

Intergovernmental Spring/Summer 1985, Vol. 11, No. 2/3

PERSPECTIVE



Garcia vs. San Antonio:

FEDERALISM
UNDER
FIRE
?

SOUTHWESTERN UNIV
LAW LIBRARY
GOV. DOCUMENTS 309
OCT 4 1985

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

**—U.S. Constitution
Amendment X**

The year was 1976, the forum was the Supreme Court, the disputants were states and localities on the one hand and the federal government on the other. The case in controversy was *National League of Cities v. Usery*, and the result was an apparent revitalization of the Tenth Amendment. Less than a decade later, the same forum hosted a similar controversy, featuring similar contenders. The result of *Garcia v. San Antonio Metropolitan Transit Authority*, however, was dramatically different.

This issue of *Intergovernmental Perspective* is devoted to the critical issues surrounding the *Garcia* case and its implications for federalism and intergovernmental relations. Featured articles on the subject have been prepared by Professors Paul Hartman and Thomas McCoy of Vanderbilt University and Professor A.E. Dick Howard of the University of Virginia. Commission Chairman Robert Hawkins also addresses the intergovernmental implications of the *Garcia* decision in his "View from the Chairman" column.

In order to understand fully the impact of the Supreme Court's stream of decisions from *NLC* to *Garcia*, it is necessary to go back in history at least to the 1940s when, in upholding the federal *Fair Labor Standards Act (FLSA)*, the Court summarily dismissed arguments that the statute constituted an unwarranted invasion of the reserved powers of the states. Indeed, the Court relegated the Tenth Amendment to the realm of "truism"—an apparent constitutional tautology with little practical value as a counterweight to the potent congressional commerce power. Ironically, then, just prior to the dawn of an era in which the court would be labelled "activist," it had carved out for itself a very large area in which it would be acquiescent—the area of congressional legislation. That acquiescence proved to be the rule for the next 35 years.

In 1976, however, the Supreme Court handed down a decision that at least was surprising and at most appeared to overturn several decades of judicial policy toward the commerce power and the constitutionally reserved powers of the states. At issue in *NLC v. Usery* were the 1974 amendments to the *FLSA* (the perennial statutory stimulus for landmark Tenth Amendment cases). The amendments extended the minimum wage and maximum hour provisions of the act to most state and local employees. Given the fairly deferential attitude which both the Warren and Burger Courts had exhibited toward acts of Congress, there was little reason to believe that the amendments would be overturned. Nonetheless, a divided Court revived interpretations of the Commerce Clause and the Tenth Amendment thought by many observers to have been judicially buried years ago:

[W]e have reaffirmed today that the states as states stand on quite different footing than an individual or corporation when challenging the exercise of Congress' power to regulate commerce. . . . Congress may not exercise that power so as to force upon the states its choices as to how essential decisions regarding the conduct of intergovernmental functions are to be made. . . .

Although state and local governments were understandably elated over the *NLC* victory, two potential problems were almost immediately apparent. First, just how much constitutional protection against national intrusions did *NLC* afford? After all, it is not merely through direct regulations enacted on the basis of the Commerce Clause that Congress may commandeer state and local decisionmaking processes. Indeed, the Court itself hinted in a footnote: "We express no view as to whether different results might obtain if Congress seeks to affect integral operations of state governments by exercising authority granted it under other sections of the Constitution such as the spending power . . . or the Fourteenth Amendment."

Second, the decision was rife with ambiguous terminology. For instance, the Court spoke of **traditional** areas of state and local service provision as being protected by the Tenth Amendment; offering by way of example, "such areas as fire prevention, police protection, sanitation, public health, and parks and recreation." Notably, the Court did not define "traditional," offer precise guidelines for identifying it, nor, as it did in a famous pornography case, suggest that it would know it when it saw it.

Moreover, the Court asserted that Congress could not through use of the commerce power interfere with state and local governments' **integral** functions. But what, beyond certain employer-employee relationships and the power to determine the location of the state capitol constituted an "integral" function—one presumably essential to maintaining the constitutionally protected attributes of state sovereignty? Again, the Court was vague.

Needless to say, *NLC* set off a flurry of litigation where problems with its applicability became almost immediately apparent, despite subsequent attempts by the high court to fashion meaningful standards out of its sometimes abstruse language. The result was a series of losses for states and localities challenging federal intrusions and an increasing skepticism, within and without the legal community, about the usefulness of the *NLC* doctrine.

Hence, in 1981, state interests lost in their bid to overturn the *Surface Mining Control and Reclamation Act*. In 1982, attempts to have declared unconstitutional portions of the *Federal Railway Labor Act* and the *Public Utilities Regulatory Policies Act* were similarly rejected. And in 1983, the State of Wyoming, employing the *NLC* precedent, failed to convince the Court that applying the *Age Discrimination in Employment Act* to state and local employment relationships violated the Tenth Amendment. It was in the context of such continuing frustrations—on the parts of litigants and judges alike—that *Garcia* came before the Court in 1985.

At issue in *Garcia* were Department of Labor regulations applying *FLSA* wage and overtime provisions to state and local mass transit employees. Those regulations had been the subjects of dispute in the lower federal courts for several

(continued on page 23)

PERSPECTIVE

2 Editorial Note

4 ACIR News

6 Intergovernmental Focus
Spotlight on the South Carolina ACIR

8 Garcia: The Latest Retreat on the "States' Rights" Front

12 Garcia: Federalism's Principles Forgotten

15 A Special Report
Investments and Judgments Can Pose Threats to Local Financial Health

18 A Fiscal Note
The Flow of Federal Funds

20 And Briefly: Books

22 The Chairman's View

Staff

John Shannon
**Executive Director and
Kestnbaum Fellow**

Lawrence Hunter
Research Director

Robert Gleason
**Director of Communications
and Publications**

Jane Roberts
Susannah Calkins
Co-Editors

Contributors

Cynthia C. Colella
Karen L. Kirkwood
Mark D. Menchik
Alisha Mullins

Intergovernmental Perspective
is published four times a year
by the U.S. Advisory Commission
on Intergovernmental Relations,
Washington, D.C. 20575
202-653-5538

Series of Appointments Made to the Commission

In recent weeks, a number of new appointments have been made to the Commission. Six reappointments also have been announced by the President, the Speaker, and the President of the Senate. Each member will serve a two-year term.

Joining the Commission as new members are:

- John Carlin, second term Governor of Kansas, currently chairs the National Governors' Association (NGA) and is past chairman of the Midwestern Governor's Conference. A member of the Kansas House for eight years, he also served as minority leader and as speaker.
- Ted Schwinden, second term Governor of Montana, served as lieutenant governor for four years, is a former member of the Montana House, and was state lands commissioner from 1969-76. He currently chairs the NGA agriculture committee.
- Edwin Meese, III, Attorney General of the United States, is the former Counselor to President Reagan and chief of staff to then-Governor Reagan in California. He also heads a special White House domestic policy council.
- William E. Brock, III, Secretary of Labor, was formerly U.S. Trade Representative. He also served in the U.S. House and Senate representing Tennessee. From 1977-81, he was chairman of the Republican National Committee.
- Mitchell E. Daniels, Jr., Deputy Assistant to the President, also serves as director of the White House Office of Intergovernmental Affairs. He is a former aide to Senator Richard Lugar (IN), and staff director of the National Republican Senatorial Committee.
- Representative Sander Levin (MI), first elected to the House in 1982, is a former county supervisor and state senator. He presently serves on three House committees: Government Operations; Banking, Finance and Urban Affairs; and the Select Committee on

Children, Youth and Families.

- Ross O. Doyen, a Kansas State Senator since 1968, previously served on ACIR from 1981-84. He is a former member of the Kansas House, and is a past president of the National Conference of State Legislatures.
- Philip B. Elfstrom, a member of the Kane County (IL) Commission, is immediate past president of the National Association of Counties. He also has been a member of that association's board for 11 years.

Reappointed to the Commission are:

- Senator William Roth, Jr. (DE), who has served on ACIR since 1975, is chairman of the Committee on Governmental Affairs. He also serves on the Finance Committee, the Select Committee on Intelligence, the Joint Committee on Taxation, and the Joint Economic Committee.
- Senator Dave Durenberger (MN) is chairman of the Subcommittee on Intergovernmental Relations and the Select Committee on Intelligence. He also serves on the Finance and the Environment and Public Works committees. He has been a member of ACIR since 1981.
- Representative Robert Walker (PA) is ranking minority member of the Subcommittee on Intergovernmental Relations and Human Resources. He also serves on the Committee on Science and Technology, and has been a member of ACIR since 1983.
- Representative Ted Weiss (NY) is chairman of the Subcommittee on Intergovernmental Relations and Human Resources and has served on ACIR since 1983. In addition, he serves on the Committee on Foreign Affairs and the Select Committee on Children, Youth and Families.
- Gilbert Barrett is chairman of the Dougherty County (GA) Commission. In 1973, he served as president of the National Association of Counties, and also is a past president of the Georgia county commissioners' association. He was initially named to ACIR in 1982.
- James S. Dwight, Jr., is a partner in the accounting firm of Deloitte, Haskins and Sells, and has served as a public member of ACIR since 1983. He has held a number of executive posts in both the federal government and in California state government.

Earlier this year, President Reagan also announced the reappointment of North Dakota Senator David Nething and Charleston (SC) Mayor Joseph Riley, Jr., to new terms on the Commission.

Commission Adopts 3-Year Research Agenda

Members of the Commission unanimously adopted an ambitious, three-year research program at their March meeting in Washington, DC. Based upon recommendations from a special subcommittee chaired by Pennsylvania Governor Dick Thornburgh, the agenda encompasses a broad range of intergovernmental issues, with special thematic emphasis on state-local relations, and the basic concepts of local governance and federalism.

The eight-part agenda includes topics ranging from the role of the national judiciary in the federal system to issues of local service delivery. Two topics were singled out for priority attention: federal preemption of state and local laws and authority, and an analysis of intergovernmental aid formulas.

A complete listing of the approved research topics follows:

- **Judicial federalism.** Taking a broad perspective, research will consider the changing role of the Supreme Court as the "arbiter of federalism" and the protector of Constitutional rights, and examine the impact of court decisions and other judicial actions on intergovernmental mandates and grant administration. Are the courts interpreting the Constitution or writing their own legislation? Can any general principles be offered to guide the role of the judiciary in intergovernmental affairs?
- **Federal preemption.** State and local officials frequently have complained that the involvement of the national government in new areas of activity often has had the effect—and frequently the intent as well—of preempting state-local discretionary authority. The focus of this study will be on three areas: where the federal government totally has excluded the states from regulating in a particular area; where federal and state governments have separate and distinct spheres of authority carved out within a given field; and where the federal government guarantees certain absolute or minimum standards, but encourages or compels the states to act as agents or partners to enforce or implement the same or similar standards.
- **Rethinking local self-government.** This broadly-defined project will establish a framework to consider the potentials, capabilities, and limitations of local governments and local self-governance.

Despite declining intergovernmental support and the existence of hard-pressed local tax bases, citizens' service demands have not abated, leading to calls for more local initiative and self-help. Viewing localities as "limited political economies" emphasizes both their capabilities and their limitations, and the research will assess whether this perspective can help explore certain local problems of intergovernmental significance. The project, for example, will explore local actions aimed at economic development and stabilization, long-considered the province of the national government.

- **Alternative approaches to providing local public services.** Another broad topic of research relating to local government and local self-reliance, this study will examine the use of innovative means of local service financing and delivery, such as levying user charges and private sector contracting. The study will build upon the Commission's earlier work in the area of interlocal service arrangements, and examine the role of intergovernmental regulations in the implementation of these arrangements.
- **Reform of means-tested welfare programs.** There are over 70 federal grant programs with benefits conditioned on income. Many of the programs are controversial and difficult to administer. This research will consider ways to achieve a more efficient welfare system, recognizing past resistance to comprehensive change and the intergovernmental character of existing financing arrangements.
- **Intergovernmental aid formulas.** An examination of intergovernmental grant formulas is particularly timely in a period when federal grants are shrinking and communities are turning more and more to their state legislatures for aid. This project will examine existing and alternative grant formulas, and suggest how allocation formulas can best achieve program goals.
- **Fiscal discipline.** At a time of \$200 billion federal budget deficits, it is useful to compare state and local budgetary controls with those at the federal level. For example, all states but one (Vermont) are restrained from running a deficit, either by constitution or statute. Moreover, most governors have the power to veto line items in budget bills. What causes fed-



John Shannon Appointed ACIR Executive Director

John Shannon, a nationally recognized authority in the areas of public finance and intergovernmental relations, has been named executive director of ACIR. During more than two decades of service with ACIR, including 18 years as assistant director for taxation and finance, he has supervised the development and publication of over 80 policy reports, has authored numerous professional articles and working papers, and has been influential in designing the research base and policy framework which have fostered such innovations as the property tax circuit breaker. In 1984, he was named ACIR's first Kestnbaum Fellow.

