# US State Debt Defaults and Constitutional Reform in Historical Perspective

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## Introduction

While the US government has never defaulted on its debt, dozens of US states, plus thousands of municipalities and other local taxing districts, have experienced debt defaults throughout US history. Three major waves of defaults were in the 1840s, the post-Civil War period, and during the Great Depression, and these waves led some states to reform their constitutional rules regarding debt accumulation. In this paper I investigate these historical cases for lessons about government debt in general, constitutional change, and whether these post-default reforms changed the form or substance of debt procedures.

As of mid-September 2018, the total outstanding debt of the US federal government is about $21.5 trillion, and the amount held by the public (rather than other government agencies) is around $15.8 trillion (US Treasury Department 2018). That's over $65,000 per resident, or $48,000 per resident if we use the lower debt figure. Despite this large amount of debt, the US government manages to make the required regular debt service payments (about $260 billion in fiscal year 2017), and has done so since the country was founded.

In addition to the federal debt outstanding, state and local governments also have a large amount of debt outstanding. Total state and local debt in 2016 was around $3 trillion, with just over 60% of this at the local level and the balance at the state level. State and local debt exists in spite of the fact that forty-nine of the fifty US states have some form of balanced budget requirement, though the stringency varies and only thirty-eight states prohibit carrying over deficits from year to year (National Conference of State Legislators 2010).

While the federal government has never defaulted on its debt, numerous states and local governments have over the course of US history. State debt defaults tend to come in waves and near financial crises, with the most prominent periods being the 1840s and 1870s. Local government defaults tend to cluster as well, but for local entities the Great Depression was by far the worst period for default, with over three quarters of the cumulative 6,298 local defaults taking place during the 1930s.[1] One state, Arkansas, also defaulted during the 1930s, largely through the assumption of local debts, though several states were also in "technical default" by missing payments though the debts were eventually paid in full (Kroll Bond Rating Agency 2011).

In response to state debt defaults, many states responded by writing new rules about incurring debt, often by amending their constitutions or by writing new constitutions. Specifically, states sought to restrain their own ability to take on debt or to run budget deficits. These constitutional changes are a classic of example of states "tying their own hands" to prevent future behavior.

In this paper, I investigate the history of state and local debt defaults and any resulting constitutional changes to state debt procedures. In addition to looking at the history of defaults and constitutional change, I also provide some evidence that these constitutional changes modified the form of incurring debt, but that governments often found ways of getting around these changes.

# 1. Overview of Historical Government Debt in the US

Before proceeding to the specific waves of debt defaults in the US, it is useful to get a sense of the changes in government debt in the US over the long run. Table 1 presents data on state, local, and national debt outstanding for selected years. The years chosen in the table are based on data availability, but correspond to several of the periods that will be discussed in this paper.

**Table 1: Government Debt for Selected Years**

| (millions of 2016 dollars) | | | | Share | | as % of GDP | |
|---|---|---|---|---|---|---|---|
| Year | State Debt | Local Debt | National Debt | States | State & Local | States | State & Local |
| 1841 | $5,475 | $709 | $142 | 86.5% | 97.8% | 11.7% | 13.2% |
| 1870 | $6,679 | $9,790 | $46,219 | 10.7% | 26.3% | 4.5% | 11.1% |
| 1932 | $49,759 | $287,678 | $342,392 | 7.3% | 49.6% | 4.8% | 32.3% |
| 2016 | $1,160,489 | $1,842,231 | $19,381,591 | 5.2% | 13.4% | 6.2% | 16.1% |

Sources: Wallis (2000) and US Census Bureau (2018) for debt data, Office and Williamson (2018) for inflation-adjustment, and Johnston and Williamson (2018) for GDP

In the early American republic, the federal government started out with a sizable amount of debt from the Revolutionary War and added to that in the War of 1812. Following the War of 1812, the federal government slowly paid down its debt until it was largely paid off in 1834. But as the federal government paid off its debt, state and local governments began to accumulate debt for a variety of projects, such as internal improvements (roads, canals, and later railroads).

By 1841, state debt accounted for 86.5% of all public debt in the US, and federal debt was negligible, only about 2% of the total. As will be discussed further in section II, the peak of state debt in 1841 turned into a debt crisis. At the time there were 26 states in the Union, and eight of them (plus one territory) defaulted on their debt, with another three states barely avoiding default. In other words, half the states at the time were in trouble with debt.

