IN THE SUPREME COURT OF ARIZONA

DARCIE SCHIRES, *et al.*, Petitioners, v. CATHY CARLAT, in her official capacity as Mayor of the City of Peoria, *et al.*, Respondents.	Arizona Supreme Court No. CV-20-0027

AMICUS CURIAE BRIEF OF
AMERICANS FOR PROSPERITY FOUNDATION – ARIZONA
IN SUPPORT OF PETITIONER
WITH CONSENT OF ALL PARTIES

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INTRODUCTION

Politicians should never use citizen dollars to unfairly subsidize private business—particularly when the public reaps no benefit of the bargain. The drafters of the Arizona Constitution understood that principle. The plain text of the Gift Clause bars the government from giving taxpayer money away by preventing "governmental bodies from depleting the public treasury by giving advantages to special interests or by engaging in non-public enterprises." *Wistuber v. Paradise Valley Unified Sch. Dist.*, 141 Ariz. 346, 349 (1984).

Unfortunately, the town of Peoria has done just that by giving citizens' dollars to a private equity firm, Arrowhead Equities LLC, and a private college, Huntington University ("firms"). What did the town get in return? Nothing, aside from illusory, unenforceable "promises" to "engage in economic development activities" and an agreement not to take part in similar projects with other Arizona municipalities. Op. ¶ 6. Not only does this violate the Gift Clause, but it defies notions of good public policy. Scholarship shows these public subsidies do not benefit citizens in the long term. They favor only two groups: the companies receiving the money and the politicians giving it. The Gift Clause rightly bars such behavior. For that reason, this Court should grant review and reverse the Court of Appeals' decision.

DISCUSSION

The Court of Appeals erred on both prongs of the legal analysis. The "deal" here does not require the firms to spend money on services that benefit the public. Instead, the only concrete requirements are for the private entities to spend money on themselves. Developing your own land is not a public purpose. Second, even if there were a public purpose, the bargain tilts so heavily in the firms' favor that it amounts to a subsidy. Before applying the law, the Court should first evaluate the scholarship on subsidies.

I. Research shows subsidies do not benefit the public.

Research reveals "targeted economic development"—*i.e.*, subsidies—do not have positive economic effects for localities. In fact, they can often hurt. The Mercatus Center at George Mason University recently released an analysis of "targeted economic development," highlighting its many failures and harms. Matthew D. Mitchell, *et al.*, *The Economics of a Targeted Economic Development Subsidy* (2019), *available at* https://bit.ly/2WTWfzv ("Mercatus").

A. There are two approaches to economic development: targeted and general.

There are two types of public economic development strategies. The first is a "general approach" where "policymakers attempt to create an environment that is conducive to economic development without offering targeted assistance to particular firms or industries." *Id.* at 5. This can include "generally applicable tax, spending, regulatory, and legal rules[.]" *Id.* Research shows that "effective general strategies include the provision of genuine public goods and the preservation of economic freedom[.]" *Id.* This is not what Peoria did—private business owners investing in their own business that the public must pay to access is not a "genuine public good."

The second is a "'targeted approach' to economic development" where "policymakers attempt to directly promote the development of particular firms and industries through the use of exclusive privileges." *Id.* This includes "targeted tax relief, targeted regulatory relief, cash subsidies, loans and loan guarantees, in-kind donations of land, and targeted provision of other goods and services." *Id.* Scholars have identified two defining characteristics of a targeted approach. First, rather than let economies work on their own, the government is inserting itself in the market to affirmatively "spur" growth. *Id.* at 6. Second, targeted growth is "discriminatory; it is executed through selective government-granted privileges to certain firms, industries, or regions—often at the expense of other taxpayers or residents." *Id.* History and academic study have not been kind to this process. "[T]he weight of economic theory suggests that the targeted approach to economic development is ineffective at best and counterproductive at worst." *Id.* at 6. This is what Peoria did.

B. The targeted approach fails.

Mercatus identifies two prominent arguments in favor of this approach: the "multiplier effect" and other "positive externalities." *Id.* at 11. The proponents of targeted subsidies build their case on the reasonable assumption that all economic activity spurs further activity—also known as the "multiplier effect." They err in two ways. *First*, they assume subsidized activity would not occur but for subsidies. The data do not support this notion. *Second*, their estimates ignore the costs of the subsidy itself, including opportunity costs.