A native of Wisconsin, Shannon received a bachelor's degree from the University of Notre Dame, a master's

in public administration from Wayne State University, and a PhD in political science from the University of Kentucky. The breadth of his professional background is noteworthy: from fiscal consultant to the government of Liberia and visiting fellow at the Centre for the Study of Federalism at the University of Australia, to political science professor and White House staffer. He also is a member of the Board of Visitors of the Graduate Center for Public Administration at the University of Kentucky, and the Board of Directors of the National Tax Association-Tax Institute of America.

He and his wife Katie are the parents of eight children, five sons and three daughters.

eral deficits? Can those instruments of fiscal discipline that constrain state-local taxing and spending be applied at the national level? A comprehensive view of the instruments, circumstances and even the philosophies of government associated with fiscal discipline may cast a new light on the federal deficit problem.

- **Federal income tax reform.** Several proposals are being discussed that would reform the federal tax on personal incomes and, indirectly, would influence state and local abilities to tax. Such proposals (including that of the Reagan Administration) would lower marginal tax rates by eliminating or restricting specific items of tax preference. In several proposals, those taxpayers who itemized their deductions could not deduct their tax payments to

states and localities. This change could increase the effective "price" of state-local taxation, also eliminating a federal tax feature that may serve to mute interstate tax competition. The state-by-state consequences of the alternative reform proposals will be examined, both for each state's tax revenues in the aggregate and for particular taxpayers' income categories.

COMMISSION SET TO MEET SEPTEMBER 20-21
 The next meeting of the Advisory Commission on Intergovernmental Relations will be held for September 20 and 21 in Washington, D.C. Among the items on the agenda will be action on the state and local taxation of interstate mail order sales and the political parties studies.

Intergovernmental Focus

Spotlight on the South Carolina ACIR

Dan B. Mackey
Executive Director
South Carolina ACIR

Even before his inauguration as South Carolina's 85th Governor, Dick Riley was already a keen advocate of strong intergovernmental cooperation. A 1977 Presidential appointee to the U.S. Advisory Commission on Intergovernmental Relations, Riley recalls, "While serving on the national ACIR, I realized that South Carolina could benefit greatly from a similar experience."

Upon taking office as Governor two years later, Riley followed up on that observation. One of his first acts of office was the creation, by executive order, of the South Carolina ACIR. Five years later, with strong support from the state's cities and counties, the General Assembly granted the ACIR full state agency status, and an initial budget of more than \$200,000 was approved.

"South Carolina is on the verge of unprecedented growth", Riley observed. "But the job we face is not simply one of coping with the problems of growth. We must also unravel the complicated system of governments which exists in our state." South Carolina, a state of some 3.3 million people, has 46 counties, 268 municipalities, 92 school districts, more than 300 special purpose districts, and a state government that is comprised of some 150 separate and semi-autonomous state agencies. Pulling these disparate entities into a stronger working relationship is the job the Governor and the Legislature have delegated to the ACIR.

"By delivering direct services to the public, regulating and licensing business activities, establishing public health and safety standards, and levying and collecting taxes and fees, these governments have a daily impact on the lives of all South Carolinians," Riley said. "Coordination of their activities, the introduction and maintenance of the best management techniques, and the assurance of equitable services at a high level of quality to all citizens is a constant challenge.

"I expect the ACIR to deal with these issues. And, I expect the ACIR to improve the coordination and cooperation between the State and its local governments and to provide research, information, and advisory services to public officials and the citizens of South Carolina."

Even before it was given its current permanent status by law, the ACIR was an active agency. Staffed and funded through the Governor's office, the Commission was an 11-member panel that focused its attention on public awareness and the mobilization of the state's leadership for a new mission. During its first two years, for example, ACIR sponsored a statewide conference on growth, planting the seeds of new ideas about the need for a State policy growth. Public opinion polls were conducted, new home rule legislation was analyzed, local government revenue alternatives were explored, and the foundation was set for a new approach to problem solving in South Carolina.

For the next three years, ACIR solicited support and broadened its role.

Statewide intergovernmental forums were held where members of the General Assembly, state agencies, local government, and private groups could meet to discuss and debate issues of mutual interest.

ACIR jumped into the legislative arena by developing a joint package with the state's municipal and county associations. It also supported measures which would allow reasonable annexation procedures, as well as permitting municipalities and counties to merge governmental functions.

In March 1983, the ACIR had a hand in breaking an old tradition and establishing a new one. The Commission co-sponsored a meeting of the U.S. ACIR in Charleston, providing at the same time an opportunity for state-level advisory commissions to meet together for the first time to swap ideas and information. The U.S. ACIR apparently liked the idea of an alternative site for meetings; it now plans at least one meeting a year away from the Nation's Capital!

Last year, South Carolina's ACIR became a full-fledged state agency. Its

PRESENT AND FORMER SOUTH CAROLINA MEMBERS

PRESENT

Rep. Robert J. Sheheen, Chmn.
Mrs. Candy Y. Waites, V-Chmn.
Mr. William Clyburn
Mr. Willis Crain
Sen. William W. Doar, Jr.
Mr. Johnnie Flynn
Mr. Dennis Gilstrap
Rep. Herbert Kirsh
Rep. Robert N. McLellan
Mayor Lewis Miller
Sen. Thomas H. Pope, III
Mrs. Betty Jo Rhea
Mr. Charles Riley
Rep. Sara Shelton
Sen. J. Verne Smith
Sen. Thomas E. Smith, Jr.
Mr. Fred S. Washington, Jr.
Mr. William Youngblood
Mrs. Anne Zeigler

FORMER

Sen. Harris Page Smith
Sen. Heyward McDonald
Mayor Johnny Dodds
Sen. Theo W. Mitchell
Dr. Anna Ruben
Mr. James Thomason
Judge Mark Westbrook
Mr. Jimmy Whitlock
Mayor Thomas Wingard

\$239,000 budget (paid half by the state and half by counties and cities) allowed for the hiring of a professional staff of four, and permitted a significant increase in the Commission's work activities.

The Commission's membership also was expanded to include a broader cross-section of the state's governmental units. Current membership on the ACIR is as follows: four state senators, four state representatives, three county governing body officials, three municipal officials, one official from the regional councils of government, one school board member, one special purpose district official, and four citizens-at-large, all appointed by the Governor.

The ACIR Chairman is Representative Bob Sheheen, a Camden attorney who is a four-term legislator and who serves as chairman of the House Judiciary Committee.

"We do not intend for the South Carolina ACIR to be an intellectual exercise," said Sheheen. "We must make some tough decisions about how we choose the critical issues to deal with and what role we should play. With the quality leadership represented on our commission and with the strength of our supporting friends, we can be effective. We can use our collective knowledge and influence to shape future policies and to foster intergovernmental cooperation."

As its primary goal, the state's ACIR has adopted the development of a state growth policy, a reaffirmation of one of the early objectives identified by the first Commission.

"South Carolina is expected to experience a 35-40% increase in population during the next 15 years," Sheheen noted, "How we cope with this growth—in terms of its demand on our tax system, our construction capabilities, and our service delivery system at both the state and local levels—is all important. Presently, we are not ready to accommodate such growth. The ACIR must anticipate the problems which are ahead of us and develop alternatives which will help us solve them."

ACIR's agenda includes other growth-related issues:

- Develop a local government finance act that will permit alternate sources of revenue for municipal and county governments;
- Evaluate existing home rule legislation and propose recommendations for improvements;
- Analyze the cost of tax incentives provided to industry by state and local governments;
- Identify the number and type of

special purpose districts in the state;

- Determine the extent of local government dependence on state and federal aid, and examine current formulas by which state revenues are shared with local governments;
- Study consolidation of governmental services, as well as examine (1) existing and potential opportunities for city/county contracts for service delivery and (2) the opportunity for contracts between public and private entities for service delivery;
- Continue advocacy for and participation in activities geared to the continuing education process among state and local elected officials.

"We have come a long way," said Ms. Candy Waites, a charter member of South Carolina's ACIR and a member of the Richland County Council. "While there are many limitations and restrictions to our present governmen-

tal system, ACIR has been indispensable in bringing diverse groups together and in promoting better understanding and better working relationships among the many levels and types of government. There is no question that ACIR can measurably improve the ability of our governments to prepare for the future growth and the inherent problems which lie ahead."

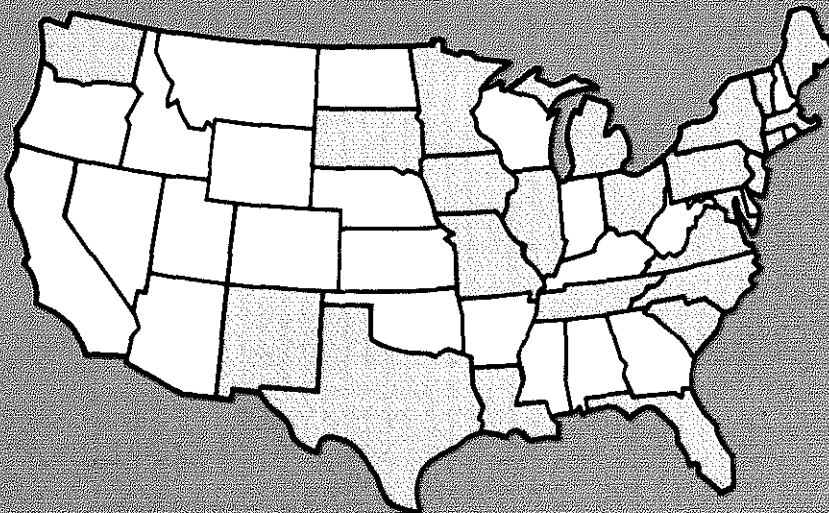
From concept to reality, Governor Riley's idea has blossomed into a full-functioning intergovernmental agency. The Commission is standing on the threshold of new governmental challenges and demands.

"The mission of our ACIR is to give continuing attention to the tensions and problems that arise in our governmental system," stated Chairman Sheheen. "We must help these governments cope with—and prepare for—the inevitable changes that will occur through our state's growth and progress. Many of our forms of government date back two hundred years or more. We must prepare them now for the 1990s and the 21st Century."

State ACIR Counterpart Organizations

Interest in state-level intergovernmental advisory groups continues to grow. Currently, 24 states have an advisory panel, 15 of which are patterned after the national ACIR.

Connecticut	Michigan	Pennsylvania
Florida	Minnesota	South Carolina
Illinois	Missouri	South Dakota
Iowa	New Jersey	Tennessee
Louisiana	New Mexico	Texas
Maine	New York	Vermont
Maryland	North Carolina	Virginia
Massachusetts	Ohio	Washington



Garcia: The Latest Retreat on the “States’ Rights” Front

Paul J. Hartman
and
Thomas R. McCoy

From the 1930s to 1976, constitutional law was relatively clear concerning the relationship between federal legislative power, particularly the commerce power, and retained state legislative powers. According to cases like *N.L.R.B. v. Jones and Laughlin*¹ and *Wickard v. Filburn*,² Congress was authorized by the Commerce Clause to regulate any activity that, taken in the

aggregate, could reasonably be found by Congress to have a substantial effect on interstate commerce. These decisions rejected the attempts in earlier cases to confine federal power under the Commerce Clause with doctrinal constructs such as “interstate” vs. “intrastate”, “flow” of commerce, and “direct” vs. “indirect effects”. The Court’s opinion in *Wickard* neatly summarized the fundamental constitutional theory behind *Wickard* and similar holdings up to 1976 by noting that “effective restraints on its [Congress] exercise must proceed from *political* rather than from *judicial* processes.”³ The essentially unlimited scope of the federal commerce power was demonstrated by the holding in *Wickard* that Congress could constitutionally regulate the raising and consumption of wheat entirely on the farm and the holding in *Katzenbach v. McClung*,⁴ that Congress could apply the public accommodation section of the 1964 *Civil Rights Act* to the racially discriminatory practice of a purely local restaurant.