By 1870, much had changed in the debt picture. Borrowing to finance the Civil War meant that the federal government was now the dominant borrower in the US, with about three-quarters of debt at the federal level. Debt at the local level also grew, meaning that state-level debt was now just 10 percent of the total. But this is not because state debt shrunk. On the contrary, in inflation-adjusted terms, it was slightly larger than 1841, though after accounting for population growth it was about half of what it was in 1841.

As detailed in section III, the 1870s saw another wave of debt sweep the nation, with ten states defaulting (though there were now close to 40 states). There was also the first wave of local debt default in US history, with 159 localities, mostly cities and counties, defaulting in that decade (in the 1840s just four localities did). The defaulting states were concentrated in the South, and they were of a much different nature than the 1840s defaults, as post-Reconstruction Southern states repudiated debts incurred by their Reconstruction governments. Despite having different causes from the debt defaults in the 1840s, the result was similar, with many Southern states amending their constitutions to put further restrictions on debt limits. These 1870s defaults are also closely tied with post-Civil War politics, as well as the repudiation of the debts of the Confederate States incurred during the Civil War. A wave of defaults followed passage of the Fourteenth Amendment to the US Constitution in 1868, although most states repudiated earlier upon reentering the Union (Ratchford 1941, 159-161).

Local debt defaults continued in the decades between 1880 and the Great Depression, with an average of 145 defaults per decade and a high of 258 in the 1890s (Advisory Commission on Intergovernmental Relations 1973). As discussed in section IV, these local defaults were nothing compared with the 1930s when 4,770 local debt defaults occurred. Unlike earlier defaults, over 60% of these local defaults were school districts and “other” districts (such as road building or levee construction districts), rather than cities or counties. In addition, four states were also in serious debt problems, though only one, Arkansas, ultimately defaulted on its debt.

Since the Great Depression and World War II, federal debt has clearly come to be the dominant form of debt, now comprising over three-quarters of all public debt. But this does not mean that state and local debt have disappeared. As a percentage of GDP, state debt is near its all-time highs, excluding the 1840s debt crisis. Similarly, local debt is also near all-time highs as a percentage of GDP, once again excluding the major local debt crisis of the Great Depression.

None of this is to say that state and local governments are on the verge of another debt crisis. Debt crises have also been the product of particular local circumstances, not some simple relationship between two aggregate variables. Rather, I bring this up to suggest that while a variety of restrictions on debt have been imposed over the years, governments have still found ways to incur debt as a part of financing overall spending. I explore this theme further in Section V, asking whether the substance or merely the form of state and local debt has changed.

# 2. State Debt Defaults in the 1840s

The first major wave of state debt defaults occurred in the 1840s. The causes of debt crisis are still debated, though the aftermath of the Panic of 1837 are often cited and is surely part of the explanation (English 1996). Sylla and Wallis (1998) do not doubt the impact of the Panic of 1837, but they point to variation in state revenue mechanisms as a proximate cause of default. In short, states that had a stable source of revenue, such as a general property tax, were able to weather the crisis without defaulting. States that relied primarily on asset finance, such as revenues from tolls and canals, saw large drops in revenue following the Panic of 1837 and were the sates that eventually defaulted (Wallis 2000). Furthermore, the defaulting states only were able to resume debt payments once they adopted a property tax.

Tables 2 and 3 provide a sketch of the relevant history for both states that defaulted and those that did not, and whether they made any constitutional changes in the years following the crisis. As Table 3 makes clear, many states that did not default on their debt, including several new states, chose to put restrictions on debt issue. Even though they had not suffered the consequences of a default, they saw the trouble other states got into and chose to tie their own hands as well.

**Table 2: States Defaulting on Debt, 1841-1842**

| State | Default | Resolution | New or Amend Constitution | Debt Restrictions? |
|---|---|---|---|---|
| Florida (terr.) | Jan 1841 | Repudiated Feb 1842 | n/a | N |
| Louisiana | Feb 1843 | Resumed 1844, eventually repudiated | 1845 | Y |
| Maryland | Jan 1842 | Resumed Jul 1848 | 1851 | Y |
| Illinois | Jan 1842 | Resumed Jul 1846 | 1848 | Y |
| Arkansas | Jul 1841 | Resumed 1869, repudiated part 1884 | 1846 | N |
| Michigan | Jul 1841 | Resumed 1846, repudiated part 1849 | 1850 | Y |
| Pennsylvania | Aug 1842 | Resumed Feb 1845 | 1857 | Y |
| Mississippi | Mar 1841 | Repudiated Feb 1842 | n/a | N |
| Indiana | Jan 1841 | Resumed Jul 1847 | 1851 | Y |

