

JK 325 / J57 / 305

PERSPECTIVE

Federal Preemption of State Branch Banking Laws under FIRREA

Sandra B. McCray

The Eisenhower Years and the Creation of ACIR

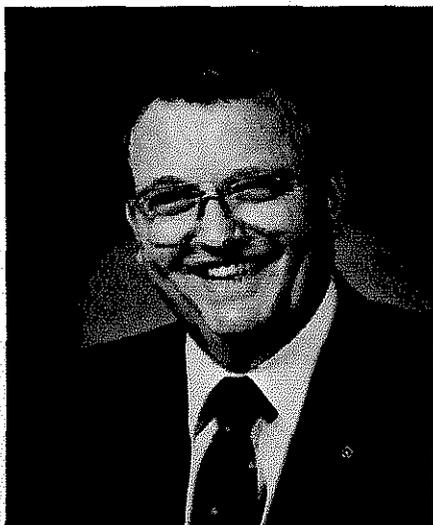
*Wm. G. Colman
and Delphis C. Goldberg*

Federalism and German Reunification

Wolfgang Welz



A View from the Commission



Serving on the Advisory Commission on Intergovernmental Relations—a personally rewarding experience for me—gives an excellent overview of developments in our federal system, as well as opportunities to hear different opinions about those developments. One also sees more clearly the connections between decisions made in Washington, DC, and their effects on government and citizens in one's home state and community.

Unfortunately, many federal, state, and local officials do not have many opportunities to acquire a broad overview. All of us in our various capacities as state legislators, governors, mayors, county officials, members of Congress, and executive branch officers are mainly concerned, as we should be, with the needs of our constituencies, departments, and committees. The pace of public life is fast enough today, and it is no mean achievement to stay on top of our principal responsibilities as elected officials or appointed executives.

The price of this pace, though, is losing sight of broad and powerful trends having significant consequences for our own responsibilities and capabilities, and we do not look over the intergovernmental fence often enough to see what is happening in someone else's yard. We are frequently surprised, therefore, when strange objects

suddenly come flying over the fence.

This limited awareness is evident in a forthcoming ACIR report on federal preemption of state and local authority. A survey of various state officials found many are not aware of the dramatic increase in federal preemption during the past two decades, or of the scope of preemption today. There is some awareness of preemption in those fields of special concern to particular officials, but not of preemption in general. Yet, preemption is sneaking up on state and local governments like a cat stalking its prey.

There is a need, therefore, for greater awareness of preemption—awareness that some 53 percent of all explicit statutory preemptions enacted in our 200-year constitutional history have been enacted only since 1969—in other words, the last 10 percent of our history. This does not even count the implied preemptions discovered by courts in their readings of federal statutes or the administrative preemptions implemented by federal agencies in their interpretations of federal statutes. Thus, preemption is a deep well of seemingly constitutional authority (i.e., the supremacy clause) from which federal officials can draw endless power.

Although ACIR recognizes the need and validity of preemption in limited areas, the Commission has expressed concern about the pace and scope of preemption. Interestingly, the Commission is finding some strange bedfellows who share this concern, including interest groups previously supportive of preemption. This is so because preemption continues to interfere with or short circuit nearly everyone's state and local agendas—whether conservative, middle-of-the-road, or liberal. As state and local governments become more active and innovative, citizens in those arenas increasingly resent interests trying to frustrate their efforts by convincing the Congress, the White House, or the courts to preempt state and local authority. Today, moreover, it is hard to argue, at least with a straight face, that the fed-

eral government is a better champion of good, fiscally responsible government than most state and local governments.

As initial steps toward limiting and making preemption more sensible, ACIR has recommended that the Congress adopt a "preemption note" process that will (1) raise consciousness about the issue, (2) encourage the Congress to consider the possible effects on state and local governments of any proposed preemption, (3) make congressional intent to preempt explicit, if preemption is in fact the intent of the Congress, and (4) contain the preemption to as narrow a field as possible.

ACIR also has recommended that federal agencies be required to publish in the *Federal Register* a clear statement as to whether a proposed or promulgated regulation is intended to preempt state or local authority.

I certainly hope a bipartisan consensus can be forged in support of more limited, essential, and sensible preemption. After all, the dramatic rise of preemption has been a bipartisan joy ride, with both Democrats and Republicans advocating preemptions to suit their particular interests. Of course, in fairness, it should be noted that members of Congress are not always aware of the preemptive consequences of legislation until some judge, bureaucrat, or congressional staffer discovers a justification for preemption in a footnote on page 561 of a committee report.

It is time, therefore, to stop, take a look at the whole preemption picture, and ask if the race to preempt is wise policy. Preemption jeopardizes the rights of state and local self-government made available to citizens by a federal system. If state and local governments are to become mere marionettes, then citizens may need to consider amendments to our fundamental compact of self-government—the Constitution of the United States of America.

