts — claim that they are necessary to grow a state's economy. They argue that some businesses will only expand and grow if the state lends a hand. A related argument is that some industries are so vital that the government must prevent firms in them from failing or relocating, lest the entire state suffer. And, most common of all, they say that these programs are tools the state must use to compete with other states who are also offering special tax treatment to firms that invest there.

Despite these varied rationales for corporate handouts, they all rest on an important assumption: Politicians who create these programs and the bureaucrats who run them possess the knowledge required to determine which companies should be subsidized and which ones should not. When considering the complexity of all the economic activity that occurs in a state — activity influenced by millions of individuals interacting with each other through markets and prices that are themselves influenced by millions of others on a national and even global scale — this seems highly improbable.* And, in fact, this is what the overwhelming majority of the economic research on the topic suggests: incentive programs do not grow a state's economy.[2]

Even before economists had the tools and data to test and find these programs to be ineffective, many Michiganders were skeptical of their value. Some rejected the innate unfairness of these programs: By design, they provide benefits to a favored few, largely at the expense of the rest. Indeed, tax incentive programs and government subsidies to private industry were not used in Michigan until recently in the state's history. In fact, Michiganders repeatedly ratified constitutions that explicitly outlawed these types of programs.

This paper chronicles the legal history of Michigan's use of corporate handouts, spanning from the ratification of the state's first constitution in 1835 to the ratification of the current Michigan constitution in 1963. It describes the developments that led to the state's strong prohibition against tax incentives, and the repeated legal challenges to this policy. It outlines the rationale used in important Michigan Supreme Court opinions, which consistently rejected the constitutionality of corporate handouts until the middle of the 20th century.

* This is sometimes referred to as "the knowledge problem." For more on this, see: Michael LaFaive and Michael Hicks, "MEGA: A Retrospective Assessment" (Mackinac Center for Public Policy, April 12, 2005), 66–69, https://perma.cc/55FW-4DHD.

Michigan's Failed Experiment With Internal Improvements

Within just its first decade of statehood, Michigan made a big bet on direct state intervention in private industry. In the middle of the 19th century, the benefits of constructing canals and railroads were obvious to all: They provided faster and broader access to New England markets and cheaper goods. State governments in New York, Pennsylvania, Maryland, Ohio, Indiana and elsewhere helped finance these "internal improvements" and were reaping their rewards. Michiganders feared they were missing out on this opportunity to boost economic development.[3]

As a result, in January 1837, a Michigan House committee on internal improvements recommended that the state build and operated its own canals and railroads in an effort to boost the rate of settlement and economic growth in Michigan. A committee report stated: "The question for Michigan to decide is whether she will by her own enterprise sieze [sic] the present opportunities to avail herself of these vast viaducts of wealth and prosperity … or whether her timidity and apathy will allow them to pass her by to swell the power and abundance of her wiser neighbors."[4] Two months later, the Michigan Legislature approved of the state borrowing $5 million to build and then operate three railroads and two canals.

A combination of factors doomed these projects. A national economic downturn, known as the Panic of 1837, contributed to reducing new settlement and investment. Michigan's governor, Stevens T. Mason, sold $5 million in government bonds to banks that did not end up paying in full — they went bankrupt shortly after Mason made the sale. Construction of the railroads and canals progressed more slowly than projected and building contractors racked up expenses that exceeded their bids. Just three years after it started this grand experiment, the Legislature passed a bill to prevent the state from entering into any more contracts to build railroads or canals.[5]

Things unraveled from there. Four out of the five projects were never completed and three were abandoned altogether. One railroad was completed but could not generate enough revenue to cover the costs of the unfinished ones. Financing of these projects proved costlier than anticipated — the state would have had to impose a 1 percent property tax just to make the interest payments on this debt. In the end, the state sold off the railroads to private investors to avoid raising taxes, but still took a significant loss.[6]

This failed experiment in state-funded railroads and canals created a significant impression on Michigan taxpayers and voters. In the late 1830s, many Michiganders likely cheered on the grand plans for state-run internal improvements, and such projects were explicitly permitted in the state's original constitution of 1835. It stated, "Internal improvements shall be encouraged by the government of this state; and it shall be the duty of the legislature … to provide by law … application of the funds which may be appropriated to these objects."[7] But just over a decade later, voters approved a new constitution that forbade the state from ever trying that again. The new 1850 constitution included this clause: "The state shall not be a part to, nor interested in, any work

or internal improvement, nor engaged in carrying on any such work."* Further, the new constitution also forbade the state from granting its credit "to, or in aid of, any person, association or corporation," and the state from owning "the stock of any company, association, or corporation."[8] Michigan's experiment in using state-funded internal improvements to boost economic development was short-lived.

People v. Salem: First Challenge to the Corporate Handout Prohibition

It wasn't long before the prohibition against state-funded internal improvements was challenged in court. Despite recent history, Michigan lawmakers wanted to make another go at publicly financing railroads. They took a different tact this time — passing bills that authorized cities and townships to help finance private railroad corporations from bond proceeds. Gov. Henry Crapo vetoed several bills of this type, apparently out of a concern for their constitutionality. But many were passed nevertheless due to legislative overrides.[9] Meanwhile, voters upheld the 1850 constitutional prohibition when they rejected a new proposed constitution in 1868 that would have again allowed for publicly financed internal improvements.[10] One of the railroad companies approved to receive bond proceeds sued Salem Township when it refused to issue bonds on the railroad's behalf after having initially approved of the deal.