Sources: Wallis, Sylla, and Grinath (2004), Wallis (2005), and state constitutions

**Table 3: Non-Defaulting States and Constitutional Changes**

| State | New Constitution Year | Debt Restrictions? |
|---|---|---|
| *Barely Avoided Default* | | |
| New York | 1846 | Y |
| Ohio | 1851 | Y |
| Alabama | n/a | N |
| *No Default* | | |
| Kentucky | 1850 | Y |
| Rhode Island | 1842 | Y |
| New Jersey | 1844 | Y |
| *New States* | | |
| Iowa | 1847 | Y |
| California | 1849 | Y |
| Wisconsin | 1848 | Y |

Sources: see Table 2

*Case Studies*

1. Maryland

Maryland defaulted on its debt in 1842, but by 1848 had resumed payments as they started to receive revenue from a newly implemented property tax (Sylla and Wallis 1998). When Maryland drafted a new constitution in 1851, they introduced several restrictions on issuing debt. These restrictions are primarily found in Article III, Sec. 22 of Maryland's 1851 constitution. The restrictions prohibited the issuing of debt unless a tax was also authorized to make the interest payments on the debt and to discharge the debt within 15 years.

Maryland also included a prohibition on using the credit of the state to benefit any individual, association, corporation, and that the state shall not be involved, in any mode, with the construction of works of internal improvement. Funding of internal improvements through private corporations, primarily the Chesapeake and Ohio canal and the Baltimore and Ohio Railroad, with state debt were the primary reasons Maryland had $15 million in state debt at the time of default. At the time this was the second highest debt load in the country in per capita terms among the states (Wallis 2005).

Debt issues related to internal improvements were also important in the defaulting states of Illinois, Michigan, Pennsylvania, and Indiana, as well as states like New York and Ohio that barely avoided default (English 1996). Not only did all of these states add general provisions restricting debt to their constitutions, Michigan, Pennsylvania, and Ohio placed further restrictions on debt to finance internal improvements.

2. Louisiana

Louisiana followed a similar pattern to Maryland, but with one important difference. Rather than issuing debt to fund canals and railroads, Louisiana's debt was issued almost exclusively to fund banks. Issuing debt for banks was the common thread among states in the South that incurred a significant amount of debt (Florida territory, Arkansas, Mississippi, and Alabama), unlike the Eastern or frontier states. By the 1840s Louisiana had issued $24 million in debt, the highest in per capita terms among the states, and more than double Maryland's in per capita terms (Wallis 2005).

Louisiana would go on to draft two new constitutions in the years that followed (1845 and 1851), but both included two major features regarding debt. As stated in Title 6, Art. 114 of Louisiana's 1845 constitution, no debt issued shall exceed $100,000. However an exception was made if there was a specific tax levied to fund both the interest and retirement of the debt, very similarly to Maryland. And to emphasize the link between taxation and debt, the Louisiana constitution went further and made clear that the tax "shall be irrepealable until principal and interest are fully paid and discharged." The 1851 constitution further added the provision (in Title 6, Art. 110) that the aggregate amount of debt of the state shall not exceed $8 million (one-third of their outstanding debt in the previous crisis).

3. Other States

In the end, Louisiana was the only Southern state to place debt restrictions in its constitution following the defaults on the 1840s. Arkansas, Florida, and Mississippi all defaulted but did not modify their constitutions regarding public debt. Alabama nearly avoided default, but also refused to tie its own hands. Most Northern states did establish restrictions on debt. This lack of debt restriction in Southern states would be an ominous warning for the next wave of debt defaults.

# 3. Repudiation of Civil War and Reconstruction Debts

The Civil War, Reconstruction, and post-Reconstruction periods are the next important period in US history regarding state debt. During the War, Southern states incurred substantial debt to fight for their right to secede from the Union and maintain the institution of slavery. Near the end of the War, these debts totaled around $96 million concentrated in just the 11 Confederate States. About two-thirds of this Confederate state debt was in the just four states: Alabama, Georgia, Louisiana, and North Carolina. (Ratchford 1941, 151). As a comparison, $96 million was about one-third of the total debts that all US states had incurred by the 1840s.