On the first point, "[r]ecent research . . . suggests that this is not a valid assumption in most cases." *Id.* at 12. For example, Amazon rejected richer incentive packages from several cities in favor of New York City and the Washington-DC-adjacent Northern Virginia for their much-desired "HQ2." *Id.* The real factor driving location decisions is labor costs and other economic considerations unlinked to government intervention. *Id.* A survey of the academic literature reveals that "in most cases, the odds are high (between 75 percent and 98 percent) that the subsidized company would have chosen to locate in the subsidizing locale even without the incentives." *Id.* at 13.

On the second point, proponents of subsidies often fail to consider *the cost of the subsidy itself*. The money used to subsidize the chosen firm does "not materialize out of thin air." *Id.* at 14. Taxpayers are footing the bill. So, whatever marginal benefit local citizens might get (if any), they involuntarily paid for it with their own hard-earned money. And there are also *opportunity* costs to a subsidy. *Id.* at 18. That is, if left in the pockets of taxpayers and not taxed out of the economy, the revenue that supports subsidies would entail its own multiplier effect. *Id.* at 18–22. Thus, the benefit of the bargain rarely falls in favor of the citizenry.

Along with the direct cash costs of a subsidy, there are many unseen costs that are "difficult, if not impossible, to quantify." *Id.* at 24. For example, subsidies can "distort location decisions" by encouraging companies to land in places that are not best suited for their operation or growth. *Id.* at 25. And favoring one firm over another could lead to "anticompetitive effects" and could lead to a firm engaging in "production inefficiencies." *Id.* at 26.

Then, there is the obvious impact on the law of supply and demand. Markets operate best when information flows freely and suppliers compete for consumer dollars. "[C]ompetition between producers to satisfy consumer desires will maximize consumer welfare and minimize producer costs." *Id.* at 27. But when the government interferes through subsidy, this "fails to maximize consumer welfare and fails to minimize costs[.]" *Id.* It also tamps down on innovation, as entrepreneurs are typically "guided . . . by the market signals of prices, profits and loss." *Id.* at 28. Subsidies stall "the market's discovery process." *Id.*

Finally, subsidies encourage rent-seeking behaviors—a socially wasteful effort to secure government privilege. *See, e.g.*, Anne O. Krueger, *The Political Economy of the Rent-Seeking Society*, 64 Am. Econ.

Rev. 291 (1974). Firms spend money lobbying and seeking the favor of politicians rather than investing in themselves or innovating. And this can lead to future shakedowns of politicians, who tend to view subsidies as sunk costs. Mercatus at 30. For example, the producers of House of Cards filmed the first two seasons in Baltimore, on the back of $26 million in tax credits, and then threatened to pull out unless Baltimore gave them *more* money for Season 3. *Id*. at 30. It worked. *Id*. This all leads to unproductive entrepreneurship. *See* William J. Baumol, *Entrepreneurship: Productive, Unproductive, and Destructive*, 98 J. Pol. Econ. 893 (1990). Rather than responding to market signals, local interests, or consumer demand, firms instead pursue what politicians favor. And this benefits two groups: the politicians and the firms—all on the taxpayers' back. Mercatus at 30–31.

C. Subsidies create perverse political incentives.

Government officials "face a number of perverse incentives that make it nearly impossible for them to dispense targeted subsidies in a manner that promotes the general welfare." *Id*. at 32. The targeted subsidies only benefit a focused, small group of people who are effectively able to gather and lobby (usually elected) officials. The general citizenry has no such advantage. *Id.* After all, politicians are "investing with other people's money." *Id.* Thus, "[p]oliticians primarily benefit by being seen as 'doing something' . . . to help the community, with the media coverage serving as free advertising to build their political brands." *Id.* at 33. Such bad incentives shift public policy decisions away from the public good and toward private interests. *See generally*, Toward a Theory of the Rent-Seeking Society (James M. Buchanan, Robert D. Tollison, & Gordon Tullock, eds., 1980).