The case made its way to the Michigan Supreme Court in 1870. It was recognized at the time to be extremely important; there were eight days of oral arguments.[11] Gov. Crapo suspected these programs to be unconstitutional, but many likely believed that the railroads would win the case. After all, most other state and federal courts had approved of local aid to railroads. But the Michigan Supreme Court, led by Justice Thomas Cooley, ruled these programs to be unconstitutional. Surprisingly, however, Cooley's opinion relied less on the 1850 constitution's prohibition on internal improvements, and more on a general limitation on the power of the Legislature to tax and spend for public purposes.[12]

Cooley's reasoning in the case was used for settling many future similar cases and so will be detailed extensively here. Cooley first admitted that the legislative power to tax and spend is very broad:

> [The sovereign power of taxation], we are told, is not, and from its very nature cannot, be controlled and limited by precise and accurate rules, which shall designate and define in all cases the particular purposes for which alone moneys shall be raised, or to which they may be appropriated when raised, or the extent of the burden which may be imposed, and it is added that upon all these points a broad and uncontrollable discretion is necessarily vested in the legislative department of every government.[13]

Cooley went on to argue, however, that this taxation power is limited:

* A few exemptions to this prohibition were allowed: wagon roads, state parks and improvements to the Grand River by the city of Grand Rapids. Mich Const 1850, Art. 14, § 9, https://perma.cc/5KAW-AGNR.

> It is conceded, nevertheless, that there are certain limitations upon this power, not prescribed in express terms by any constitutional provision, but inherent in the subject itself, which attend its exercise under all circumstances, and which are as inflexible and absolute in their restraints as if directly imposed in the most positive form of words.[14]

He identified three "fundamental maxims in the law of taxation" that "inhere as conditions in the power to impose any taxes whatsoever, or to create any burden for which taxation is to provide."[15] Only when these principles are observed is "the legislative department . . . exercising an authority over this subject which it has received from the people."[16] These principles are: (1) the tax must be "imposed for a public, and not for a mere private purpose" because a tax that is "in no way connected with the public interests or welfare . . . ceases to be taxation and becomes plunder;" (2) the tax must be apportioned fairly; for instance, state burdens must be borne equally by all state taxpayers; and (3) when taxes are imposed only on certain localities, the benefit should go solely to that locality.[17]

Cooley argued that it is the role of the courts to enforce these principles. He then went on to define what constituted a public purpose:

> I do not understand that the word *public,* when employed in reference to this power, is to be construed or applied in any narrow or illiberal sense, or in any sense which would preclude the Legislature from taking broad views of State interest, necessity or policy, or from giving those views effect by means of the public revenues. Necessity alone is not the test by which the limits of State authority in this direction are to be defined, but a wise statemanship must look beyond the expenditures which are absolutely needful to the continued existence of organized government, and embrace others which may tend to make that government subserve the general well-being of society, and advance the present and prospective happiness and prosperity of the people. To erect the public buildings, to compensate the public officers and to discharge the public debts, are not the sole purposes to which the public revenues may be applied, but, on the contrary, considerations of natural equity, gratitude and charity are never out of place when the general good of the whole people is in question, and may be kept in view in the imposition of the public burdens.[18]

Having set out the general rules of legal taxation, Justice Cooley analyzed the legislation in question. He noted that the tax was a local tax that was supposed to have a local benefit.[19] But the railroad is a private enterprise that would be "owned, controlled, and operated by a private corporation for the benefit of its own members[.]"[20] The benefit to the corporation would be the main result and the benefit to the locality would be only ancillary:

> Primarily, therefore, the money, when raised, is to benefit a private corporation; to add to its funds and improve its property; and the benefit to the public is to be secondary and incidental, like that which springs from the building of a grist-mill,

> the establishment of a factory, the opening of a public inn, or from any other private enterprise which accommodates a local want and tends to increase local values.[21]

Because the railroads strenuously argued they were akin to public roads, Justice Cooley examined this argument at length. He noted that while railroads do accommodate public travel, they remain in private hands. Railroads are businesses just like hotels, stage coach lines, or grist mills, he argued.[22] Justice Cooley cited with approval a Wisconsin case wherein that state's court determined that taxation to create a public hotel was improper despite "the incidental benefits which the public" was to receive from the hotel's construction.[23]

Justice Cooley then discussed whether the fact that eminent domain is occasionally used to benefit railroads makes them materially different from other businesses. He argued that the only reason eminent domain could be allowed to assist railroads is the impracticability of requiring every property owner to acquiesce and sell their land, not because railroads met the requirements of a public purpose. Further, the state must reserve the right to supervise and control a railroad that relies on the use of eminent domain so as to ensure that the public benefits.[24]

Even if building a railroad reached the level of being an absolute necessity, it still would not meet the definition of a public purpose for which taxation may be used, Justice Cooley went on to argue. He used a shortage in physicians as an example:

> Certain professions and occupations in life are also essential, but we have no authority to employ the public moneys to induce persons to enter them. The necessity may be pressing, and to supply it may be, in a certain sense, to accomplish a "public purpose;" but it is not a purpose for which the power of taxation may be employed. The public necessity for an educated and skillful physician in some particular locality may be great and pressing, yet if the people should be taxed to hire one to locate there, the common voice would exclaim that the public moneys were being devoted to a *private* purpose.[25] (Emphasis in original)

And the size of the benefit to the public should not matter either, he reasoned, marking a distinction between the construction of public roads and that of business enterprises:

> The opening of a new street in a city or village may be of trifling public importance as compared with the location within it of some new business or manufacture; but while the right to pay out the public funds for the one would be unquestionable, the other by common consent is classified as a private interest, which the public can aid as individuals if they see fit, while they are not permitted to employ the machinery of the government to that end.[26]

Justice Cooley indicated that most of society needs, i.e. its necessities, are not the concern of the government, but of "private inclination and enterprise":

> By common consent also a large portion of the most urgent needs of society are relegated exclusively to the law of demand and supply. It is this in its natural