As the Union army began to take control of Southern states in 1864 and early 1865, they set up new provisional governments which usually also wrote new constitutions. In general we can refer to these governments, Constitutions, and debt incurred with the label Reconstruction, even though official Reconstruction legislation from Congress would not come for a few more years.

After the important racial issues, one of the first tasks of the new Reconstruction governments in their new constitutions was to repudiate the debts incurred to fight the war (Ratchford 1941, 159-161). Thus, we could label the debt repudiation in this period as its wave of defaults, those these defaults were not due to an inability to service the debt, but rather the view that debt was incurred for illegitimate purposes.

During Reconstruction, the newly readmitted states immediately begin issuing debt as well, though in this case not prosecute a war, but nominally to rebuild their economies. The overwhelming amount of debt issued was for the construction of railroads, though small amounts were issued for other rebuilding purposes such as levee construction. However, the debt issued was characterized by widespread fraud, with little of the funds being used to construct infrastructure of any sort. Other debt was issued to authorize conversion bonds from pre-war debt, including in some cases promises to repay some of the repudiated debt from the 1840s (Ratchford 1941, 172-176).

By around 1874, total debt in Southern states was around $247 million, up from about $146 million at the beginning of Reconstruction (Ratchford 1941, 183). Around 1874 is also the period of time when many states were retaken by Democrats and Reconstruction governments were overthrown. Once again, a new round of constitution writing occurred, with states once again repudiating debt incurred by what they viewed as an illegitimate regime. But importantly, the new state constitutions of the 1870s also frequently included new restrictions on issuing of debt, by the state itself, and in a few cases by local governments.

The pattern of first repudiating Civil War debt upon reentering the Union in the late 1860s, and then further repudiating Reconstruction debt once Democrats retook control in the 1870s, was common across nearly all Southern states. But the precise time at which new debt restrictions were put in place varied. Some states put them in place before they officially repudiated the Reconstruction debts, others waited until after, and a few put no new restrictions in place. The only state with a different history of debt in this period is Virginia, which had to deal with the unique issue of the new state of West Virginia, carved out of Virginia during the Civil War, and how Virginia's pre-war debts should be apportioned to West Virginia.

*Case Studies*

1. Georgia

Georgia incurred one of the largest Civil War debt totals. By the end of the war, Georgia had accumulated over $18 million, second only to North Carolina (Ratchford 1941, 151). When Georgia's first Reconstruction constitution was drafted in October of 1865, repudiating the Civil War debt was one the main accomplishments, other than the obvious changes of abolishing slavery and repealing the secession ordinance (Ratchford 1941, 160).

Another constitution was drafted and approved in 1868, as official Reconstruction began in earnest and Georgia was readmitted to the Union. The 1868 constitution did include one important restriction on the issuing of public debt. Article 3, Sec. 5 of the 1868 Georgia constitution prevented the state from using its credit to aid any private company unless "the whole property of the company shall be bound for the security of the State."

After repudiating its $18 million Civil War debt, Georgia was left with about $2.8 million in other legitimate debts from before the war. By 1868 this had grown to $6.5 million, and despite the restriction mentioned above in the 1868 constitution, the debt further grew to $18 million by the end of Reconstruction (Ratchford 1941, 183).

The majority of the debt in Georgia was issued for the construction of railroads. In just the first three legislative sessions under the 1868 constitution, over $8 million in bonds were issued by the state for the construction of over thirty different railroads (Scott 1969, 98-99). While legislation required that railroads complete 20-mile sections before bonds would be issued, the Governor often issued bonds before any construction began, and in many cases, it never did begin (Ratchford 1941, 173). This pattern of issuing bonds for companies that never constructed much of anything was characteristic of the fraud across the South in this period.

By 1872, the Democrats had regained control of the legislature, effectively putting an end to Reconstruction in Georgia. In 1872 it was becoming clear to the legislature that many of the bond issues were fraudulent, and some of the debt was repudiated (Scott 1893, 100). However, the issuing of new debt continued, until all the debt was repudiated in May of 1877 (Scott 1893, 105-106).