In spite of the apparent vigor and permanence of this notion of an essentially unlimited commerce power, “states rights” proponents never gave up the fight to find some doctrinal limitations, some judicially constructed limits, on federal legislative power to act contrary to the wishes of one or more state governments. Finally, in Justice William Rehnquist, they found a constitutional theoretician who seemed equal to the task. In 1976, Justice Rehnquist authored the four vote opinion in *National League of Cities v. Usery*⁵ and persuaded Justice Blackmun to concur, though with acknowledged misgivings.

With a single bold stroke in *Usery*, Justice Rehnquist actually did three separable things. First, he announced that the previously ignored Tenth Amendment protected states’ interests by restricting the exercise of federal power in the same way that the first Amendment protects individuals’ interests by restricting federal power. In other words, the federal government could not interfere with certain state activities unless a compelling interest could be shown to justify the interference. Unlike the pre-1930 doctrinal constructs discarded in *Jones & Laughlin*, Justice Rehnquist’s Tenth Amendment theory was not simply a narrowing of the definition of the Commerce Clause. Rather, it appeared to be a limitation that, like the First Amendment, applied to the exercise of any federal power delegated anywhere in the body of the Constitution. Second, Justice Rehnquist defined this new Tenth Amendment restriction as a prohibition against any federal action that impaired “the State’s freedom to structure integral operations in areas of traditional governmental functions.”⁶ Third, Justice Rehnquist found that application of the wage and hour provision of the *Fair Labor Standards Act* to municipal employees violated the Tenth Amendment restriction on federal action. He seemed to assert that increasing the cost to the city of providing a particular service impairs the city’s legis-

lative power to choose among legislative options and structure government operations. Thus, the implication of this application of the Tenth Amendment principle is that any federal action directed at state or municipal governments is barred if it has the effect of increasing the cost of doing business for the regulated government unit.

This third aspect of Justice Rehnquist's analysis in *Usery* was probably the source of Justice Blackmun's misgivings in his concurrence, and was the primary focus of Justice Stevens' vigorous dissent. Not surprisingly, it was this third aspect of *Usery* that the Court first moved away from in subsequent cases. As Justice Stevens accurately predicted in his *Usery* dissent, the Court was not about to hold that it was a violation of the Tenth Amendment for Congress to regulate state employment discrimination, safety standards in state-owned work places, and environmentally damaging state activities such as water and air pollution.⁷ The erosion of this third element of Justice Rehnquist's *Usery* construct was completed with the decision in *E.E.O.C. v. Wyoming*⁸ that held that Congress did not violate the Tenth Amendment when it prohibited the State of Wyoming from retiring its game wardens at age 55 to lower costs and increase efficiency.

What remained of *Usery* after cases like *E.E.O.C. v. Wyoming* was the basic theory of states' rights under the Tenth Amendment and the definition of the scope of those rights in terms of the "freedom to structure integral operations in areas of traditional governmental functions." As one might have predicted, confusion and inconsistency were the order of the day in the many lower federal courts that attempted to distinguish between traditional state government functions and all other state government functions. One lower court concluded that the *Usery* doctrine required a hands-off approach to the operation of a municipal airport; but another lower court found no *Usery* immunity for regulation of air transportation.⁹ Regulation of ambulance services was precluded by *Usery* in one case, but the operation of a mental health facility did not fall within the *Usery* exemption from federal regulation in another case.¹⁰ Licensing automobile drivers was insulated from congressional control by *Usery*.¹¹ However, regulation of traffic on the public roads did not receive *Usery* immunity.¹² Thus, it was incumbent upon the Supreme Court to refine or revise its definition of the protection afforded the states by the Tenth Amendment, if indeed the Court planned to stick by the basic *Usery* notion that the Tenth Amendment provided some such protection.

In *Garcia v. San Antonio Metropolitan Transit Authority*,¹³ the Court solved its *Usery* problems, not by refining the "traditional government function" standard, but by flatly overruling *Usery*. The Court simply rejected the

“ We therefore now reject, as unsound in principle and unworkable in practice, a rule of state immunity from federal regulation that turns on a judicial appraisal of whether a particular governmental function is ‘integral’ or ‘traditional’.” —Justice Blackmun

central *Usery* notion that the Tenth Amendment contained judicially enforceable doctrinal limitations on the exercise of federal power. Justice Blackmun, the fifth vote by separate concurrence in *Usery*, authored the 5-4 majority opinion in *Garcia*, acknowledging that his earlier misgivings in *Usery* had proved to be entirely too well-founded.

At the outset of his *Garcia* opinion, Justice Blackmun proclaimed that an examination of the application of the *Usery* standard over the last eight years persuaded the majority that the attempt to draw the boundaries of state regulatory immunity from congressional action in terms of "traditional governmental functions" is "not only unworkable but inconsistent with established principles of federalism."¹⁴

Justice Blackmun's analysis began with a review of the confusion and inconsistencies in lower court applications of the "traditional government functions" standard. Noting that the distinctions on which the cases purported to turn were "elusive at best," Justice Blackmun suggested that the doctrinal difficulties were closely akin to those encountered by the Court in earlier cases involving state immunity from federal taxation.¹⁵ In those cases, the Court attempted to distinguish between non-taxable governmental functions and taxable proprietary state functions. Justice Blackmun noted that the "governmental" and "proprietary" functions test was so uncertain and unstable that the Court finally concluded that it was untenable and abandoned it.¹⁶ He observed that the distinction discarded by the Court as unworkable in the area of state tax immunity proved no more useful in the field of congressional regulatory immunity under the Commerce Clause.¹⁷

Justice Blackmun also rejected "tradition" as the test for immunity of state action from federal interference. The most obvious defect of an historic approach, Justice Blackmun pointedly observed, is that it prevents a court from accommodating changes in the historic functions of states—changes that have in fact resulted in once-private functions, such as education, being assumed by state and local governments. He concluded that reliance on history as an organizing principle for immunity produces linedrawing of the most arbitrary sort.¹⁸ Finally, Justice Blackmun noted that "traditional governmental functions" could not be equated with "necessary" governmental services for the purposes of defining the scope of state freedom from congressional action. What is "necessary," of course, is so variable that it provides no criterion at all.

According to Justice Blackmun's analysis, the Court has not been able to evolve a definition of what constitutes a "traditional governmental function" for *Usery* purposes because every attempt encountered the same fundamental problem. It is the same problem that explains why the Court was never able to provide a basis for the governmental/proprietary distinction in the intergovernmental tax immunity field. As Justice Blackmun sees it, the problem is that neither the governmental/proprietary distinction, nor any other distinction that undertakes to segregate important governmental functions, can be faithful to the role of federalism in a democratic society.²⁰ He explains that the "essence of our federal system is that within the realm of authority left open to them under the Constitution, the States must be equally free to engage in any activity that their citizens choose for the common weal, no matter how unorthodox or unnecessary anyone else—including the judiciary—deems state involvement to be. Any rule of state immunity that looks to the 'traditional,' 'integral' or 'necessary' nature of governmental functions inevitably invites an unelected judiciary to make decisions about which state policies it favors and which ones it dislikes."²¹

Because "The science of government . . . is the science of experiment,"²² the *Garcia* majority rejected "as unsound in principle and unworkable in practice, a rule of state immu-

“ In short, we have no license to employ freestanding conceptions of state sovereignty when measuring congressional authority under the Commerce Clause. ” —Justice Blackmun

nity from federal regulation that turns on a judicial appraisal of whether a particular governmental function is 'integral' or 'traditional.'"²³

Justice Blackmun's conclusion that the "traditional government function" standard was unsound did not lead him to attempt a revision of the standard, however. That conclusion proved to be simply a preliminary step on the road to the fundamental holding in *Garcia* that no restriction of that sort, or any similar sort, should be found in the Tenth Amendment or anywhere else in the Constitution. In flatly rejecting the fundamental premise of the *Usery* holding, Justice Blackmun stated that "State sovereign interests . . . are more properly protected by procedural safeguards inherent in the structure of the federal system than by judicially created limitations on federal power."²⁴ Neatly summing up this aspect of its opinion the majority concludes: "we have no license to employ freestanding conceptions of state sovereignty when measuring congressional authority under the Commerce Clause."²⁵ In short, the Court in *Garcia* returned to its pre-*Usery* conviction that effective restraints on the Commerce Clause power of Congress must proceed from political rather than from judicial processes.

In the majority's view, the principal and basic limit on the commerce power of Congress is the built-in restraint that the federal system provides through state participation in the federal political process. This political process ensures that laws that unreasonably burden or hamper the States will not be promulgated.²⁶ The political or "procedural" safeguards include state control of the selection process in both the executive and legislative branches of the federal government and the direct representation of the States in the Senate, where each State receives equal representation.²⁷ The *Garcia* majority found support for this procedural view of the states' constitutional status in statements by Madison and other framers of the Constitution to the effect that "special restraints on federal power over the States inhere principally in the workings of the National Government itself, rather than in discrete limitations on the objects of federal authority."²⁸

In vigorous *Garcia* dissents, Justices Powell and O'Connor deprecated the basic position of the *Garcia* majority that the Court is not necessary to protect the states against Congress. Justice O'Connor characterized the majority's position in the bluntest terms as a "holding that the States as States retain no status apart from that which Congress chooses to let them retain."²⁹ Her pessimistic view of the likely results of this doctrinal position is clearly implied by her comment that "all that stands between the remaining essentials of state sovereignty and Congress is the latter's underdeveloped capacity for self-restraint."³⁰

In view of Justice O'Connor's somewhat uncharitable—but nonetheless largely accurate—characterization of the majority's doctrinal stance, three observations seem to be called for. First, leaving the process of balancing state interests and federal interests to the political processes that comprise the federal government isn't such a bad idea. Justice Powell in

his dissent asserts that leaving protection of the states' interests to the political process makes no more sense than leaving the individual rights guaranteed by the Bill of Rights to be protected by the political process alone.³¹ But on this point, Justice Powell is surely wrong. The issue in *Garcia* is simply the allocation of government power between two governmental units, not the protection of the *individual* from the tyranny of the majority. Unlike the status of an individual, there is nothing sacrosanct about the status of a particular unit of government. Natural law philosophy accords no such status to any particular unit or subdivision of government. Since all units of government are derivative of the body politic, it seems appropriate that adjustments in the allocation of powers between units should be more readily subject to the will of the political majority than should adjustments to the relationship between the individual and the government.³² The recognition by the national electorate that most social and economic issues are now of national concern, and that relatively few matters remain of purely local concern, should not raise serious constitutional problems.

The second observation worth making is that the majority in *Garcia* seems to be on sound ground when they assert that the states are quite capable of protecting their own legitimate interests through the federal political process. The majority noted with some satisfaction that the regulatory interference with state mass transit systems that was challenged in *Garcia* was accompanied by "substantial countervailing financial assistance" from Congress that may have left state systems "better off than they would have been had Congress never intervened at all in the area."³³ This broader measure of Congress' responsiveness to state interests reinforced the majority's "conviction that the national political process systematically protects States from the risk of having their functions . . . handicapped by Commerce Clause regulations."³⁴ Similar reinforcement could be drawn from a study of the disposition of any number of legislative proposals put before Congress in recent years. For example, state pressure brought to a grinding halt pending congressional action stemming from the 1964 recommendations of the Willis Committee, where the proposed legislation would have limited the power of the states to impose various taxes.³⁵ Since that date, there has been a flow of congressional bills into the hopper designed to establish comparable federal restrictions on state taxation of interstate commerce, but no new legislation has been passed.³⁶

The third important observation called for by the decision in *Garcia* is that in spite of the majority's declarations to the contrary, the decision in *Garcia* does not entirely remove the Supreme Court and the rest of the federal judiciary from the process of adjusting the relationship between state interests and congressional power. As a practical matter, the meaning of any congressional regulation, and thus the extent to which that regulation will be read to interfere with state interests, is a matter of statutory interpretation for the federal judiciary and ultimately the Supreme Court. Where Congress has left any uncertainty about its intentions on the matter, the Court's view of appropriate federal-state relationships will control the decision on whether the regulation should be read to apply to the states or to preempt state actions in the

“ The political process ensures that laws that unduly burden the States will not be promulgated. ” —Justice Blackmun

“ . . . State sovereign interests, then, are more properly protected by procedural safeguards inherent in the structure of the federal system than by judicially created limitations on federal power.” —Justice Blackmun

area. A good illustration of the Court's solicitude for state interests in the construction of congressional enactments can be found in two decisions from this year's Supreme Court docket involving the applicability of federal antitrust laws. In one case, the Court held as a matter of statutory construction that the federal prohibition was not intended to apply to the monopolistic practices of a municipality in the sale of services.³⁷ In the second case, the Court held as a matter of statutory interpretation that the *Sherman Act* was not applicable even to the anticompetitive practices of a private association of trucking companies, as long as those practices were pursued with the approval of and under the supervision of the State.³⁸ In reaching both holdings, the Court relied on a "state action exception" that had previously been grafted onto the antitrust laws by the Court based on its notions of federalism.³⁹

Thus, the Court in *Garcia* only ceded to Congress the ultimate power to adjust federal-state relationships where Congress speaks absolutely unambiguously. One should not underestimate the continuing influence on a day-to-day basis of the Court's own notions of the appropriate balance between state and federal spheres of influence.