> operation, and without the interference of the government, that gives us the proper proportion of tillers of the soil, artisans, manufacturers, merchants and professional men, and that determines when and where they shall give to society the benefit of their particular services. However great the need in the direction of any particular calling, the interference of the government is not tolerated, because, though it might be supplying a public want, it is considered as invading the domain that belongs exclusively to private inclination and enterprise. We perceive, therefore, that the term "public purposes," as employed to denote the objects for which taxes may be levied, has no relation to the urgency of the public need, or to the extent of the public benefit which is to follow. It is, on the other hand, merely *a term of classification, to distinguish the object for which, according to settled usage, the government is to provide, from those which, by the like usage, are left to private inclination, interest or liberality*. (Emphasis in original)
>
> It creates a broad and manifest distinction — one in regard to which there need be neither doubt nor difficulty — between public works and private enterprises; between the public conveniences which it is the business of government to provide and those which private interest and competition will supply whenever the demand is sufficient. When we draw this line of distinction, we perceive immediately that the present case falls outside of it.[27]

Justice Cooley then noted that the elimination of the "internal improvements" language from the 1835 constitution meant that railroads were no longer a public purpose:

> It was at one time in this State deemed true policy that the government should supply railroad facilities to the traveling and commercial public, and while that policy prevailed, the right of taxation for the purpose was unquestionable. Our policy in that respect has changed; railroads are no longer public works, but private property; individuals and not the State own and control them for their own profit; the public may reap many and large benefits from them, and indeed are expected to do so, but only incidentally, and only as they might reap similar benefits from other modes of investing private capital. It is no longer recognized as proper or politic that the State should supply the means of locomotion by rail to the people, and this species of work is therefore remitted to the care of private enterprise, and cannot be aided by the public funds, any more than can any other private undertaking which in like manner falls outside the line of distinction indicated.[28]

His argument continued that governmental discrimination of different industries — in this case, to single out some for favors — is not legal and only can be authorized if the state enacts a constitutional amendment specifically permitting it (similar to the "internal improvement" language of the 1835 constitution):

> But the discrimination by the State between different classes of occupations, and the favoring of one at the expense of the rest, whether that one be farming or

> banking, merchandising or milling, printing or railroading, is not legitimate legislation, and is an invasion of that equality of right and privilege which is a maxim in State government. When the door is once opened to it, there is no line at which we can stop and say with confidence that thus far we may go with safety and propriety, but no further. Every honest employment is honorable, it is beneficial to the public; it deserves encouragement. The more successful we can make it, the more does it generally subserve the public good. But it is not the business of the State to make discriminations in favor of one class against another, or in favor of one employment against another. The State can have no favorites. Its business is to protect the industry of all, and to give all the benefit of equal laws. It cannot compel an unwilling minority to submit to taxation in order that it may keep upon its feet any business that cannot stand alone. Moreover, it is not a weak interest only that can give plausible reasons for public aid: when the State once enters upon the business of subsidies, we shall not fail to discover that the strong and powerful interests are those most likely to control legislation, and that the weaker will be taxed to enhance the profits of the stronger. I shall not question the right of the people, by their Constitution, to open the door to such discriminations, but in this State they have not adopted that policy, and they have not authorized any department of the government to adopt it for them.[29]

Justice Cooley examined two additional justifications for the railroad tax: the incidental local benefit from increased property values and enhanced transportation services for personal travel or business. He made short work of negating the first rationalization: "The incidental benefit which any enterprise may bring to the public, has never been recognized as sufficient of itself to bring the object within the sphere of taxation."[30] The second justification made a better case, but was still found wanting:

> If this consideration is sufficient in the case of common carriers [which include railroads], it must be sufficient also in the case of any other employment. There is nothing in the business of carrying goods and passengers which gives the person who conducts it a claim upon the public different in its nature from that of the manufacturer or the merchant. … But if the Legislature should pass an act providing that the township of Salem should give or loan a certain percentage of its taxable property to any merchant who will undertake to erect a store within the township, and hold himself ready at all times to sell goods therein to the people of the township on terms as favorable as those he would exact from others, he would be a bold man who should undertake to defend such legislation on constitutional principles. Yet the case would possess all the elements of public interest which are to be found in the case before us; the public convenience would be subserved, and there would be a like tendency to increase local values. … And when we have once determined that a municipal government can tax its citizens to make a donation to a railroad company, because of the incidental benefits expected from its operation, we do not go a single step further when we hold that

> it may use the public funds to erect a cotton or woolen factory, or a building suited to the manufacture of tobacco, and present it, on grounds of public benefit, to any person who will occupy it.[31]

Justice Cooley concluded by claiming that issuing public bonds for the purpose of financing railroads would violate the 1850 constitution because the state did not have the power to use taxation for the primary purpose of benefiting a private enterprise:

> The case before us is that of a private corporation demanding a gratuity which has been voted to it in township meeting upon the assumption that its business operations and facilities will incidentally benefit the township. … [T]he first and most fundamental maxim of taxation is violated by the act (…).[32]

Chief Justice Campbell joined Justice Cooley's opinion, but elaborated and likened taxations for private purposes to robbery:

> It has been said to be too clear to need argument that it would be usurpation and not legislation to take the property of A and give it to B. It must be on the same ground equally illegal to tax A for the benefit of B; for the amount of property taken against his will cannot make any difference in the principle, neither can it make the wrong any less that he has companions in misery. Taxation for private purposes is no more legal than robbery for private purposes.[33]

Chief Justice Campbell also rejected the concept that public money could be taxed to aid one business at the expense of another without a clear language in the constitution authorizing such:

> All industry helps general prosperity. No line can be found which can, in law, make one business more public than another. The power to resort to taxation to set men up in any business is a power that is foreign to the purposes of government. It is not legislative power, but unlimited sovereign will, that can compel one private citizen to furnish means to another. Taxation is only lawful to enable the government to fulfill its public duties, and to pay such expenses as are incident to public business. There is necessarily a considerable discretion to determine what means may be desirable to enable the government to do its work creditably, but a power to tax one citizen for the private emolument of another, upon any theory of mere incidental advantage to the general prosperity of large or small communities, can only rest on a foundation of absolute and irresponsible power to make favored classes and citizens, and make the whole body of taxpayers tributary to them. No such power can be tolerated in a republic, and no hint of such a power is to be found in our constitution. As far as it speaks at all on the subject it prohibits State aid to private persons or enterprises, and if there is no specific prohibition of taxation for private purposes, it was on the same principle which left out prohibitions against giving private property away to

> private persons, — that is to say, the principle which renders it unnecessary to forbid powers which could not exist without clear and express grant.[34]

And with this, the court ruled unconstitutional the 1864 bill that authorized municipalities to help finance railroads. In many ways, this case was seminal; in the decades that followed, courts relied on it when deciding on similar challenges to the prohibition against state-funded internal improvements and other subsidy programs for private firms or industries. Several other cases involving local bonding for railroads were brought before the court over the next few decades, and in each case, the court repeatedly reaffirmed its ruling in *Salem*.[35]

Then in 1898, a trial court refused to follow *Salem* and the rulings that followed from it. That court was utterly convinced that because the courts of other states and the U.S. Supreme Court had not concurred, these cases were "radically wrong" and not binding precedent.[36] But, once again, the Michigan Supreme Court affirmed the holding of its prior decisions.[37]

Marshes, Streetcars, Sugar and Corn: New Attempts to Overturn *Salem*

Eventually, challenges to the 1850 constitution's prohibition on state-funded internal improvements moved beyond financing railroads. Two cases, one in 1884 and one in 1888, raised the question of whether taxes could be used to drain marshes, or what would be called wetlands today. In the first case, the Michigan Supreme Court held that raising taxes to drain marshes — in this instance, dredging the Dowagiac River — was unconstitutional since it fell within the definition of an internal improvement, which was clearly prohibited in the 1850 constitution. The opinion stated:

> [Taxes for draining marshes] deprives the citizen of his property without due process of law; and it makes no difference that it was assented to by a majority of legal voters. A person may give his own property to whom he pleases, but he cannot compel his neighbor to part with his property except by due process of law. I do not think the law can be sustained upon the theory advanced by counsel for defendant, that the taxation was for a local purpose, and such purpose meritorious and beneficial to the public. It may be conceded that the straightening and deepening of the channel of the Dowagiac river would be conducive to the public health; that it would be advantageous to the roads leading across the swamp, and very much lessen the expense of keeping such highways in repair. Yet all this does not obviate the constitutional objections to the statute under which this tax was levied, and the remedy for existing evils must be sought in some other direction.[38]

The court clarified this ruling in an 1888 case, holding that public funds could only be used to drain marshes to protect public health. They could not be drained "for the purpose of private advantage, such as improving the quality of the land, or rendering it more productive or fit for cultivation."[39] In other words, if the primary purpose of draining the marsh was to benefit private interests, it was not allowed.

New cases challenging the court's ruling in *Salem* and other internal improvement cases originated in Detroit. The Legislature passed a law that enabled the city to use public funds to create a streetcar system.[40] In the 1899 case that followed, the city of Detroit argued that the *Salem* decision "was never accepted as correct by the profession in this state, and is contrary to the decisions of other courts."[41] The city further argued that streetcars provided for the public welfare and were of a "local interest," as opposed to an internal improvement.[42] Finally, the city argued that constitutional prohibition against state-funded projects of this type was outdated and needed to be reconstrued to meet the demands of the times.[43] To this, the court replied:

> It is said that the constitution was adopted a long while ago, and that this is a gigantic age, in which enterprises are being formed on a scale so vast as to be almost beyond comprehension, and the constitution ought to be given a construction in keeping with the spirit of the age. ... Constitutions do not change as public opinion changes. Their provisions do not mean one thing one day and another another day. … The courts cannot substitute their judgment of what the constitution ought to be for what the people have made it. Its provisions must remain and control until the people see fit to change them in the way provided by the constitution itself.[44]

The court ruled that Detroit could not use its power to tax to subsidize the construction of streetcar railways. Despite the clear prohibition in the constitution, the court noted, additional cases like these were likely to continue:

> These were very positive provisions [to the 1850 constitution], and by adopting them the people believed they had rendered it impossible that projects of doubtful wisdom and utility should be engaged in at the public cost. But diseases in the body politic, like those in the human system, are likely to take on new forms from time to time, and they are not to be exorcised by words, or kept off by constitutional inhibitions.[45]

The court was right: This was not the last time the state's highest court would hear a case concerning streetcars in Detroit. A similar case reached the Michigan Supreme Court in 1907.[46] The court once again decided whether a streetcar system was an internal improvement and held that such a project was prohibited. Chief Justice Carpenter distinguished internal improvements such as railroads and streetcars from common government provisions of parks, water systems, sewers and street lights. The latter all promote public health and safety, whereas the former do not.[47]

Justice Grant agreed with Chief Justice Carpenter's conclusion, but did so for a different reason. He argued that the streetcar was to be leased and operated to a private party, which would have the effect of taxing all Detroiters for the benefit of a few private interests.[48] He indicated that Michigan case law held that public expenditures on railroads, which operate in a similar way, are not justified, and therefore neither is public spending on streetcars.[49]

Two cases challenging the 1850 constitution's ban on state subsidies for private enterprise of an entirely different sort were also decided during this period. They both involved the agricultural industry and the Legislature's attempt to provide aid to certain producers of certain products.