With federal Reconstruction officially ending in 1877, Georgia drafted yet another new constitution in late 1877. This new constitution contained a number of important provisions restricting public debt. Article VII, Sec. III specified that the state could only issue debt for a very limited number of purposes: short-term revenue deficiencies (not to exceed $200,000); defense of the State; and to pay existing public debt (those that had not been repudiated, of course). Article VII, Sec. VII placed a number of restrictions on the issuing of debt by local governments (not to exceed seven percent of the assessed value of taxable property), and Section VIII of the same article prohibited the state from assuming any local debts (unless incurred for defensive purposes). In light of the defaults by numerous railroads, the state of Georgia owned numerous assets of railroads, and Article VII, Sec. XIII of the constitution required that any proceeds from selling railroads be applied to the public debt.

2. South Carolina

The sequence of constitution writing and rewriting in South Carolina was similar to Georgia. Upon secession from the Union, a constitution was ratified in 1861, but this constitution contained no provisions limiting public debt. By the end of the war, South Carolina had contracted about $2.8 million in debt, very much on the low end among the Confederate states (Ratchford 1941, 151). After the war, South Carolina's first Reconstruction constitution was adopted in 1865. This constitution contained no provisions regarding public debt and did not yet officially repudiate the Civil War debts.

It was not until the 1868 constitution that South Carolina would repudiate its Civil War debt, and establish some limitations on the issue of public debt (Ratchford 1941, 160). By 1868 South Carolina had accumulated $5.8 million in debt, but the bulk of this was debt from before the Civil War that was still valid. The most notable debt limit in the 1868 constitution was in Article 9, Sec. 7, which allowed the state to issue debt provided that a tax was levied to pay the interest on the debt.

What followed in South Carolina was a massive period of issuing public debt. The debt was issued for so many different purposes and so much fraud was involved, that there was dispute at the time and among historians as to exactly how much debt was contracted. One historian of state public debt (Ratchford 1941, 182) claims the correct figure was $23 million, though a state committee found a total of $29 million (Scott 1893, 85), and one contemporary historian put the figure as high as $33 million (Pike 1874, 130).

The exact figure for South Carolina debt is not important for my analysis, but the widespread disagreement shows the extent of debt issued, and the confusion and resulting potential for fraud. Scott (1893, 79-82) lists nine distinct functions for which the debt was issued between 1868 and 1871. These functions include paying interest on previous debt, funding the state bank, aid to private railroad companies, the establishment of a land commission, and various conversion bonds. Despite reassurances from the state legislature in 1872 that all the debt was valid, later that year the Governor announced that the interest due could not be paid.

South Carolina would remain under the control of the Republican Reconstruction regime until 1877, but by 1873 they saw the need to remedy their self-imposed debt troubles. The legislature attempted to put the debt on solid footing by consolidating all debt into a single issue of bonds, though this was only at 50 percent of par value (and much of it would be repudiated a few years later under the post-Reconstruction government).

But most important in 1873 was a constitutional amendment, the first since the constitution was ratified in 1868. The new Article 16 of the South Carolina constitution prohibited the state from issuing any new debt, unless it was approved by a vote of the people, including a two-thirds supermajority requirement of those voting on the issue. When the new Democratic regime wrote a new constitution in 1895, they maintained this restriction on debt and the two-thirds vote of the people requirement (Article X, Sec. 11 of the 1895 South Carolina constitution), and would remain in place until a 1977 amendment introduced some significant changes.

3. Other States

In the midst of the multiple debt repudiations following the Civil War and Reconstruction, most of Southern states placed new constitutional restrictions on debt issue. In 1868, North Carolina wrote a new constitution which required popular votes for local debt (Article 7, Sec. 7) and extending state credit to private corporations (Article 5, Sec. 5), as well as requiring a tax funding any new debt until all old debt had been paid off. The 1868 constitution in North Carolina was the governing document in the state until 1971.

Alabama's 1867 constitution required a two-thirds vote of the legislature for most new debt, including extending the state's credit to any private entities (Article IV, Sec. 32). When Alabama wrote a new constitution in 1875, it prohibited all new debt, except for defense of the state, and here still requiring a two-thirds vote of the legislature (Article XI, Sec. 3), which was also maintained in the 1901 constitution and is still in force today.

The Texas constitution of 1866 placed a two-thirds requirement of the legislature on any new state debt (Article VII, Sec. 33), but also gave the legislature power to guarantee the bonds of railroad companies (also with a two-thirds requirement, Article VII, Sec. 36). The 1869 constitution dropped any mention of the two-thirds requirement and the mention of railroads, but did require that the State or counties create "adequate means for the payment" of any debt incurred (Article 12, Sec. 23). The 1876 Texas constitution did finally place strong restrictions on state debt: no debt could be created except for limited purposes, such as repaying old debt and defensive purposes (Article III, Sec. 49). These strong restrictions were in place until a 1991 constitutional amendment.