FOOTNOTES

¹301 U.S. 1 (1937).

²317 U.S. 111 (1942).

³317 U.S. at 120 (emphasis added). Surprisingly, Justice Powell dissenting in *Garcia v. San Antonio Metro Transit Authority* seemed oblivious to this widely quoted statement from *Wickard*. His dissent in *Garcia* asserted that the majority's view was without "so much as a dictum of any court in support of the view that the role of the States in the federal system may depend upon the grace of elected federal officials, rather than on the Constitution as interpreted by this Court." 105 S. Ct. 1005, 1023 (1985).

⁴379 U.S. 294 (1964).

⁵426 U.S. 833 (1976).

⁶*Id.* at 852.

⁷*Id.* at 880-81.

⁸460 U.S. 226 (1983).

⁹*Garcia v. San Antonio Metro Transit Authority*, 105 S. Ct. 1005, 1011 (1985).

¹⁰*Id.*

¹¹*Id.*

¹²*Id.*

¹³105 S. Ct. 1005 (1985).

¹⁴*Id.* at 1007.

¹⁵*Id.* at 1012.

¹⁶*Id.* at 1013.

¹⁷*Id.* at 1014.

¹⁸*Id.*

¹⁹*Id.* at 1015.

²⁰*Id.*

²¹*Id.*

²²*Id.*, quoting from *Anderson v. Dunn*, 6 Wheat. 204, 226 (1821).

²³105 S. Ct. at 1016.

²⁴*Id.* at 1018.

²⁵*Id.* at 1017.

²⁶*Id.* at 1020.

²⁷*Id.* at 1018.

²⁸*Id.*

²⁹*Id.* at 1037.

³⁰*Id.*

³¹*Id.* at 1025, n. 8.

³²In what has proved to be something of a landmark article on the subject of federalism, Professor Wechsler made this same point as follows:

The judicial function in relation to federalism thus differs markedly from that performed in the application of those constitutional restraints on Congress or the states that are designed to safeguard individuals. In this latter area of the constitutional protection of the individual against the government, both federal and state, subordination of the Court to Congress would defeat the purpose of judicial mediation. For this is where the political processes cannot be relied upon to introduce their own corrective—except to the limited extent that individuals or small minorities may find a champion in some important faction. Wechsler, "The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government," 54 *Colum. L. Rev.* 543 at 560, N. 59 (1954).

³³105 S. Ct. at 1020.

³⁴*Id.*

³⁵See Hearings before the Special Subcommittee on State Taxation of Interstate Commerce (Willis Committee), House Committee on the Judiciary (89th Cong. 2d Sess. on H. R. 11798) (Interstate Taxation Act 1966).

³⁶In response to the critical congressional study of state and local tax structure and its administration, the states combined to cure many of the evils in state and local taxation. This was done by the adoption of two statutes: (1) The Uniform Division of Income for Tax Purposes Act (UDITPA). (See 7 A Uniform Laws Ann. 91, Master Edition 1978, for list of States adopting the Uniform Act), (2) The Multistate Tax Compact (See 1 State & Local Taxes, All States Unit (P-H) paragraph 6310 et. seq. for the text of the Compact). It seems clear that the states do possess the power to act effectively in pursuit of their interests.

³⁷*Town of Hallie v. City of Eau Claire*, 53 L.W. 4135 (1985).

³⁸*Southern Motor Carriers Rate Conference, Inc. v. U.S.*, 53 L.W. 4422 (1985).

³⁹*Parker v. Brown*, 317 U.S. 341 (1943).

Paul J. Hartman is Professor of Law, Emeritus, and Thomas R. McCoy is Professor of Law, at Vanderbilt University.

Garcia: Federalism's Principles Forgotten

A.E. Dick Howard

Two centuries ago, the framers who met at Philadelphia labored to produce a Constitution crafted to the needs of a free people living in a republic of extended territory. Drawing on the lessons of history, they sought to give the central government sufficient authority to deal with such national concerns as commerce among the states, while dispersing power in such a way as to protect individual liberty and local self-government—two of the ends for which the war of independence had been waged.

A linchpin of that constitutional order is federalism. One has but to read the text of the Constitution—which refers to the states at least fifty times—to realize how central the concept of federalism was to the founders' thinking. Indeed, it was a concern about the potential power of the new federal government that led to the adoption of the Bill of Rights.

In the nineteenth century, that perceptive French traveler, de Tocqueville, lavished praise on American federalism in his *Democracy in America*. On the link between self-government and liberty, he commented, "A nation may establish a free government, but without municipal institutions it cannot have the spirit of liberty."

As Americans prepare to celebrate the Constitution's bicentennial, the Supreme Court appears to have forgotten both the framers' intent and the teachings of the nation's history. In February, the Court decided *Garcia v. San Antonio Metropolitan Transit Authority*. Five justices joined in a majority opinion concluding, in effect, that if the states "as states" want protection within the constitutional system they must look to Congress, not to the courts. The "principal means," Justice Blackmun wrote, by which the role of the states in the federal system is to be ensured "lies in the structure of the Federal Government itself."

The states and localities, to be sure, will survive the impact of *Garcia's* immediate holding, which involves the application of the *Fair Labor Standards Act* to a municipally-owned mass transit system. The holding is bound to be both burdensome and expensive, but most local governments will find ways to adjust, as they have done to other fiscal and legal vicissitudes. But far more than labor laws and bus drivers' pay is at stake in *Garcia*.

Garcia raises fundamental questions about the role of the Supreme Court as the balance wheel of the federal system. *Garcia* abdicates a function which history, principle, and an understanding of the political process argue strongly that the federal judiciary should undertake. For those who care about the health of American constitutionalism—including, but not limited to, federalism—*Garcia* should be an unsettling decision.

Although the ultimate reach of *Garcia* is unclear, the decision adopts a variation on a theme asking the Court to hold its hand when a litigant claims that a federal action is beyond the authority of the federal government in that the action encroaches upon some protected right of the states. Final resolution of such claims, this thesis runs, should be left to the political branches of the government.

Such a position reads an important part of the founders' assumptions out of the constitutional order. One may debate—though the point has long since been academic—whether the founders intended the Supreme Court to have the power of judicial review. But assuming the legitimacy of that doctrine, it is hard to escape the conclusion that the founders assumed that limiting national power in order to protect the states would be as much a part of the judicial function as any other issue.

James Madison, in *Federalist No. 39*, was explicit: there must be a tribunal empowered to decide "controversies relating to the boundaries between the two jurisdictions." The nature of the ratification contest—especially the Federalists'

“ Despite some genuflecting in Court's opinion to the concept of federalism, today's decision effectively reduces the Tenth Amendment to meaningless rhetoric when Congress acts pursuant to the Commerce Clause. ” —Justice Powell

need to reply to anti-Federalist charges—supports the conclusion that the proponents of the Constitution saw the necessity that federalism be among the institutional arrangements to be protected in the constitutional system.

The principle of the rule of law adds force to what this history teaches. A basic tenet of Anglo-American constitutionalism is that no branch of government should be the ultimate judge of its own powers. The principle that one cannot be a judge in one's own cause is of centuries' standing.

“ The States' role in our system of government is a matter of constitutional law, not of legislative grace. ” —Justice Powell

This principle is stated by Sir Edward Coke in *Dr. Bonham's Case* (1610) and, in our own time, has been reinforced by *United States v. Nixon* (1974). The principle is especially important in a system which, in addition to being federal, looks to checks and balances and the separation of powers to restrain arbitrary government.

A further flaw in *Garcia* is its resting upon erroneous suppositions about the ways in which the nation's political process actually works. Essential to any argument that the Court should abstain from adjudicating limits on national power *vis-à-vis* the states, is the notion that the states have ample protection in the processes of politics.

This assumption has two dimensions. One is institutional—that the states have a major part in structuring the national government. The other is political—that the ways in which the process actually works (such as in the political parties and in Congress) focus on the states. In fact, neither branch of the argument reflects current realities.

There was a time when the states had considerable influence over the shape of federal politics. Under the original Constitution, U.S. senators were elected by the legislatures of their respective states. The Constitution did not set federal standards for congressional elections; the states controlled the franchise. And it was up to the state legislatures as to how to draw the boundaries of congressional districts.

All this has changed. The Seventeenth Amendment (adopted in 1913) brought direct election of senators. Judicial decisions (such as that striking down the poll tax) and acts of Congress (notably the *Voting Rights Act of 1965*) have federalized much of the law respecting the franchise. The 1965 statute, for example, requires preclearance (by the Attorney General or the District Court for the District of Columbia) of voting changes in areas covered by the *Act*. State power to apportion congressional seats has been circumscribed by decisions such as the Supreme Court's 1964 opinion in *Wesberry v. Sanders*, requiring that congressional districts be based on population.

Accompanying these significant shifts in institutional arrangements has been a palpable decline in the “political” safeguards. Political parties, especially at the state level, no longer are the force they once were. Increased use of primaries and the impact of “reforms” have had the unintended consequence of encouraging the development of alternative institutions. Most striking has been the rise of PACs (political action committees), which now number in the thousands.

The “nationalization” of campaign finance has led to the weakening of the federal lawmakers' loyalties to constit-

uents. Special interest politics have tended to replace consensus politics. Moreover, the explosive growth of the federal government in modern times has brought the emergence of the “iron triangle”—the convergence of bureaucrats, interested legislators (often powerful committee chairmen), and lobbyists to determine the shape of federal programs.

In defense of having the Court abdicate Tenth Amendment questions, as it did in *Garcia*, one sometimes hears the argument that the Court cannot resolve empirical questions. Thus, it is argued, assessing the facts of a given case so as to “balance” competing state and federal interests requires the Court to undertake a mode of inquiry that more properly belongs to legislators. Yet in other areas of constitutional litigation the Court resolves empirical questions as a matter of course. Every case involving claims that a state act burdens commerce requires the resolution of economic and other such data, but the Court does not shirk this task.

Another objection to the Court's having a role in Tenth Amendment cases is that the justices cannot draw workable distinctions, such as deciding (as precedents before *Garcia* had sought to do) what is and what is not a “traditional governmental function” (and hence entitled at least to some presumptive measure of protection against federal intrusion). Such line-drawing is, of course, difficult. But its being difficult does not mean that it should not be undertaken, any more than the conceptual difficulties of deciding what constitutes “speech” or “religion”—the thorniest of problems—are grounds for not deciding First Amendment cases.

Whatever the tangles confronting the Court, there are even graver reasons to question Congress' competence or willingness to make considered judgments on constitutional

“ In my view, federalism cannot be reduced to the weak 'essence' distilled by the majority today. ” —Justice O'Connor

questions—especially when the question is that of the limits of Congress' own power. The judicial process may have its flaws, but it aspires to a degree of rationality, including analytical reasoning, that one does not associate with the legislative process. The limits of time, the pressures of lobbyists, the temptations of expediency, undue reliance on staff, and other distractions often have more to do with the final shape of legislation than any thinking about constitutional issues. Martin Shapiro makes the point well: “The nature of the legislative process, combined with the nature of constitutional issues, makes it virtually impossible for Congress to make independent, unified, or responsible judgments on the constitutionality of its own statutes.”

Still another argument for the Court's leaving the states and localities to the tender mercies of Congress is that the Court needs to husband its scarce political capital. This argument raises the spectre of a return to “dual federalism”—the *ancien regime*, before 1937, when the Supreme Court often derailed federal social and economic legislation in the name of states' rights.