II. Peoria fails on the law.

The Gift Clause is straightforward: "Neither the state, nor any county, city, town, municipality, or other subdivision of the state shall ever . . . make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation[.]" Ariz. Const. art. 9, § 7. This Court evaluates Gift Clause cases under a two-pronged analysis, which "provides that a governmental expenditure does not violate the Gift clause if (1) it has a public purpose, and (2) in return for its expenditure, the governmental entity receives consideration that 'is not so inequitable and unreasonable that it amounts to an abuse of discretion, thus providing a subsidy to the private entity.'" *Turken v. Gordon*, 223 Ariz. 342, 345 (2010) (citing *Wistuber*, 141 Ariz. at 349).

The first prong considers "the existence of public benefits[.]" *Id*. at 348 (citing *Kromko v. Ariz. Bd. of Regents*, 149 Ariz. 319, 321 (1986)). This Court has found it difficult to nail down a definition of public purpose and holds it is "better elucidated by examples" as these purposes "might not have been familiar to [Arizona's] Constitution's framers." *Id*. at 346. Some examples include projects that directly benefit the public, such as temporary housing for veterans, dilapidated housing clearance projects, or water lines. *Id*. Courts consider the "reality of the transaction" and not just "surface indicia of public purpose." *Cheatham v. DiCiccio*, 240 Ariz. 314, 320 (2016). Thus, the analysis must go beyond just construing anything that *might* be a public purpose as a public purpose. It requires a factual analysis of this transaction itself.

On the second prong, courts take a "'panoptic view' of the transaction." *Id*. at 321 (quoting *Turken*, 223 Ariz. at 352). They consider the transaction as a whole, rather than isolated parts. *Id*. at 322. The key question this Court asks is: "Does the expenditure, even if for a public purpose, amount to a subsidy because '[t]he public benefit to be obtained from the private entity as consideration . . . is far exceeded by the consideration being paid by the public?'" *Turken*, 223 Ariz. at 348. Thus, "the most objective and reliable way to determine whether the private party has received a forbidden subsidy is to compare the public expenditure to what the government receives under the contract." *Id*.

Peoria fails both prongs of this Court's analysis, as its subsidy has no public purpose and the benefit of the bargain does not favor the public.

A. Peoria's gift has no public purpose.

Giving money to a private entity to invest in its own property with no benefit to the public cannot serve a public purpose. As Petitioners note, the campus is not open to the public, local citizens inure no favor, such as free admission, and there is no other tangible benefit other than vaguely-defined indirect economic commitments. Pet'r's Br. at 2. Unlike the many examples in prior cases, such as sewer lines, the local citizens receive nothing. If the Court of Appeals' decision stands, virtually anything could be construed as a public benefit.

Consider a hypothetical town that awarded a homeowner $500,000 to beautify her house with new gardens. Passers-by could look at them from the street but would be barred from entering unless they pay an admission fee that went into the homeowner's pocket. In exchange, the homeowner promises to improve her own gardens, covering some of the cost herself, and engage in "economic development activities." Under the Court of Appeals' analysis, this is lawful, even though it is a direct gift of taxpayer money to a single citizen. That the recipients here are firms, rather than a citizen, should not alter the outcome. To allow such gifts is to render the Gift Clause meaningless, which is not what the Constitution's drafters intended.

Respondent cites this Court's prior ruling upholding bonds issued by Pinal County to copper manufacturers for air pollution control facilities. Resp't's Br. at 14 (citing *Indus. Dev. Auth. of Pinal Cty. v. Nelson*, 109 Ariz. 368, 371–373 (1973)). In *Nelson*, the bonds had a defined public purpose that would directly benefit taxpayers by controlling air pollution. *Nelson*, 109 Ariz. at 373. If a requirement of the subsidy is improving air quality, that is a tangible benefit that, under this Court's precedent, is the type of public benefit demanded to avoid offending the Gift Clause.

Respondent attempts to liken that to Peoria's gift, but the two scenarios are quite different. Peoria relies on many intangible, generic benefits like "promoting economic development and job growth, promoting educational opportunities in the STEM field, and repurposing an 'unused or underutilized property[.]" Resp't's Br. at 14–15 (cleaned up). These purported "benefits" are either intangible and unmeasurable or provide no concrete benefit to the public. If the college provided free tuition to the town, or agreed to beautify a publicly accessible space, or committed to improving public roads, it might pass this Court's test. But it does none of these things. And even if the purported benefits were somehow tangible or beneficial to the public, the academic research is clear that none of them carry true value.