Florida had defaulted on its debt as a territory in 1841 but did not put any restrictions on debt following that episode. But following the post-Civil War defaults, Florida's 1875 constitution forbade the state from issuing any bonds, except for defensive purposes or redeeming old debt at a lower interest rate (Article IX, Sec. 6). Further the state could not use tax revenue to pay the debt of private chartered companies (Article IX, Sec. 7).

Tennessee adopted a new constitution in 1870, and contained a few restrictions on debt, but none strongly restricting state debt. Article II, Sec. 31 prohibited the state from extending its credit to any private entities or municipalities. Article II, Sec. 33 also prohibited the state from issuing any bonds to railroad companies if those companies are in default on any previous bonds.

Most important among the Southern states, however, is one state that did not place strong restrictions on debt: Arkansas. The 1874 constitution of Arkansas did place very tight restrictions on local debt, both prohibiting the issue of local debt in most cases (Article XVI, Sec. 1) and prohibiting the state from assuming local debt (Article XII, Sec. 12). But as we will see in the following section, the prohibition on local debt was significantly relaxed in the 1920s and the state mostly ignored the prohibition on assuming local debt. One constitutional amendment in Arkansas from this period is notable: an 1884 amendment to their 1874 constitution which repudiated a large part of their debt, including some pre-Civil War debts.

# 4. Defaults during the Great Depression

As the decades between the first two waves of defaults and the Great Depression passed, an important change to public debt occurred across the US: a shift from state debt to local debt. This shift was already becoming apparent in the 1870s, but accelerated in the ensuing decades. In 1870, local debt of cities, counties, and special taxing districts such as school districts was already slightly larger than state debt, though they were at least comparable: $516 million in local debt and $352 million in state debt.

Up to 1913, state debt remained roughly constant, while local debt exploded to over $4 billion, more than 10 times state debt and 72% of all public debt in the US including federal debt (Wallis 2000). Federal debt would of course grow significantly during the First World War, but by 1932 local debt was over 42% of the total. State debt was comparatively small, such that roughly half of public debt was at the state and local level.

Along with mounting local debt came more local debt defaults. Virtually unknown prior to the 1870s, there were 159 local debt defaults in the 1870s. The 1890s saw a peak of 258 local debt defaults, but all of the decades between the 1870s and 1920s saw some substantial local debt defaults. But the massive buildup of local debt in the 1920s (roughly doubling in the aggregate) and the onset of the Great Depression made the 1930s by far the worst decade for local debt defaults with an estimated 4,770 (Advisory Commission on Intergovernmental Relations 1973).

In some sense, it could be said that the restrictions of state debt worked too well. While states tied their own hands regarding debt issue, they largely left local governments free to incur debt. As discussed above, this was not universally true. As discussed in the previous section, Georgia did place some limitations on the issuing of local debt and prohibited the state from assuming local debt, and other states did as well. Arkansas also placed restrictions on local debt, but as will be seen in the case study below Arkansas often either ignored these provisions and further amended their Constitution to allow local governments to borrow under certain conditions.

As an example, the strong constitutional restrictions in Florida discussed in the previous section certainly limited public debt: Florida, along with Nebraska, had essentially no outstanding debt in the 1920s and 1930s. But this obscured an important change: cities, counties, and special districts had accumulated $532 million in debt by 1932. In inflation-adjusted terms, local debt in

Florida alone was 40% greater than all the state debts in 1870. At $338 per capita, Florida had the most outstanding in 1932, followed by New Jersey ($279 per capita), New York ($271 per capita), Oregon ($205 per capita), Wyoming ($187 per capita), and California ($186 per capita). For these high-local-debt states, around 85 percent or more of the debt was at the local level (US Census Bureau 1935).

Because only one state, Arkansas, defaulted during the Great Depression, it is the only state I will use as a case study. But when it comes to the total amount of debt, Arkansas was not atypical, with $137 in per capita debt in 1932 it was almost exactly at the national aggregate of $141 in per capita debt (US Census Bureau 1935). Arkansas was also typical in how the debt was used, primarily to fund local infrastructure such as roads and bridges. But Arkansas was the only state to default on its debt during the Great Depression, making it atypical in that sense, and Arkansas's debt started at the local level but was later assumed by the state. Tennessee is a good example of a state that mismanaged its debt, but was still able to avoid default.