The first case reached the Michigan Supreme Court in 1900 and involved sugar beets. In 1897, the Legislature passed a bill that provided a "bounty" to sugar manufacturers. If manufacturers bought sugar beets that were grown in Michigan for a price of $4 per ton or more, the state would pay them a subsidy.[50] Presumably, the rationale behind this was twofold: It protected Michigan sugar beet growers from competition from growers in other states and Canada, and, secondly, it capped the cost manufacturers would have to pay for Michigan-grown sugar beets. The court held this program to be unconstitutional:

> This taxation is for no such public purpose that it can be upheld. There is no power in the state to authorize a tax for private purposes. Taxes can be levied only for public purposes to accomplish some government end. The legislature … cannot take the property of A and give it to B, nor can it tax it for the benefit of B. Here is a private corporation now calling upon the state for a sum of money to aid it in carrying on a private business, most of which money, if paid, must come out of the pockets of people who are not engaged in that business, and who have no interest in it.[51]

Later, in 1907, another case involving agricultural production reached the high court. This time the Legislature did not attempt to subsidize manufacturers directly, but rather attempted to fund an association designed to represent the interests of the entire corn industry, called the Michigan Corn Improvement Association. A sum of $500 dollars was appropriated by the Legislature to this private organization that aimed to create "a deeper interest in and a better knowledge of the culture and improvement of corn." The auditor general, under the advice of the attorney general, refused to appropriate the funds and the association sued.[52]

The court made short work of this case, ruling it unconstitutional in an opinion that spanned just two paragraphs (the first of which was dedicated to the facts of the case). The court stated:

> It is obvious from the foregoing statement that the only persons who will be directly benefited by the proposed appropriation are those 'actively interested in the improvement of corn.' The authority of the Legislature to make such an appropriation was denied by Justice Cooley in his opinion in [*Salem*, 20 Mich 452]. He said: 'But the discrimination by the state between different classes of occupations, and the favoring of one at the expense of the rest, whether that one be farming or banking, merchandising or milling, printing or railroading, is not legitimate legislation, and is an invasion of that equality of right and privilege which is a maxim in state government. When the door is once opened to it, there is no line at which we can stop, and say with confidence that thus far we may go with safety and propriety, but no further. Every honest employment is honorable. It is beneficial to the public. It deserves encouragement. The more

> successful we can make it, the more does it generally subserve the public good. But it is not the business of the state to make discrimination in favor of one class against another. The state can have no favorites. Its business is to protect the industry of all, and to give all the benefit of equal laws.' This reasoning was approved by this court in [*Michigan Sugar Co*, 124 Mich 677], and in accordance therewith an act giving a bounty for the manufacture of beet sugar was adjudged unconstitutional. We think that decision rules this case, and that the law under consideration is unconstitutional.[53]

Through 1907 then, the Michigan Supreme Court had repeatedly upheld Justice Cooley's original ruling against all state subsidies for private purposes. This prohibition held for a variety of different arrangements, including local railroad bonding, streetcar railway construction in Detroit, the draining of marshes for purposes other than public health, and direct and indirect support for certain agricultural products and services.

Reaffirming the Prohibition: The 1908 Constitution

Michigan's 1850 constitution was repeatedly endorsed by voters. A provision in it required that voters consider establishing a convention to modify the constitution every 16 years. Voters approved of such a convention in 1866 but then soundly rejected the proposed constitution that convention created.[54] Voters again rejected — by a three-to-one margin — a new constitution in 1874 after the Legislature initiated a review and a commission appointed by the governor recommended changes.[55] The Legislature continued its attempt to modify the constitution, placing on the ballot proposals to establish a constitutional convention in 1890, 1892 and 1904. Voters rejected these conventions each time. They also rejected conventions in 1882 and 1898, turning down the question that the 1850 constitution required the state to ask every 16 years.[56]

But then in 1906, voters approved the establishment of a constitutional convention. The convention delivered a new constitution, which voters ratified in 1908. But the new document contained only a few important changes.[57]

The change that attracted the most attention and discussion related to the process for amending the constitution; voters were empowered to propose amendments directly.[58] Another important change was the declaration of "home rule" for local governments, providing them with the explicit authority to establish and enforce local laws and means to provide for the general welfare of their residents.[59] A University of Michigan law professor and convention delegate, John A. Fairlie, writing in 1908, summarized these additions: "[T]hese provisions establish the principle of local self-government on a much broader and firmer basis in the state of Michigan than in any state except a few west of the Mississippi river[.]"[60]

The section of the 1850 constitution of most interest to this study was modified by the convention, but not in a substantive way. The language prohibiting the credit of the state being given to any person, association or corporation was kept, as was the language prohibiting state-funded internal improvements. But the latter section was modified to allow for additional types of

state-funded infrastructure development. Whereas the 1850 constitution made exemptions only for "public wagon roads" and the "expenditure of grants to the state of land or other property," the new constitution also exempted spending for reforestation and the "protection of lands owned by the state of Michigan."[61]

Fairlie called these changes "clearly needed" and went further to question whether the main prohibition was needed any longer. But, he noted, "the convention preferred to act conservatively in relaxing the restrictions of the present Constitution."[62]

A New Round of Challenges to the 1908 Constitution

A steady supply of legal challenges to the prohibition on public expenditures for private purposes continued after the 1908 constitution was ratified. The first concerned a local municipality's ability to rebuild structures destroyed by fire and it reached the Michigan Supreme Court in 1911. In this case, the city of Petoskey had paid a corporation to rebuild a factory that had burned down. City residents filed suit, and the court held that the payment "was an attempt to use public moneys in furtherance of a private enterprise, which agreement the [city] council could not lawfully make."[63]