Such a risk is chimerical. For the court to play a role in protecting the states as states under the Tenth Amendment, as the majority set out to do in the Court's 1976 decision in *National League of Cities v. Usery* (overruled in *Garcia*),

“ The Court today surveys the battle scene of federalism and sounds a retreat. . . . I would prefer to hold the field and, at the very least, render a little aid to the wounded. ” —Justice O'Connor

raises no question about Congress' power over the *private* sector.

As to keeping the Court out of unnecessary controversies, most of the debate over “judicial activism” in recent decades has involved such issues as school prayer, criminal justice, and abortion. Federalism cases may provoke academic debate—and, of course, matter enormously to state and local officials—but they stir little outrage in the country at large. It is individual rights decisions that, by and large, stir passions. One doubts that the partisans of *Garcia* would be content to see individual rights matters, because they may be controversial, left likewise to the political process.

Garcia betrays a glaring disregard of a basic truth about American constitutionalism: that institutional rights, under our Constitution, are a form of individual rights. Even such basic guarantees as those in the Bill of Rights and the Fourteenth Amendment do not secure absolute personal rights. The protection created is against governmental (that is, institutional) actions, not against infringements by private parties. Thus, for individual rights to be secured requires assurances as to the stability of the institutional safeguards explicit or implicit in the Constitution.

The individual American—as the heir to those who brought the Constitution into being and agreed to its adoption—has a fundamental entitlement to living under the form of government spelled out in the Constitution. The separation of powers is not to be abandoned simply because it may be inconvenient. Likewise, one of the predicates of the constitutional order is that the Supreme Court adhere to the values of federalism as manifestly implicit in the Constitution.

Federalism may be an elusive idea, but it is no mere abstraction. And, while it was essential to the adoption of the original Constitution, it is more than simply a political compromise adopted to get the Constitution underway. Federalism is linked with individual liberty and with the health of the body politic.

It is through participating in government at the local level that the citizen is educated in the value of civic participation. A robust federalism encourages state and local governments as schools for citizenship. Moreover, federalism both reflects and encourages pluralism, allowing individual idiosyncracies to flourish. One often hears Justice Brandeis quoted on the states' serving as “laboratories” for social and economic experiments. The states are more than mere laboratories; to the extent they encourage pluralism, the states are handmaidens of the open society.

Ultimately, the case for federalism rests on a concern to preserve the right of choice—the essence of political freedom. States and local governments have, of course, often trampled this very right, for example, when they have denied the vote because of one's race. The remedies for such abuses lie in vigorous judicial enforcement of constitutional guarantees and in Congress' power to protect civil rights. But the need to guard against trespasses by states or localities on individual liberties does not undermine the conclusion that federalism as such can operate as part of the very matrix of protection for individual liberties.

In refusing to enforce the Tenth Amendment—to play the role they regularly undertake in respect to other provisions of the Bill of Rights—the *Garcia* majority leaves an important constitutional sentry post unmanned. What recourse do those who care about the health of federalism have?

There are other opportunities for courts to vindicate the underlying values. Federal statutes may be interpreted in light of their impact on state and local governments. For example, the Court's 1981 *Pennhurst* decision lays down the salutary rule that federal grant conditions, to be binding on state and local governments, must be clearly identified as such when grant funds are accepted. Notions of comity can come into play when reviewing lower courts' use of their equity powers to reform state institutions (such as prisons) or when deciding how far a federal court may go in intervening in state court proceedings (as in the Court's 1971 decision in *Younger v. Harris*).

Ultimately, one may hope for the undermining or demise of *Garcia*. The majority decision stops short of saying that under no circumstances could the constitutional structure impose affirmative limits on federal actions affecting the states. A more favorable fact situation than that in *Garcia*, one entailing a more serious intrusion on the states and a more marginal federal interest, might furnish the occasion to begin the movement away from that unfortunate decision.

Early and outright reversal of *Garcia* should not lightly be predicted, even assuming new justices are appointed to the Court. Reversals typically come only after a precedent has been robbed of vitality. The Court decided *Gideon v. Wainwright* (1963), requiring states to appoint counsel for felony defendants unable to afford a lawyer, only after 20 years of experience under *Betts v. Brady* proved that an *ad hoc* approach would not do. Likewise, it was easier for Justice Blackmun to rationalize the result in *Garcia* by pointing to the Court's difficulties in post-*National League of Cities* decisions such as *EEOC v. Wyoming* and *FERC v. Mississippi*.

Still, one can hope that eventually a majority of the justices will come to realize the mistake made in *Garcia*. Because federalism is an intrinsic component of the constitutional system—indeed, bolsters other constitutional values—safeguarding that process cannot be left to the unrestrained discretion of the political branches. It may be that the authority pronounced in *National League of Cities* (and renounced in *Garcia*) ought to be sparingly used. But it is salutary that the political branches know that the Court has power to step in when the facts point to intervention.

It is no less legitimate and proper for the Supreme Court to concern itself with assuring the health of federalism as it is for the Court to uphold individual liberties as such. In neither case is abdication of the Court's proper role consistent with the principles inhering in the Constitution.

A. E. Dick Howard is White Burkett Miller Professor of Law and Public Affairs at the University of Virginia School of Law.

Investments and Judgments Can Pose Threats to Local Financial Health

Susannah E. Calkins
and
Philip M. Dearborn

In the past decade, sporadic headlines about municipal budget and debt crises have fostered a public perception that many jurisdictions may be teetering on the edge of bankruptcy, and that default on principal and interest of municipal debt is not rare. However, a recent ACIR study, *Bankruptcies, Defaults, and Other Local Government Financial Emergencies*,¹ shows that the probability of a local

government defaulting on its general obligation, long-term debt has been virtually zero over the last 40 years. In fact, over the most recent ten years, only one government defaulted on its long-term debt, and the total amount involved was only \$110,000.

This outstanding credit record results from two basic features in the financial structure of most local governments. First, governments are service-oriented; payroll costs for teachers, police and other service providers generally average one-half to three-quarters of their expenditures. Capital costs, as reflected in principal and interest payments on long-term debt, usually average only five to ten percent of total spending. Thus, the cost of meeting debt service is not a large component of local budgets, and in the event of a financial crunch there is considerable room for spending retrenchment in the relatively large portion of the budget going for non-debt expenditures.

Second, at the time budgets are adopted, estimates of the anticipated revenues are usually quite firm. Virtually all local governments still rely on property taxes as a major revenue source. The exact amount of property taxes to be levied is usually known before the budget is approved, and the amount actually received seldom varies as much as one percent from the estimate. Estimates of revenues from other taxes and sources, although less certain, generally do not vary enough to alter total revenues by more than a few percent. Here again, governments have sufficient flexibility to offset a small underrealization of revenues without affecting debt service payments.

Thus, the typical local government spends only a small portion of its budget on debt service, and has revenues which are substantially assured before spending is authorized. Under these circumstances, only totally inept fiscal management by government officials could result in default on long-term debt.

It is important to note that while both New York and Cleveland defaulted on short-term debt because of the large cash payment demands such debt causes, neither city had any trouble paying the relatively small amounts of their budgets required for long-term debt service. In both instances, the governments retrenched in other parts of their budgets, and made their long-term debt service payments on time.

If the normal situation in local government finances is such as to virtually preclude general obligation bond defaults, what unusual conditions could trigger such an event? The 1985 ACIR report specifically listed two developments occurring since the Commission's initial report in 1973 which indicate potential sources of future financial emergencies.

First, lawsuits or other legal actions, such as arbitration awards, can cause sudden unplanned massive revenue losses or expenditure demands. The most likely situation, and one that seems to be occurring with greater frequency is large liability judgments against small governments.

Second, failure to protect a government's liquid assets, either from bad investments or investments which cannot be liquidated without large losses, can cause severe financial distress. In the few months since the completion of the ACIR report, there have been significant developments relating to both losses on municipal judgments and investments. These developments have stimulated public interest and press comment.

Judgments and Arbitration Awards

The ACIR examination of cases in which a local government experienced a financial emergency, default or actual bankruptcy indicated that in several cases the problems were directly caused by judgments, and were significant enough to cause the government to file for bankruptcy. Any sudden, unplanned large expenditure demand creates problems for any local government; it is particularly serious for a small government or one in already weak financial condition.

Growing attention has been directed toward the impact of judgments on the financial health of local governments because of developments which increase the exposure of municipalities to suits and judgments. As local services expand, municipalities are more likely to be engaged in providing the types of local services which may trigger tort suits: in addition to the provision of traditional services such as jails, fire protection, and schools, local governments now provide day care, street festivals, health care, and various types of transportation. In addition, there have been substantial increases due to court decisions in the 1970s broadening municipal antitrust, civil rights, and personal injury liability.

The size of settlements for many types of cases has been increasing. Municipalities are known to have "deep pockets" and are particularly attractive targets. A recent study pointed out that in New York, municipalities have been exposed to large judgments by the doctrine of joint and several liability, that states that "if the tortious conduct of each of two or more persons is a legal cause of a single and indivisible harm all such parties are liable to the injured party for the entire harm. Therefore, it is possible for a municipality to be only 1% liable for a tortious act, but 100% liable for the judgment."²

While settlements in civil rights cases have not generally resulted in severe financial stress for governments, some have been costly. Bridgeport, CN., settled a discrimination suit first filed in 1975 by issuing \$6 million in bonds. In many cases, the fact that plaintiffs who win are entitled to recover the cost of their attorneys' fees results in total costs for the municipal defendant which far exceed the damages awarded.

Although it is difficult to find definitive figures on costs to municipal governments, there is evidence in press reports that local governments are rapidly becoming aware of the serious nature of the problem. A recent news story quotes specialists on municipal law as estimating that the cost to taxpayers for settling claims has tripled over the past five years.³ The recent New York State Assembly Local Governments Committee study undertook to quantify the size of the problem and reported that in 1983, judgments and claims paid by New York municipalities, other than New York City, amounted to \$10.5 million, and New York City alone paid \$78 million.⁴ The Corporation Counsel of the District of Columbia, in requesting a \$1 million appropriation increase for the current fiscal year, commented that "the whole problem of lawsuits against the city is burgeoning. Cities nationwide are experiencing a veritable explosion in municipal liability."

The increase in municipal exposure to judgments has resulted in a sharp increase in the cost of liability insurance for those governments who do not assume the risk of self-insurance. Many local governments face increases of more than 100% in insurance costs. In New York State, the largest municipal insurer—that has written \$10 million in municipal insurance policies for 229 governments—announced that it was leaving the municipal insurance field because it had paid off \$2.00 for every \$1.00 of insurance written.

Increases in insurance costs are sharpest for smaller jurisdictions. The New York study found that the average increase for 16 governments surveyed was 150% between 1984 and 1985. A wholesale insurance broker was quoted as commenting that: "Overall increases appear to be approximately 100%. However, smaller entities are experiencing much higher increases, especially for their general liability coverage. A town that paid \$3,000 last year may have a renewal premium of over \$10,000 for the general liability alone. Larger public entities may experience smaller increases in proportion." Ironically, it is the smaller jurisdictions which can least afford to skimp on insurance coverage, since a single large judgment can often threaten its financial health.

The ACIR report suggested several possible courses of action to alleviate this serious problem. State governments may need to consider alternatives which eliminate or mitigate the exposure of local governments. An obvious alternative, for those states which have not already done so, would be to limit the size of judgments permitted against local governments. However, if the permissible amount of the judgment is scaled to the size of the government to protect smaller units, it hardly seems fair to determine how much a plaintiff is awarded on the basis of government size. If the cap is not scaled, it might have to be unreasonably low to protect small units. A better alternative may be to require all local governments to carry insurance or to establish a state insurance pool for local governments, especially for the smaller units.

Investment Losses⁵

Financial stress can also be caused by poor cash management practices. As interest rates rose during the early 1980s, municipalities were under pressure to maximize their revenues by investing their unused cash at the prevailing high interest rates. Money management firms launched aggressive campaigns designed to attract surplus funds to securities offering rates of interest above those on traditional investments. A financial device that became quite popular was the repurchase agreement, in which a municipality would purchase a U.S. government security with an agreement that it would be sold back to the seller at a specified time for an amount that included a specified amount of interest. In effect, the municipality was loaning money for a specified time period, with the government security as collateral.

Aware of problems which could develop because of uncertainty over the status of the collateral (the government securities) in the case of a bankruptcy by the security dealer, some states attempted to protect their municipalities from potential problems by regulating the practice of investing in repurchase agreements. Florida, for example, required all government securities dealers to sign documents defining a repurchase as a sale and purchase, not a loan. Michigan channeled all such investments through the state. In other cases, the collateral was held by the security dealer in trust for the municipality, or was held by a third party.