*Case Studies*

1. Arkansas

As discussed in sections in the previous sections, Arkansas was no stranger to debt defaults. Having defaulted on its debt in 1841, Arkansas made no constitutional changes to limit future debt. Like most Southern states, it defaulted on both its Civil War and Reconstruction debts. Constitutional changes were made in this period, mostly related to the issuing of local debt. The poor credit rating from three defaults in four decades probably also served as a limit to much state borrowing. By the early twentieth century, Arkansas's state debt was down to around $1 million dollars, from highs of over $8 million in the late nineteenth century.

Arkansas's restriction on the issuing of local debt in its 1874 constitution prevented counties, cities, towns, and other municipalities from issuing debt. To get around this prohibition, in the early twentieth century the legislature began approving special improvement districts for the construction of roads in the state. In 1915 the legislature passed "The Alexander Road Law" which provided a general procedure for creating these local improvement districts, 120 of which had been created by the following year. Another 312 improvement districts were created by special acts through 1920 (Ratchford 1941, 383-385).

The 1920s saw several important changes leading to an eventual debt crisis. First, a 1926 amendment to the constitution allowed city governments to issue debt if approved by voters for a wide variety of purposes, such as roads, sewers, firefighting, public parks, and many other local services (Amendment 13, changing Article XVI, Sec. 1). Next, with many of the road improvement districts in distress, the legislature passed the "Martineau Act" in 1927, which gave the state the authority to assume over $70 million in local debt (again, despite constitutional prohibitions to doing so). Additional debt was issued by the state to fund highways as well as Confederate pensions, meaning that the state now had over $120 million in debt (Ratchford 1941, 386-387), which would further grow to $164 million by 1932 (US Census Bureau 1935).

As tax revenues declined across the nation with the onset of the Great Depression, Arkansas's available revenue fell from about $22.5 million in 1930 to about $16 million two years later. About half of the decline came in the highway fund, with gasoline and auto license taxes declining by about $3.5 million between 1930 and 1932 (Ratchford 1941, 392-393). By August of 1932, the state of Arkansas defaulted on some payments, and in March 1933 it defaulted on all highway bonds. No payments were made again until 1935, and these were made at a significantly reduced interest rate as the old debt was reissued as new debt with a lower, three percent rate (Ratchford 1941, 394-395).

The most interesting outcome from our perspective is the constitutional changes that followed the default. Voters approved two important amendments to the constitution in 1934. Amendment 19 dealt with taxes and spending, requiring a three-fourths vote of the legislature (or a majority of voters) to increase any of the taxes in existence at the time and to pass spending bills. Amendment 20 to the Arkansas constitution put strong restrictions on the issuing of debt. Except for refunding old debt and for assuming road district bonds, Amendment 20 prohibited the state from issuing any bonds "for any purpose whatsoever" unless approved by voters. These two amendments taken together limited both the debt that Arkansas could issue, as well as limiting the means to raise revenue to pay for debts and other purposes.

Arkansas's tight restrictions on debt would be loosened to some extent in subsequent years. In 1984 voters approved constitutional Amendment 62, which allowed cities and counties to issue bonds for capital improvements if approved by voters. Two years later in 1986 voters approved another change in Amendment 67 that allowed local governments to issue revenue bonds for capital improvements without a vote of the people in most cases. Then in 2004 voters loosened the restrictions on state debt with Amendment 82, allowing the state to issue bonds to pay for infrastructure for large economic development projects. And in 2016 voters approved a constitutional amendment overhauling the requirements for both the Amendment 62 local bonds and the Amendment 82 state bonds, in both cases making it easier to issue them and to issue them for more purposes than originally defined.

2. Other States

While no other states defaulted on their debt in the Great Depression, the issues with local defaults of debt were widespread across the country. Among the regions of the US, only the New England states were spared from having many local government defaults, where they had just seven defaults in the 1930s. All other regions of the US had at least 200 defaults, and looking over the long sweep of history from 1839 to 1969, except for New England ,each region had at least two-thirds of its local defaults happen in just that one decade of the 1930s (Advisory Commission on Intergovernmental Relations, 1973). While the local debt crisis did not lead to many constitutional changes, states such as Michigan, North Carolina, and New Jersey set up state debt commissions to assist local governments that were in trouble and to monitor local debt issues (Kroll Bond Rating Agency 2011). North Carolina also appears to be the only state, other than Arkansas, to modify its constitution with respect to debt in the 1930s. The essential change was Amendment 92 allowing for certain kinds of debt to be permitted if approved by voters (previously the legislature had this power).