The next challenge occurred in 1915 and tested the prohibition in a new way. At question was whether the Legislature and the city of Detroit could appropriate money and issue construction bonds to the Detroit Museum of Art, which was organized as a private, nonprofit corporation.[64] Apparently, the Legislature attempted to bolster the public purpose of the institution by passing a bill that required one-fourth of its governing board to be held by Detroiters.[65] The court held that museum was a private entity and could not be aided by public expenditures:

> The same rule of construction should apply in this case that has been applied to the many attempts made by municipalities in this state to aid railroad and industrial projects. … The case at bar does not differ in principle, but only in degree, from the cases cited. The act creating this corporation was very cleverly devised to diminish the objections which were raised in those cases, and which might be raised under this constitutional provision [Mich Const 1908, Art X, § 12], but the fact still remains that it is a private corporation.[66]

A unique arrangement in Grand Rapids was the next case to challenge the 1908 constitution. The city allowed taxpayers to work off their tax debts. One individual sought to lower his debt by working on various properties owned by a bank. He contracted with the city to do this and then hired labor. When a worker got hurt, the question arose whether this arrangement was proper. Since the beneficiary of this labor was a private bank and public funds (or debt) was involved, the Michigan Supreme Court stated: "Contracts which involve an attempt to use public money for the furtherance of a private enterprise are void."[67]

Overturning the Apple Cart: The Court Topples 71 Years of Precedent

As shown thus far, the Michigan Supreme Court heard a number of cases in which certain state actions were argued to meet the "public purpose" requirement, including railroads, streetcars, corn and sugar production and art museums. Each case presented a challenge to the question from a slightly different angle. But in each case, for nearly a three-quarters of a century, the court upheld the precedent established by Justice Cooley's opinion in *Salem*. So, it is somewhat surprising that the case that eventually led the court to overturn this precedent and significantly expand the definition of public purpose was one that was very similar to earlier cases.

This new case involved apples. In 1939, the Legislature passed the Baldwin Apple Act, which applied a tax on apple growers. The proceeds of this tax were to be used to fund the newly created Michigan State Apple Commission, whose mission was to aid the industry and promote the sale of Michigan-grown apples.[68] A group of apple growers sued and won their case in lower courts.[69]

The case was very similar to the *Michigan Corn Improvement Association v. Auditor General*, a case from 1907. In that case, the Legislature attempted to appropriate money to the MCIA for the purpose of promoting corn in Michigan. Citing a similar case from seven years prior involving subsidies for sugar producers, the court had ruled the corn appropriation to be unconstitutional, because only private interests in the corn industry would directly benefit.[70]

Despite the similarities with these previous cases, in *Miller v. Michigan State Apple Commission*, the Michigan Supreme Court, in a 6-2 decision, overturned the lower courts' ruling and declared the Baldwin Apple Act's tax constitutional. The decision relied on establishing a new approach to what meets the definition of public purpose.

The majority argued that the question was not whether the advertising and promotion of Michigan apples — an act which would directly benefit only apple growers — is a public purpose, but rather whether the result of that advertising was a public purpose. Here, the court relied on the assumption that giving tax dollars to a commission charged with promoting Michigan-grown apples would result in the increased use of apples.[71]

Then the court cited Justice's Cooley's decision in *Salem*, calling it the "leading authority … as to what constitutes a public purpose."[72] This was surprising, of course, because that decision established the strict definition of public purpose that previous courts had relied on for decades in deciding against similar attempts to expend public resources. What this court did was cherry-pick from Justice Cooley's opinion, citing only the prelude leading up to his decision. That section of his written opinion had discussed the broad parameters of what constitutes a public purpose. But the rest of *Salem* argued that private benefits are not public purposes, and it ultimately decided that state funds used to benefit private businesses were unconstitutional.

So, while the court in *Miller* quoted Justice Cooley saying the power to tax for public purposes was not "narrow or illiberal" and did not "preclude the Legislature from taking broad views of State interest," it ignored what he later declared: "It is conceded, nevertheless, that there are certain limitations upon this power, not prescribed in express terms by any constitutional

provision, but inherent in the subject itself, which attend its exercise under all circumstances, and which are as inflexible and absolute in their restraints as if directly imposed in the most positive form of words."[73] And the majority opinion omitted Justice Cooley's judgement that spending tax dollars where "the benefit to the public is to be secondary and incidental, like that which springs from the building of a grist-mill, the establishment of a factory, the opening of a public inn, or from any other private enterprise which accommodates a local want and tends to increase local values" is unconstitutional.[74]

After quoting Justice Cooley in this piecemeal way, the majority argued that the size of the apple industry in Michigan was so large as to constitute a public purpose. Evidence of this was provided: The average annual value of apples produced in Michigan over the previous 10 years surpassed that of peaches, pears, grapes, cherries and plums, combined.[75] The court then reasoned: "We perceive that the stimulation of so large and important an industry will result in a benefit to the general public well-being, the increased prosperity of the entire apple growing industry of necessity being reflected throughout the commonwealth. … We hold that the tax is for a public purpose."[76]

This line of reasoning had been addressed and explicitly rejected by Justice Cooley in *Salem*. He stated that the Legislature had no authority to use public funds to promote certain professions or occupations, no matter how essential they were perceived to be: "The necessity may be pressing, and to supply it may be, in a certain sense, to accomplish a 'public purpose;' but it is not a purpose for which the power of taxation may be employed."[77] He punctuated this point by claiming that it would even be unconstitutional to used public funds to support a doctor in an area with pressing medical needs.[78] Further, he argued: "[T]he term 'public purposes,' as employed to denote the objects for which taxes may be levied, has no relation to the urgency of the public need, or to the extent of the public benefit which is to follow."[79] In other words, the size of the positive impact certain state spending might have — the very rationale used in the *Miller* decision — should not factor into determining whether it is a public purpose.