In 1982, there were two failures of government securities firms dealing in repurchase agreements: Drysdale and Lombard-Wall. Creditors of Lombard-Wall, including local governments, had about \$1.1 billion at stake, but in a very rare recovery of a securities firm from a Chapter 11 bank-

ruptcy filing, Lombard-Wall eventually paid off all its investors. Investors lost the use of their money for a long period, but only the investment income they would have received during the time assets were frozen was an actual monetary loss. Among Lombard-Wall's major creditors was the New York State Dormitory Authority that lost about \$17 million in potential investment income.

In May 1984, two more firms—Lion Capital and RTD Securities—filed under Chapter 11. Thirty municipalities had approximately \$40 million invested in repurchase agreements with Lion. Among the investors were 24 New York state school districts which had been induced to invest their cash reserves in Lion by an aggressive marketing campaign. This campaign included obtaining an opinion letter from the Office of the State Comptroller that approved the use of the firm for investments. New York school districts are particularly interested in investing unused cash because they receive as much as 80% of their budgets from state tax collections in a two-month period in the fall. Among the municipalities involved in the Lion collapse were several with amounts over \$1 million in unsecured claims: Saratoga County (NY) with \$3.05 million; the Pioneer Yorkshire School District (NY) with \$2.16 million; the East Meadow Unified Free School District (NY) with \$1.74 million; and the Morgan (CA) Redevelopment Agency with \$1.7 million. Other creditors included Kodiak Island Borough (AS), at \$1.3 million, and the San Jose (CA) Redevelopment Agency at \$1.26 million.

In addition, many investors (including 36 New York school districts) managed to withdraw \$60 million in investments from the firm up to 90 days before its collapse. The federally-appointed trustee is expected to sue these investors for return of the money in order to create a larger pot of cash to distribute among various creditors.

Lion was subsequently indicted for grand larceny and conspiracy by a New York grand jury for securities fraud—basically for using one set of collateral for two sets of loans—and two Lion officers pleaded guilty to grand larceny. Efforts to reach a settlement between the Bradford Trust Company and 34 municipalities involved in the Lion bankruptcy were complicated by a dispute involving the collateral held by Bradford Trust. The municipal governments maintain that the securities were collateral for repurchase agreements made with Lion, while Bradford asserts that the securities were collateral for loans it made to Lion. The guilty plea of the two Lion officers may establish the fact that Lion was operating fraudulently and facilitate a settlement between Bradford and the municipalities.

Less than a year later, in March 1985, E.S.M. Government Securities collapsed. Most of the losses were sustained by savings and loan associations, and the event triggered the Ohio bank crisis. However, up to 16 municipalities stood to lose more than \$105 million. Once again, most believed that their repurchase agreements were "fully collateralized" by securities held by Bradford Trust. However, Bradford said all the securities it held were collateral for a loan from Bradford to E.S.M. and that Bradford held no E.S.M. customer accounts. Among the municipalities involved are Beaumont (TX) that could lose \$20 million, or 65% of its total cash; Toledo (OH) with \$21 million at stake; Clallam County (WA) at \$10 million; and Clark County (NV) at \$14 million. Cities such as Tulsa (OK), that wisely had held the collateral on their investments, were forced to sell the collateral to regain their principal and forfeit the interest.

The failure of E.S.M. was rapidly followed by the collapse of Bevell, Bresler, and Schulman in April 1985, as nervous investors rushed to claim their collateral. Court records revealed that about \$140 million was at stake. The only municipality known to be involved was Washington, DC. Since Washington was able to liquidate the collateral securing its repurchase agreement, it did not sustain a loss.

Summary

The 1985 ACIR report pointed out that two developments occurring since the 1973 report on financial emergencies—investment losses and expenditure demands caused by judgments—are potential causes of financial emergencies for cities. Wise management and investment of idle funds are within the control of the local government; prudent choice of investments for both the avoidance of risk and appropriate timing have always been important for local financial management.

Protection against financial crises caused by the impact of large court or arbitration judgments is considerably more difficult, particularly for smaller governments, in view of the unpredictability of such occurrences and because of the recent increases in municipal insurance costs. States and localities need to explore new ways of protecting themselves against sudden unplanned large expenditure demands caused by these judgments.

FOOTNOTES

¹U.S. Advisory Commission on Intergovernmental Relations, A-99, Washington, D.C., March 1985.

²New York State Assembly, Committee on Local Governments, "Deep Pockets", A Study of Municipal Tort Liability, May 15, 1985.

³"Lawsuits' Surge Strains Budgets of Many Cities," *New York Times*, May 12, 1985, p. 1.

⁴New York State Assembly, *op. cit.*

⁵Information in this section is based on reports in **Credit Markets**.

Susannah E. Calkins is an ACIR Senior Analyst. Philip M. Dearborn, a consultant to the Commission, directed the ACIR study of local bankruptcies, defaults and other financial emergencies.

The Flow of Federal Funds

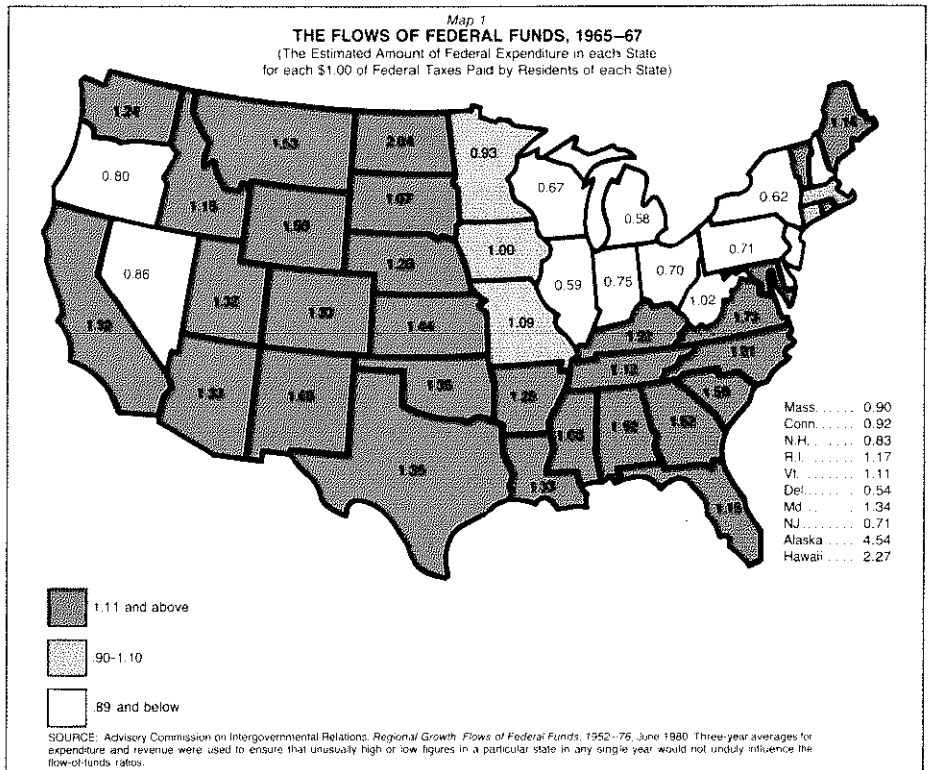
Michael Lawson
Analyst

From time to time, ACIR has attempted to estimate how the flow of federal funds to the 50 states compares to the tax revenues sent to Washington from each of the states. The three maps (1967, 1976 and 1984) show all federal expenditures (procurement contracts, Social Security payments, grants-in-aid, federal payroll, etc.) in each state as a ratio of revenues received. For example, an estimated ratio of 1.50 would indicate that for every tax dollar a state's residents sent to Washington, the federal government spent \$1.50 in that state. Conversely, an estimated ratio below 1.00 would indicate federal expenditures in a state were less than the revenues sent to Washington by residents of that state—e.g., a ratio of .75 would translate into 75¢ in spending for every dollar Washington received.

Over the nine year period 1967-76, there has been a marked convergence of these ratios. Standard deviations among states have narrowed considerably, typically with ratios rising in the Northeast/Midwest and declining in the South/West. However, since 1976 this convergence seems to have abated.

While these fluctuations reveal interesting demographic, economic and policy trends—and that certain state economies are highly dependent on federal government activities—they should not necessarily be considered good or bad in and of themselves. Rather, they are, for the most part, the result of governmental decisions made outside the confines of intergovernmental relations.

On the revenue side, the major factor affecting tax flows to Washington is the federal income tax. As long as there are states with higher per capita incomes than others, these jurisdictions will make greater tax payments than those states with relatively low incomes. Furthermore, the progressivity of the federal income tax accentuates interstate variations in tax payments. This is a direct result of the federal government's past and present efforts to levy taxes based on an "ability to pay". Indeed, the convergence during the 1967 to 1976 period primarily was due to rising personal in-



	1982-84	1974-76	1965-67
Std. Deviation, All states*	0.23	0.24	0.60
Std. Deviation, EXCLUDING Alaska and Hawaii*	0.23	0.21	0.33

*Generally speaking, a relatively high standard deviation figure indicates a relatively large disparity in the flow-of-funds ratios; conversely, a low standard deviation indicates a smaller disparity among the states.

come in poorer regions of the country.

The expenditure component in the equation accounts for nearly all government spending, a significant proportion of which has no direct intergovernmental impact. Social Security payments, for example, would be more heavily-concentrated in states with large retirement communities (e.g., Florida, Arizona, California). Military procurement would occur in states where highly-specialized defense contractors are located. Payroll expenditures are concentrated in the Virginia and Maryland suburbs of Washington, DC, and states which have federal regional offices or other installations. And military bases are—

for the most part—located for strategic purposes, or in the case of naval bases, in states which have major ports.

Nevertheless, it is interesting to apply these circumstances to the five states with the highest ratios, and the five with the lowest in 1984.

THE HIGHEST RATIOS (federal expenditures exceed tax payments)

New Mexico. While federal revenues derived from the state were below average, procurement contract awards, mostly for nuclear energy research around Los Alamos and Albuquerque, were twice the national average on a per capita basis. Salaries and wages for

federal employees also were twice the national average.

Mississippi. While federal expenditures were only slightly above average, Mississippi's per capita personal income was the lowest in the nation.

Virginia. Because of the substantial presence of the federal government in the Washington, DC suburbs and in the Tidewater area, payments to military and civilian employees were three times the national average. Per capita procurement contract awards also were higher than average.

Missouri. Although the level of revenue collection was 7% below average, the high level of procurement contracts let in the state—twice the national rate—accounted for Missouri's high ratio.

Hawaii. Federal revenue per capita equaled the national average, but salaries and wages for military and federal civilian employees were almost four times the national average.

THE LOWEST RATIOS (tax payments exceed federal expenditures)

Michigan. Revenues paid by Michigan residents were about equal to the national average, as was federal spending for most categories. However, the state had less than half the per capita federal spending for procurement contracts, and salaries and wages.

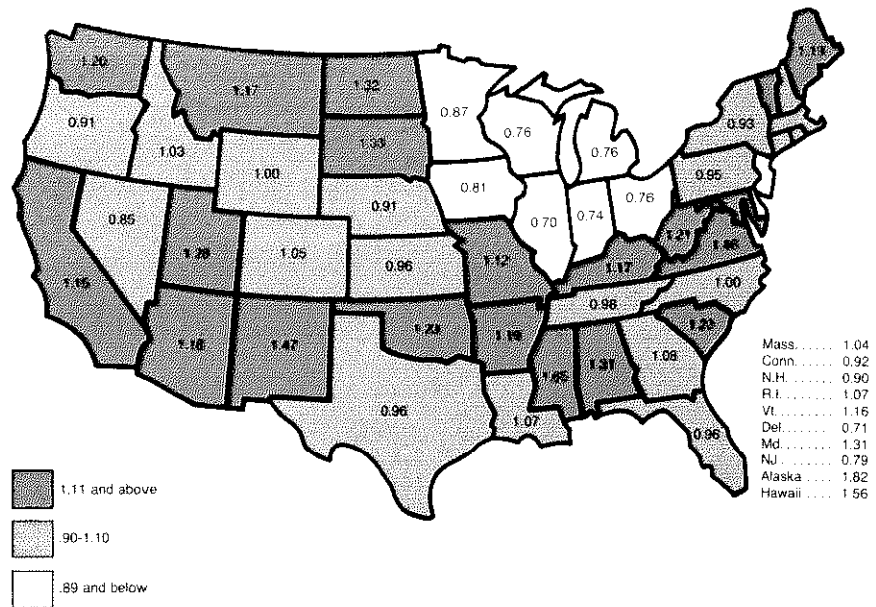
Texas. The revenues that Texans sent to Washington were approximately 6% greater than the national average, but per capita spending for grants-in-aid, payments to individuals (primarily Social Security and pensions), and procurement contracts were below the national average.