B. The public is not getting the benefit of the bargain.

The city also fails the second prong. As the above scholarship reveals, these subsidies do not benefit the public. They instead disrupt market forces and create perverse incentives. And unlike many of the companies in this Court's precedents, the firms here do not need to take part in any public-facing expenditure. They simply must engage in "economic development activities." This is an unenforceable promise that is impossible to define.

Respondent's expert argues the real benefit is $11.3 million in the "economic value of the promise to operate a branch campus of HU in the City of Peoria, including the promise to repurpose the building for the campus." Resp't's Br. at 19. Respondent also cites HU's "substantial obligation to develop and open a new campus in Peoria at a minimum cost of $2.5 million[.]" *Id.*

The Mercatus scholarship shows there is, at best, no benefit (direct or indirect) to the public of targeted subsidies. And as Respondents concede, indirect benefits are "not consideration under contract law" where they are "not bargained for as part of the contracting party's promised performance." Resp't's Br. at 17 (citing *Turken*, 223 Ariz. at 350). Respondents instead attempt to rely on the "bargained for" commitment of the firms to renovate their own property and refrain from "entering similar agreements with other Arizona cities." *Id.* at 18. On the first point, the same arguments against a "public benefit" apply with equal force here. A private firm's commitment to spend money on itself cannot weigh the benefit of the bargain in favor of the public. On the second point, the commitment of exclusivity, the town is trying to shoehorn in indirect benefits. It is impossible to assign any value to that commitment without considering what Peoria gains by having the college here and not in Glendale next door. Such indirect benefits are improper in this context and, even if they were, scholarship excludes their reality. *See supra* at 3–5.

Finally, the city and Court of Appeals repeatedly cite the firms' promise to engage in "economic development activities." To have an enforceable contract, "there must be an offer, an acceptance, consideration, and sufficient specification of terms so that the obligations involved can be ascertained." *Rogus v. Lords*, 166 Ariz. 600, 602 (App. 1991). Arizona courts have consistently held that "it is essential to an enforceable contract that . . . its terms be sufficiently clear so that one can state with certainty the obligation involved." *Malcoff v. Coyier,* 14 Ariz. App. 524, 526 (App. 1971). A requirement to engage in "economic development activities" fails this test. It has no specification of terms, no defined obligations, and no defined scope; it is unenforceable. A good check is to imagine what a breach of contract suit would look like here, an impossible task. Even Arizona's most creative lawyers would likely struggle to come up with articulable claims.

Thus, Petitioners are right to argue this is a benefit of "zero" dollars. Op. ¶ 5. This is no contract, but instead one party gifting something to another. "It is hornbook that an illusory contract is unenforceable for lack of mutuality." *Shattuck v. Precision-Toyota, Inc.*, 115 Ariz. 586, 588 (1977).

In fact, the public's benefit of the bargain here may be worse than zero—it could be negative. Mercatus' study shows subsidies create perverse incentives, weaken local markets, disrupt competition, and create an unbalanced labor force. *See supra* at 3–6. This disadvantages existing businesses and residents of the city. Taxpayers are paying an outside firm to compete with them. For example, a local bakery that wants to build a new shop now must bid on construction contracts against a publicly subsidized outside competitor. It is one thing to give a local business a gift—still unlawful, for sure—but it is something worse to pay the firms to enter Peoria and compete for its labor and resources. Local small businesses, who may not have the political clout or finances to lobby politicians for their support, both foot the bill and compete against their new subsidized neighbors.

Conclusion

The town of Peoria gave a private equity firm and private college a gift in the form of millions of taxpayer dollars. Academic research shows subsidies do not improve local economies and do not benefit the public. And all these firms promise to do in exchange for receiving the gift is spend the money on themselves. The rest of the promises are illusory and unenforceable. This arrangement fails the Court's Gift Clause test. This Court should grant review of the Petition and, after considering the merits, vacate the lower court's order.

Respectfully submitted, on 29 May, 2020.

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