It is difficult to identify exactly what led the court to depart so significantly and abruptly from the precedent established in *Salem* and upheld in the seven decades that followed. A pair of law review articles published shortly after the *Miller* decision, however, suggest some possible explanations. An unauthored article in the *The University of Chicago Law Review* published in June 1941 states: "The court undoubtedly was influenced by the fact that seven states expend money to advertise their leading products under statutes similar to the one in question, and that none of these statutes has been declared unconstitutional."[80] A similar review of the case published in *Notre Dame Law Review* and authored by Thomas W. Cain connects the *Miller* decision to a Florida court case from 1937 that ruled that state support for the Florida Citrus Commission for the purpose of advertising Florida-grown fruit was legal.[81]

There's a reasonably chance these legal scholars were on to something. The majority opinion in *Miller*, in fact, references the advertising of citrus fruit in building its case that advertising apples would have a positive effect on apple production and therefore benefit the public broadly and constitute a public purpose. The court wrote: "Statistics indicate that the consumption of apples

has shown a marked decrease while that of citrus fruits, extensively advertised, has correspondingly increased."[82] Further, it approvingly cited a case from Florida where a court there ruled "that the protection of the citrus industry is a matter within the police power of the state."[83]

It is worth emphasizing how the reasoning of this court decision differed so dramatically from that used by Justice Cooley in *Salem*. He had acknowledged that:

> By common consent also a large portion of the most urgent needs of society are relegated exclusively to the law of demand and supply. It is this in its natural operation, and without the interference of the government, that gives us the proper proportion of tillers of the soil, artisans, manufacturers, merchants and professional men."[84]

One could reasonably assume Justice Cooley would have no qualms adding apple growers to that list. But here in the *Miller* case, the majority is basing its opinion on the idea that it knows that more apples being grown and sold in Michigan will produce beneficial outcomes for the general welfare. Without a doubt, the majority in *Miller* seems to have willfully ignored Justice Cooley's larger point about the proper division between public and private spheres.

This point was not lost on the dissenting members of the court. Justice Wiest stated: "The tax here involved is not in any sense for government purposes but an unauthorized tax to aid a particular private industry," and he quoted Justice Cooley's supply-and-demand language.[85] He also forewarned: "If this tax is sustained it opens the door to like legislation in innumerable instances."[86]

The law review articles penned shortly after the case was decided also questioned and criticized the ruling. One of the reviews argued that the court's assumption — advertising Michigan-grown apples will necessarily produce a positive public benefit — was suspect:

> Whether or not the aid proposed will operate to bring Michigan apple sales back to "normal" and thus serve a public purpose is a question which the court hurriedly answered in the affirmative. Actually, the end result of the advertising program is quite doubtful. If the Michigan apple advertising program is successful and Michigan apples become established as a "super" brand, the economic effect will be to increase the demand for Michigan apples at the expense of other kinds of apples, other kinds of fruit, and apple substitutes. There will probably be more extensive advertising schemes by all states concerned, each tending to counteract the effect of the other. The final result from Michigan's point of view is apt to be an apple market approximately the same in size as at present with increased production costs because of money spent for advertising.[87]

Cain concluded his article in the *Notre Dame Law Review* with this evaluation:

> If the courts decide that a small group of farmers who are engaged in the occupation of apple production, constitute a public, there is nothing to bar the legislature from enacting taxes, not general taxes, but specific taxes, upon any one

> specialized branch of agricultural pursuit. It is indeed an ingenious means of taxation, but the Constitutionality, although decided upon by the court, is far from obvious.[88]

After Apples: The Making of the 1963 Constitution

After the *Miller* ruling, the Michigan Supreme Court expanded the definition of the public purpose, leaving it almost wide open. In 1947, the court heard a case questioning whether the city of Kalamazoo was allowed to fund a private, nonprofit — the Michigan Municipal League — with tax dollars. With a unanimous decision, the court indicated that categorically defining public purpose "difficult, if not impossible."[89] Further, the opinion cited the legal publication, American Jurisprudence, that provided an overview of the national trend on this issue:

> A public use changes with changing conditions of society, new appliances in the sciences, and other changes brought about by an increase in population and by new modes of transportation and communication. The courts as a rule have attempted no judicial definition of a public as distinguished from a private purpose, but have left each case to be determined by its own peculiar circumstances. Generally, a public purpose has for its objective the promotion of the public health, safety, morals, general welfare, security, prosperity, and contentment of all the inhabitants or residents within the municipal corporation, the sovereign powers of which are used to promote such public purpose.[90]

The court ruled that funding this private organization was a proper use of tax dollars as it fit this new and very broad definition of public purpose.

At the same time, the voters of Michigan chose to slightly reduce the constitutional limitations on public expenditures for internal improvements. Constitutional amendments in 1945 and 1946 modified Article 10, Section 14, by adding exemptions for all public roads, harbors, waterways, airports and other aeronautical facilities. Also exempted were improvements to rivers, streams and lakes "for purposes of drainage, public health, control of flood waters and soil erosion."[91] While these amendments certainly expanded what could be deemed a public purpose, it is important to note that voters kept the broad prohibition against internal improvements in place.

Further, the voters of Michigan rejected a proposal in 1961 to amend the constitution to explicitly allow the Legislature to spend or loan up to $50 million to aid "public benefit corporations for the purpose of financing industrial, manufacturing and municipal projects in the state."[92] Despite this vote, the debate over taxpayer-funded corporate welfare would be questioned again when voters approved the creation of a constitutional convention in 1961.