Wyoming. The primary reason for this state's low ratio is that Wyoming residents paid 15% more in federal taxes than the national average.

Illinois. This state, too, sent a significantly larger amount of federal taxes (14%) to Washington than the national average while federal expenditures in the state were 27% below average. Like many of the high and low ranking states, federal expenditures for procurement contracts, and salaries and wages explain much of the relative ranking.

New Jersey. Having the third highest per capita personal income in the nation, New Jersey residents paid 28% more in taxes than the national average, while federal expenditures were 10% less than average—again mostly accounted for by the relatively low levels of spending on procurement contracts, and salaries and wages.

Map 2
THE FLOWS OF FEDERAL FUNDS, 1974-76
(The Estimated Amount of Federal Expenditure in each State for each \$1.00 of Federal Taxes Paid by Residents of each State)

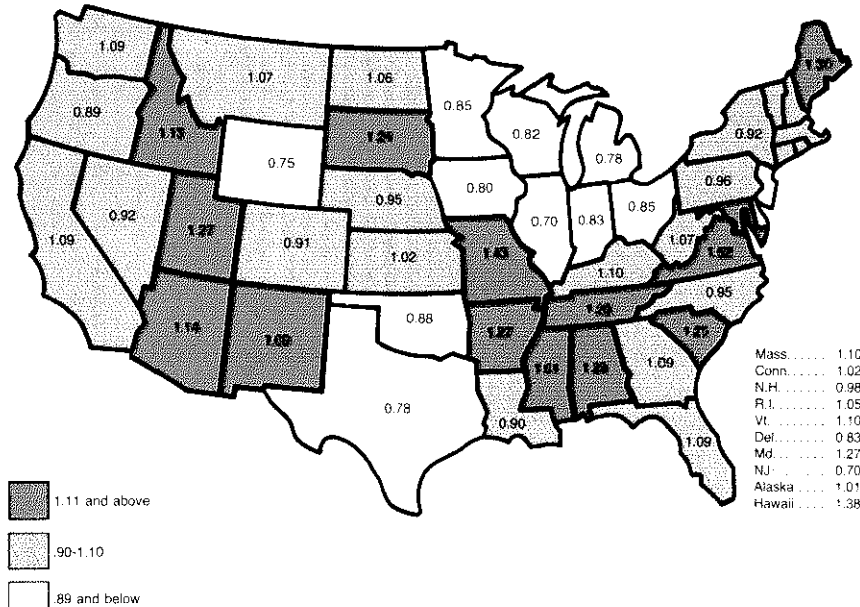


SOURCE: Advisory Commission on Intergovernmental Relations, *Regional Growth: Flows of Federal Funds, 1950-76*, p. 55, June 1980. Three-year averages for expenditure and revenue were used to ensure that unusually high or low figures in a particular state in any single year would not unduly influence the flow-of-funds ratios.

	1982-84	1974-76	1965-67
Std. Deviation, All states*:	0.23	0.24	0.60
Std. Deviation, EXCLUDING Alaska and Hawaii*:	0.23	0.21	0.33

*Generally speaking, a relatively high standard deviation figure indicates a relatively large disparity in the flow-of-funds ratios; conversely, a low standard deviation indicates a smaller disparity among the states.

Map 3
THE FLOWS OF FEDERAL FUNDS, 1982-84
(The Estimated Amount of Federal Expenditure in each State for each \$1.00 of Federal Taxes Paid by Residents of each State)



SOURCE: ADIR staff computations based on federal expenditure data from U.S. Bureau of the Census, *Federal Expenditures by State for Fiscal Year 1984* (see also prior years); March 1985. Allocation of federal tax revenue by state for 1982-84 provided by The Tax Foundation, Inc., Washington, D.C. Three-year averages for expenditure and revenue were used to ensure that unusually high or low figures in a particular state in any single year would not unduly influence the flow-of-funds ratios.

	1982-84	1974-76	1965-67
Std. Deviation, All states*:	0.23	0.24	0.60
Std. Deviation, EXCLUDING Alaska and Hawaii*:	0.23	0.21	0.33

*Generally speaking, a relatively high standard deviation figure indicates a relatively large disparity in the flow-of-funds ratios; conversely, a low standard deviation indicates a smaller disparity among the states.

And Briefly: Books

Patricia Koch
Librarian

Cigarette Tax Evasion: A Second Look (A-100)

Although there has always been casual smuggling of cigarettes across state lines, large-scale organized smuggling did not emerge until the mid-1960s, when tax rate differentials among the states widened. Not a major tax source, cigarette taxes were a convenient way for states to fill in gaps in their budgets. In 1977, ACIR issued a report on cigarette bootlegging recommending that smuggling cigarettes across the state lines be made a federal crime. Such legislation passed in 1978.

This report presents current estimates of cigarette tax losses, particularly those attributable to organized smuggling, and recommends what national and state governments could do to further reduce these losses.

The Commission found that cigarette smuggling has declined dramatically since the 1970s. The decline is due in large part to the enactment of the *Federal Cigarette Contraband Act of 1978*. Moreover, there have been numerous state tax increases since 1981, and state cigarette tax differentials—which were the primary cause of cigarette smuggling—have widened in the last few years. Therefore, the possibility of a resurgence in cigarette smuggling in the future is increased, particularly if law enforcement efforts become less effective. Budget problems also have forced states to reduce the resources devoted to enforcing state cigarette tax laws in some cases.

The Commission recommends:

- continued congressional support for the cigarette enforcement efforts of the Bureau of Alcohol, Tobacco and Firearms;
- active state law enforcement, including stronger efforts if needed when state cigarette taxes are increased;
- closer cooperation between military, federal and state officials to reduce the incidence of bootlegging on military installations; and
- renewed efforts by states to reach agreements with Indian leaders for precollection of the cigarette tax on sales in reservations.

Significant Features of Fiscal Federalism, 1984 (M-141)

This report is a compendium of statistical information on state and local revenues and expenditures; federal grants-in-aid; and major trends in intergovernmental finance and relations. Published annually, the volume has earned a reputation as one of the most comprehensive reference sources for information on the operations of the intergovernmental fiscal system.

According to the 1984 edition, all levels of government spent over \$1.2 trillion in 1984—or 34.4% of GNP. Ten years ago, all levels of government spent \$460 billion—or 32.1% of GNP.

In 1984, 70% of government spending was attributable to the national government, totaling \$880 billion or \$1,665 for each citizen. By comparison, state-local spending amounted to \$378 billion, or \$715 per person.

Basic tables cover such areas as federal, state and local expenditures and revenues; state tax trends; state and local income, sales, corporate, business and property taxes; public employment and earnings; and major features of state budget systems. State fiscal discipline mechanisms also are reviewed in this year's edition—including the line-item veto authority of governors, statutory or constitutional tax and expenditure limits, and "rainy day" funds.

Special sections feature a glossary of terms, the major highlights of the report, and a fiscal profile of each state.

1982 Tax Capacity of the Fifty States (M-142)

Using an ACIR designed methodology known as the Representative Tax System (RTS), this report endeavors to answer the question: what would be the total revenue and relative rankings of each of the 50 states if every state applied identical tax rates to a number of commonly-use taxes?

The RTS method of measuring tax capacity examines the ability of the states to raise revenues by applying a uniform set of tax rates to some 26 tax bases including, for example, sales, personal income, and corporate income. Thus, "tax capacity" under RTS

would comprise the amount of revenue that each state would realize if a uniform set of rates was applied nationally.

Over the last 20 years, a series of reports prepared by the Commission has emphasized the need for building a better measure of state tax capacity than the most commonly used yardstick, per capita income. This report represents an annual update of the RTS publication, containing the standard methodology and estimates of tax capacity for 1982. The report also gives a description of the methodology and results of several experimental modifications to the RTS.

In 1982, the Commission found that the use of a single index, resident per capita income, to measure fiscal capacity misrepresents the actual ability of many governments to raise revenue. Because states tax a wide range of economic activities other than the income of their residents, the per capita income measure fails to account for sources of revenue to which income is only related in part. The Commission thus recommended that the federal government use a fiscal capacity index, such as the representative tax system, which more fully reflects the wide diversity of revenue sources that states currently use.

The rates used in the report are "representative" in that they are the national average tax rates for each base. Because the same tax rates are used for every state, regardless of the rates a given state actually imposes, estimated tax yields vary only because of differences in the underlying bases.

The report also includes state-by-state graphs showing trends in total tax capacity and effort, based on the RTS methodology, as well as breakdowns on capacity and revenues for seven tax categories.

Bankruptcies, Defaults, and Other Local Government Financial Emergencies (A-99)

City Financial Emergencies, published in 1973 by ACIR, discussed the history and incidence of financial emergencies through 1970. That report found that financial management

problems are the principal cause of emergencies, and that states should provide assistance to local governments facing such emergencies. The 1973 report also examined the finances of 30 large U.S. cities for evidence of possible emergencies.

This report updates the findings of the 1973 report, examines recent financial emergencies, and reviews how new state laws and changes in the federal bankruptcy code have helped resolve emergencies. It also reexamines the finances of the 30 cities studied in the earlier report.

According to the report, there is no evidence of an increase in local government financial emergencies (bankruptcies or defaults), nor is there much likelihood of an upsurge in municipal bankruptcies in the near future. From 1972 to 1983, only three instances of general purpose government bankruptcies were filed, and only one long-term general obligation bond defaulted. Defaults on general obligation notes also were rare occurrences over this period, although there were major defaults in New York and Cleveland.

The report also found that bankruptcies were a more common occurrence for special districts, especially those associated with real estate developments. Eighteen bankruptcies occurred in special districts from 1972 to 1984, including one school district—San Jose (CA). Most of these bankruptcies involved small amounts.

Please note the feature article in this issue of *Intergovernmental Perspective* that highlights the report and recent developments in this important area.

The States and Distressed Communities: State Programs to Aid Distressed Communities—Catalog of State Programs, 1983 (M-140)

The primary objective of "The States and Distressed Communities" project was to assemble a central record of state programs directed to distressed persons, places and businesses. ACIR identified 20 indicators (program areas) of state assistance to distressed communities. From 1979 through 1983, four annual surveys were conducted to determine what state-financed programs had been authorized and implemented to aid distressed communities.

Two types of state efforts are included in this catalogue: targeted program indicators (including housing subsidization, economic development incentives, and community development programs) and untargeted program indicators (including state efforts to improve the fiscal condition of local governments). The volume is divided into five chapters—one for each policy area.

Where data are available, program entries include code citations for program authorization, and descriptions of program purpose and program targeting criteria. For some of the programs, such as revenue sharing and education finance, the data are summarized in tables; for other programs, such as single family housing and industrial development bonds, the data are provided in narrative form.

The Question of State Government Capability (A-98)

This report examines how and to what extent state governments have changed over the past 30 years. For the purpose of the study, state governance was divided into numerous structural and functional areas that can serve as guidelines on which to measure change.

The states occupy a crucial role in the intergovernmental system. Their constitutional status places them in a pivotal position between national and local jurisdictions, and they are the dominant subnational partner in federal programs.

Recent developments in the role of the states as intergovernmental managers also have strong implications for the future of the federal system. And, states have taken on an increasing role in state-local finance and in supporting local government.

This report discusses several major issues including how the states' role in

the federal system has changed; how these changes have affected the states overall influence in the intergovernmental system; the significant diversity among states; and state representational, structural and fiscal reforms.

Other Recent Releases:

Financing Public Physical Infrastructure, A-96, June 1984, \$2.00.
A Catalog of Federal Grant-in-Aid Program to State and Local Governments: Grants Funded FY 1984, M-139, December 1984, \$4.75.

Changing Public Attitudes on Governments and Taxes, S-13, October, 1984, \$3.00.

Strengthening the Federal Revenue System: Implications for State and Local Taxing and Borrowing, A-97, October 1984, \$5.00.

Fiscal Disparities: Central Cities and Suburbs, 1981, M-138, \$3.00.