Other states had difficulties with state debt, even though none made the same mistake as Arkansas by assuming such a large amount of local debt in such a short amount of time. Ratchford (1941, 407-428) singles out Tennessee as having the most significant issues with state debt during the Depression after Arkansas, though Tennessee did not ultimately default. Kroll Bond Rating Agency (2011) also includes Louisiana, South Carolina, and Texas as states that were also near default, and did experience "technical defaults" which were settled in full within 90 days. For example, Louisiana failed to make a payment in March 1933 as their assets were frozen at the time due to bank runs, but they were back making scheduled payments by May.

Ratchford (1941, 433) summarized the basic debt rules of the states as of 1938 by grouping states into three groups. The major divisions were how debt for most purposes could be issued. The three groups were:

1. 18 states required a vote of the electorate and a constitutional amendment
2. 17 states required a vote of the electorate by referendum (usually a lower bar than an amendment)
3. 13 states left it up to the legislature, and of those states 9 had essentially no quantitative limit

# 5. Have State and Local Governments Changed Their Borrowing Habits?

Experience with debt and default throughout US history have clearly produced changes in state constitutions regarding the issuing of debt. In many cases states that defaulted or nearly defaulted saw fit to tie their own hands, though this was not universally true. States that did not take the opportunity to restrict debt following a crisis often had a repeat crisis further down the road.

But we also saw that placing restrictions on state debt was no panacea, as many states shifted to local debt at the dawn of the twentieth century to fulfill many of the same functions that state debt had served in the nineteenth century, primarily financing of internal improvements, infrastructure, public education, and other economic development projects. In fact, if we go back even further in history to the build up of state debt in the 1830s, one might attribute it to unwillingness of the Jackson administration to fund internal improvements and Jackson's insistence on paying off the national debt. These actions led states to take up the reins of debt and development projects.

What is next for public debt in the US? The national debt continues to increase, though this is primarily to fund consumption and transfer programs rather than infrastructure. If we look back at Table 1, we will see that despite limits placed on state and local debt over the years, state debt is at essentially its highest level as a percent of GDP since the 1840s, and the combination of state and local debt is higher than any time other than the Great Depression.

So state and local governments have indeed continued to use debt to finance activities. In some cases, the debt may be contracted on a much sounder basis, possibly lower the future risk of default. State budgets are also much larger today than in the past, meaning that there is more slack in the budget, and if states run into financial difficulties they have plenty of other functions to cut back on before debt.

Still, one could speculate about the next evolution in public debt. In some sense, the next evolution may already be here, with unfunded liabilities such as state pension plans. While estimates of the size of the unfunded liabilities vary, depending on the assumptions about future economic growth, market returns, and demographics, but the number is probably somewhere between $1.4 trillion (Pew Charitable Trusts 2018) and $6 trillion (American Legislative Exchange Council 2017). Whatever the true number, unfunded pension liabilities are certainly comparable to state or local debts in size, and possibly double the two combined.

Of course, unfunded pension liabilities are not the same thing as public bonds, but they do share many similar features. They are promises to pay future funds in exchange for some present consideration: money in the case of bonds and labor services in the case of pensions. In seven states, pensions have constitutional protections, and in most other states they are treated as either contracts or property (only two states, Indiana and Texas, have essentially no legal protections for pension). Thus, pensions have legal status that is similar to bonds in many states (Munnell and Quinby 2012).

It is also likely that state public debt will evolve in some ways we can not foresee right now, and that it will happen following some critical turning point in history. The wave of debt defaults in the 1840s followed one of the worst economic downturns in the antebellum period, the Panic of 1837. The destruction and turmoil of the Civil War produced the next wave of defaults. And finally, the Great Depression was the catalyst for knocking down the massive local debts.

While history cannot tell us when or if another debt crisis will occur, it does strongly suggest that it will be followed by a new round of constitutional reforms that will change the form of public debt, though perhaps pushing into another sphere rather than diminishing its importance.

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[1] The number of defaults through 1969 are reported by the Advisory Commission on Intergovernmental Relations (1973), and the post-1969 data comes from Moody’s (2017).