In developing a new constitution, convention delegates wrestled with state-funded economic development on multiple occasions. Article 10, Section 14 of the 1908 constitution, which explicitly prohibited state-funded internal improvements, was discussed at length, and its sharp

divide between public and private purposes was described as being "very important."[93] Some delegates, however, wanted to completely eliminate it, arguing:

> The provision in the present constitution developed as result of the panic of 1837. We do not believe there is a danger of the recurrence of such a panic. We would prefer to remove any legislative straightjacket and permit the legislature to meet the challenges and opportunities with wholesome cooperation with local units of government, private industry and universities.[94]

This attempt to remove the prohibition completely failed, however, with some delegates citing the proposed constitutional amendment that voters had just rejected two years prior. The argument that seemed to carry the motion to maintain a type of prohibition on state-funded internal improvements was the desire to draw a clear line between internal improvements that serve a public purpose and those that primarily serve a private purpose. Arguing against striking the provision entirely, one delegate stated:

> [U]nder the language which the committee has adopted . . . the state at least cannot engage in internal improvements of a private nature. Now, if you want to authorize the legislature or enable it to get into internal improvements of a private rather than a public nature, then vote [to strike the provision]. But if you want to leave it like it is … so that the state can engage in any internal improvement as long as it is of a public nature — for the benefit of the public, in other words, not for the benefit of some private interest — why then it is very clear how you should vote.[95]

In the end, the delegates approved what would become Article 3, Section 6 of the 1963 constitution: "The state shall not be a party to, nor be financially interested in, any work of internal improvement, nor engage in carrying on any such work, except for public internal improvements provided by law."

The convention also addressed a relatively new form of state aid, which was to benefit a special class of private interests. Some municipalities were offering special tax exemptions to certain firms in an apparent effort to entice them to set up shop in their jurisdiction. This issue arose as delegates debated whether to keep a provision that stated, "The power of taxation shall never be surrendered, suspended or contracted away." One delegate commented:

> The power of taxation should reside perpetually with the state and its corporate districts and should never be surrendered, delegated or assigned to private parties. An important development in regard to this section in the recent years has been the practice of some communities to give exemptions or other special incentives to lure industry to their areas. Potential problems arise when communities promise tax exemptions of 5, 10, or 20 years to new industries. Some of these industries remain only as long as these exemptions or other special incentives remain in force, and the long run value of this special treatment for new industries is questionable. These policies to some extent involve a contracting away of the

> taxing power and to this extent are construed by some to be in violation of this section.[96]

That provision was approved and remained at Article 9, Section 2 of the 1963 constitution.

The final instance in which the constitutional convention considered taxpayer-funded subsidies for private purposes related to modifying Article 10, Section 12 of the 1908 constitution, which banned the granting state credit to or "in aid of any person, association or corporation, public or private." Delegates ultimately decided to keep that language the same, but they added language to clarify that this would not prohibit the state from investing public funds in private markets for the purpose of providing retirement benefits to public officials and employees.

But in discussing this provision, some delegates wanted to also exempt using state credit for economic development purposes. One delegate summarized the opinion of the committee that rejected this proposal:

> One thing that we were asked to do that we have not done was to so change this wording that it would not prevent the loaning of state credit for the purpose of improving, bringing in industry and making industrial inducements. That was carefully considered by the committee. It was ruled out. We don't think it is sound policy. We know that we have competitors that use it, but we don't think that we should add to that situation by permitting Michigan to get into the same category.[97]

Still, when being considered before the whole convention, an amendment was made to Article 10, Section 12 that would allow the Legislature to loan a maximum of $100 million to private industries for the purpose of economic development. A delegate in favor argued that this was meant "to give the same advantage to Michigan which other, large industrial states of this union are taking on their own."[98] Another argued that this would allow "community wide development" that would provide the "necessities" for "the modern economy."[99]

Several delegates spoke out against this amendment. One called it a "gimmick" and reminded the convention that voters had just rejected this exact proposal two years before.[100] Another highlighted that the types of projects this money would likely be used for were precisely ones that "the composite judgement of private enterprise" deemed unsound.[101] Yet another delegate argued that economic development programs like these undermine belief in the residents of Michigan to generate prosperity on their own:

> That this great state of Michigan, endowed as it is with its great wealth of natural resources — agricultural, mineral, industrial — in the presence of an adequate labor supply and industrial facilities, should get involved in a program such as this is beyond my comprehension. It seems to me to lack, basically, a faith in the future of Michigan and in the capabilities of our people. The soundest and most wholesome economic development will not be an artificially stimulated state

> industrial subsidy, which is what this would be, but one based on a positive, forward looking leadership, sound government and free enterprise.[102]

The amendment was voted down 84-39.[103] Almost immediately, another amendment was proposed. It would have struck the phrase "authorized in this constitution" in this section and replaced it with "authorized by law," thereby putting the discretion to allow taxation for private economic development purposes with the Legislature.[104] That amendment was also defeated. Finally, a third attempt was made to enable the state's credit to be used for economic development, and again, the delegates rejected it, this time 93-40.[105]

The constitutional convention of 1963 discussed at length, on several different occasions, the question of whether tax dollars should be allowed to be used to benefit private interests or even for the broader purpose of economic development. While some delegates consistently argued in favor of these policies, the convention as a whole rejected them, and the 1963 constitution that voters ratified retained language that prohibiting expending public funds for private benefits.

Conclusion

Michigan lawmakers routinely fund and create new economic development programs. They take different forms, but they all are aimed at using public resources to aid a private interest, whether that be automobile manufacturers, filmmakers, real estate developers, technology start-ups, the tourism industry or battery manufacturers. But more than likely, all of these programs, handouts and special tax treatment would have been deemed unconstitutional for about the first hundred years of Michigan's history as a state.

Although the state's constitution did not change in a significant way, corporate handouts began to be permitted following a 1941 case concerning the apple industry. A close look at the case reveals that the arguments used to overturn Michigan's long-standing precedent against corporate handouts were exceptionally weak. Justices simply argued that apples were big business, and as such, worthy of subsidy. It may be time for the courts to revisit this decision and the larger question of the constitutionality of using taxpayer resources to subsidize private interests.

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