Forthcoming:

Changing Public Attitudes on Governments and Taxes (1985), S-14.
The States and Distressed Communities, A-101

Intergovernmental Service Arrangements for Delivering Local Public Services, A-103

Emerging Issues in American Federalism: Papers Prepared for ACIR's 25th Anniversary

ORDER NOW!

ORDER NOW!

_____ **A-101: The States and Distressed Communities—\$5.00**

What states are doing to help their local governments to improve conditions in declining communities

_____ **A-103: Intergovernmental Service Arrangements for Delivering Public Services—\$5.00**

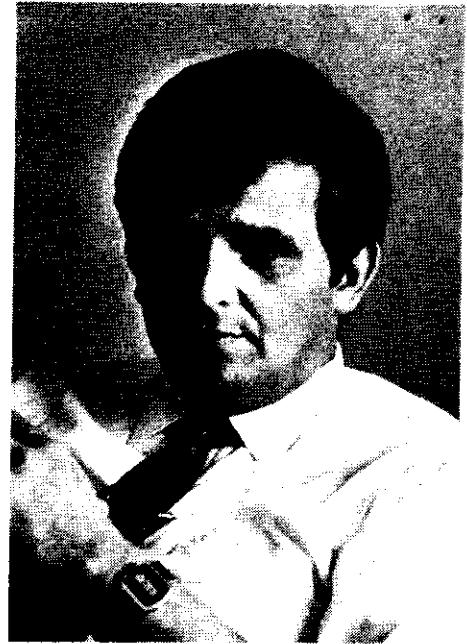
How local governments are using service agreements and contracts for public service delivery

Name _____

Address _____

To order, complete this order form (indicating the number of copies of each publication), enclose your check or money order made payable to ACIR, and return to: **ACIR Publication Orders, 1111—20th Street, NW, Washington, DC 20575.**

The Chairman's View



In the baseball-oriented motion picture "Bang the Drum Slowly", the star pitcher and seasoned coach fleece fans in hotel lobbies with a card game called "tegwar". What the pigeon never learns is that tegwar is an acronym for The Exciting Game Without Any Rules.

With its *Garcia v. San Antonio Metropolitan Transit Authority* ruling, the Supreme Court has basically consigned state and local governments to play tegwar with Washington—with the Congress controlling the deal. In effect, it has said that the basic rule book of our federal system—the Constitution—is inoperative as it relates to states and localities, and that they must look to the whims of the political process for their rights.

For the 5 to 4 majority Justice Blackmun wrote: "... the principal and basic limit on the federal commerce power is that inherent in all congressional action—the built in restraints that our system provides through state participation in federal governmental action." Before entering the rarified atmosphere that must surely affect the thinking of learned jurists, it might be wise to locate that so-called restraint they find in congressional action.

Where was the restraint in the mandatory 55 mph speed limit law? In the 21 drinking age law? In seat belt regulation? In the regulation of intrastate air carriers? In the setting of federal standards for truck load limits on interstate highways?—to name just a few involving the U.S. Department of Transportation alone.

In the future, where will the restraint be found in such issue areas as unitary taxation? And in proposals to establish uniform insurance laws?

There are a number of reasons for lack of restraint by the national government. The direct election of U.S. Senators, for example, removed the institutional tie that the Congress had with the states when Senators were selected by state legislatures. There also is the recent explosion in the number of national special interest groups, the weakening of state political parties and processes, and, of course, the Supreme Court itself that has taken an activist role in curtailing state latitude. Because states and localities do not vote as entities for federal office seekers, it is hard to understand how they are protected by the political process.

If one strips away all the verbiage in *Garcia*, the Court is saying that the Congress has the right to constrain the authority of state and local governments in any way it sees fit. Or the reverse, that the Congress has the authority to determine the scope of its own power. The principle is clear: what the sovereign giveth, the sovereign can take. Any restraint depends on the benevolence of the Congress and the Executive Branch, and the Court has no constitutional role to protect the rights of state and local governments. If such is true, then let's admit that we have not federalism, but centralized government.

In a former age, both explicit and implicit constitutional prerogatives were respected by the political and legal processes. We had operational principles which held, that for state and local governments to be self-governing political systems, they had to have adequate authority to make decisions, adequate tax resources to fund those activities, and

control over their public agencies that implement policies. The Supreme Court and state courts played a critical role in balancing the authority and responsibilities between governments.

Alexis de Tocqueville called the Supreme Court "... a unique tribunal, one of whose prerogatives is to maintain the division of power appointed by the Constitution between these rival governments". To maintain this division between rival governments, the Court must foster restraint, a restraint not found in the normal political process. For if that were the case, there would be no need for a Supreme Court. Restraint was to be exercised through constitutional remedies, or as Hamilton would have said, through the application of fundamental law.

That five Justices in *Garcia* were willing to abrogate their responsibility to apply fundamental law to issues of state-federal rivalry merely points to the loss of operational federalism—with staggering implications.

A recent headline in a California newspaper reporting that state and local governments face millions of dollars of increased costs to comply with the *Garcia* decision signals one clear implication. Other interest groups are sure to seek federal legislation to increase their salaries and benefits, and the Congress will come under even more pressure to increase spending. We can also expect the Congress to widen its authority at the expense of states anytime a hot issue comes along, such as the drinking age requirement. From this perspective, *Garcia* is just one more step toward making state and local governments administrative arms of the federal government.


It is not an overstatement to say that we are in the throes of a constitutional crisis. The sad fact is that many of the intergovernmental players see it as a crisis of policy. Yet, it is precisely when we treat federalism questions as policy issues rather than as constitutional issues that we foster crisis.

This nation needs to recognize that governments can only exist and prosper when they have wide authority and fiscal capacity to operate. Since the Supreme Court appears to have abdicated its role as federalism referee, state and local governments should seek constitutional remedies to constitutional issues. The Congress should be petitioned for an amendment to the Constitution that gives operational mean-

ing to the Tenth Amendment; failing this, the states should resolve to call a convention for the purpose of drafting such an amendment.

Additionally, we should seek federalism reform that would return to state and local governments real authority to run programs along with tax resources to fund such programs—free from federal encroachment.

The *Garcia* decision makes many of us who desire inter-governmental balance wonder if we shouldn't move toward a dual federalism by severing all links between federal programs and state and local programs. While this is unrealistic, it is mandatory, at the very least, to commence rebuilding constitutional foundations. One part of that strategy should be to educate jurists that constitutions are fundamental laws that constrain and empower different units of government. Those governments are the cornerstone of our ability to self-govern, and the role of the courts should be to enhance the democratic process, not weaken it.



Robert B. Hawkins, Jr.
Chairman

(continued from page 2)

years where they had become a perfect illustration of the legal confusion surrounding the concepts articulated in *NLC*. In the absence of clear signals from the Supreme Court, district and appellate court rulings were inconsistent—the mass transit regulations being ruled constitutional, for example, in Macon (GA), New Castle (DE), Chattanooga (TN), and Augusta (GA), but unconstitutional in San Antonio (TX) and Puerto Rico. In the end, the opinion of U.S. District Court Judge Fred Shannon of San Antonio that “local public mass transit systems . . . constitute integral operations in areas of traditional governmental functions . . .”, was subject to review by the Supreme Court. The resultant ruling became the Court’s most important federalism-related judgment of the 1984-85 Term—a judgment also likely to have profound constitutional and political ramifications for many years to come.

Thus, a bitterly divided Court overruled *NLC*, calling standards set forth in that case “not only unworkable but . . . inconsistent with established principles of federalism. . . .”

Although the Court’s difficulty in grappling with the *NLC* doctrine over the past decade—coupled with state and local governments’ failure to circumvent perceived national intrusions using *NLC* principles—had led many to question the usefulness of the *NLC* tests for constitutional inquiries, few were probably prepared for the Court’s complete reversal in *Garcia*. Indeed, the Court chose to go well beyond the already unusual step of overturning recent principle.

It denounced “judicially created limitations on Federal power,” calling “unsound in principle and unworkable in practice, a rule of state immunity from Federal regulation that turns on a judicial appraisal of whether a particular function is ‘integral’ or ‘traditional.’” In so deciding, the Court removed itself as an arbiter in future controversies pitting the congressional commerce power against state sovereignty claims.

Moreover, the Court implied that to the extent that states are protected from regulatory intrusions by the national government, that protection is found not in the Constitution but in the “structure of the Federal Government itself” and the

GARCIA UPDATE

- According to the National League of Cities, the *Garcia* ruling may cost cities up to \$1.75 billion a year, \$500 million for counties, and up to \$300 million for states.
- Four proposals have been introduced in the Congress that would mitigate the effects of the *Garcia* decision. S. 1570 (Nickles-OK and Wilson-CA), the most comprehensive bill, exempts state and local employees from overtime provisions, eliminates retroactive application, and permits continued state and local use of volunteers without being subject to minimum wage and overtime requirements. S. 1434 (Wilson-CA) provides an overtime exemption for state and local employees. H.R. 2936 (Byron-MD) exempts only police and firefighters. H.R. 2866 (Ford-TN) provides for the optional use of compensatory time for police and firefighters.
- Congressional hearings on the proposals are expected to be held in September.
- In June, the Department of Labor announced that state and local governments will be subject to departmental enforcement actions requiring compliance effective April 15, even though most investigations will be delayed until October 15.
- White House officials have indicated that a decision on the Administration’s position on pending legislation likely will be made by mid-September.
- Many national and state organizations are sponsoring workshops for public officials in order to help them sort out the consequences of the *Garcia* ruling and to develop compliance strategies.
- In October, ACIR will conduct three field hearings which will focus on the constitutional ramifications of the *Garcia* decision.

national political process—a process that according to the Court, “insures that laws that unduly burden the states will not be promulgated.”

Not surprisingly, the *Garcia* dissent was stinging. One opinion declared that the decision “substantially alters the Federal system embodied in the Constitution” and represents “an outright rejection of the history of our country and the intention of the Framers of our Constitution.” Another dissent accused the majority of reducing federalism to a “weak essence.” And still a third Justice noted that the underlying principles of *NLC* would, in time, “again command the support of a majority of his Court.”

Whether or not a new majority will someday return to these issues remains to be seen. In the meantime, an important and lively debate continues outside of the judicial arena.

**Current Members of the
Advisory Commission
On Intergovernmental Relations**

(July 1985)

Private Citizens

James S. Dwight, Jr., *Washington, DC*
Robert B. Hawkins, Jr., **Chairman,**
Sacramento, California
Kathleen Rothschild, *Wilmette, Illinois*

Members of the United States Senate

David Durenberger, *Minnesota*
William V. Roth, Jr., *Delaware*
James R. Sasser, *Tennessee*

Members of the

U.S. House of Representatives

Sander Levin, *Michigan*
Robert Walker, *Pennsylvania*
Ted Weiss, *New York*

**Officers of the Executive Branch,
Federal Government**

William E. Brock, III, *Secretary,*
U.S. Department of Labor
Mitchell E. Daniels, Jr., *Deputy Assistant*
to the President and Director, Office of
Intergovernmental Affairs
Edwin Meese, III, *Attorney General*

Governors

John Carlin, *Kansas*
Ted Schwinden, *Montana*
John H. Sununu, **Vice Chairman,**
New Hampshire
Dick Thornburgh, *Pennsylvania*

Mayors

Ferd Harrison, *Scotland Neck,*
North Carolina
William H. Hudnut, III, *Indianapolis,*
Indiana
Robert Martinez, *Tampa, Florida*
Joseph P. Riley, Jr., *Charleston, South*
Carolina

Members of State Legislatures

Ross O. Doyen, *Kansas Senate*
David E. Nething, *Majority Leader,*
North Dakota Senate
William F. Passannante, *Speaker*
Pro Tem, New York Assembly

Elected County Officials

Gilbert Barrett, *Dougherty County, Georgia,*
County Commission
Philip B. Elfstrom, *Kane County, Illinois,*
County Commission
Sandra R. Smoley, *Sacramento County,*
California, Board of Supervisors

*The Chairman of the Advisory
Commission on Intergovernmental
Relations has determined that the
publication of this periodical is
necessary in the transaction of the
public business required by law of
this Commission. Use of funds for
printing this periodical has been
approved by the Director of the Office
of Management and Budget through
August 1985.*

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE, \$300

Bulk Rate U.S. Postage PAID Permit No. 827 Washington, D.C.

3RD CLASS BLK. RT.