David E. Nething
North Dakota Senate

PERSPECTIVE

2 A View from the Commission

David E. Nething

4 ACIR News

7 Federal Preemption of State

Branch Banking Laws under FIRREA

Sandra B. McCray

16 Intergovernmental Digest

**19 The Eisenhower Years
and the Creation of ACIR**

Wm. G. Colman

and Delphis C. Goldberg

25 Federalism and German Reunification

Wolfgang Welz

30 Books, etc.

Staff

John Kincaid

Executive Director

Pamela L. Reynolds

Editor

Intergovernmental Perspective
(ISSN 0362-8507) is published
four times a year by the
U.S. Advisory Commission
on Intergovernmental Relations,
Washington, DC 20575
202-653-5540

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 document has been approved by the Director of the Office of Management and Budget.

On the ACIR Agenda

The last meeting of the Advisory Commission on Intergovernmental Relations was held in Washington, DC on June 22, 1990. Following are highlights from the agenda and Commission actions.

Senator Jerzy Regulski of Poland, undersecretary for Local Government Reform, briefed the Commission on local government developments in his country.

Federal Preemption of State and Local Authority

The Commission approved a report on federal preemption of state and local authority. This report documents the increase in number and scope of federal preemptions as federal grants decline in proportion to state-local revenue, and outlines the variety of implementation approaches taken in the preemption statutes. State officials suggest a need to use federal preemption power carefully and to select implementation techniques that allow states and local governments discretion in the compliance process. Bea Block, staff attorney at the State and Local Legal Center, discussed preemption in U.S. Supreme Court cases.

State and Local Roles in International Affairs

The Commission approved two reports on state and local roles in international affairs. State and local governments are looking outward in this new era of international markets, worldwide economies, multinational corporations, and *people-to-people* diplomacy. State and local international activities contrast with the traditional notion that foreign affairs is strictly the domain of the U.S. government, and while there have not been any major problems for the federal system or U.S. foreign policy there are issues of coordination and cooperation. These reports will be available soon.

John Stremlau deputy director of the policy planning staff at the Department of State, spoke to the Commission about the need to reevaluate U.S. involvement in changing societies. In his closing remarks, he stated that "this is the most creative period of problems of governance and the social contract since the Republic was founded 200 years ago."

Boundary Review Commissions: Roles and Status in 1990

The Commission approved publication of a study on boundary review commission structures, missions, and powers, and the degree of controversy surrounding their activities. The commissions exist in 11 states. The report is based primarily on telephone surveys of the commissions and of the city and county associations. The workloads of many boundary commissions have moved increasingly toward annexation cases. Some commissions have developed new mediating roles, and county and city representatives in most of the states support these bodies. Of the 11 boundary commissions, eight were created between 1959 and 1969; three have been created since then, the latest being Virginia in 1980.

Mandates: Cases in State-Local Relations

The Commission approved publication of an information report on state mandates. The primary concern of local governments is the imposition of unfunded mandates, but there also are questions of accountability, public opposition to rising taxes, and the implications of mandates for local self-government. In the seven states studied—Connecticut, Florida, Massachusetts, New York, Ohio, Rhode Island, and South Carolina—there has been an effort to work out an accommodation with local governments on these issues, using a variety of ap-

proaches. This report provides information to help states improve their own accommodations with local governments on mandate issues.

Survey on Tax-Exempt Private-Activity Bonds

ACIR, in cooperation with Dennis Zimmerman of the Library of Congress' Congressional Research Service, surveyed states to obtain information on the state and local government experience with the volume cap on state and local issuance of tax-exempt private-activity bonds. The volume cap was instituted as part of the *Tax Reform Act of 1986*. The survey included questions about the priorities established by each state to allocate private-activity bonds between state and local government activities, the volume and composition of the bond allocations, and suggestions for reform of the existing volume cap rules. The report, *The Volume Cap for Tax-Exempt Private-Activity Bonds: State and Local Experience in 1989*, was published in July.

President Appoints New Commissioner

President George Bush appointed Samuel B. Nunez, Jr., to the Commission in August 1990. Senator Nunez is President of the Louisiana State Senate.

NGA Elects New Chairman

Commissioner Booth Gardner, governor of Washington, was elected chairman of the National Governors' Association at the annual meeting in Mobile, Alabama.

New USCM President

Commissioner Robert M. Isaac, mayor of Colorado Springs, was elected president of the U.S. Conference of Mayors at the June conference in Chicago.

Commissioner Snyder Named County Leader of the Year

Commissioner James J. Snyder of Cattaraugus County, NY, was selected as County Leader of the Year by *American City and County*. He is featured in a cover story in the July 1990 issue of the magazine.

An ACIR for Poland?

At the invitation of the government of Poland, Bruce D. McDowell, ACIR's director of Government Policy Research, met with officials from September 1-7 to explain the structure and operations of ACIR and the benefits it provides in the American system of government. He made a presentation to the first meeting of deputy ministers, appointed by the Prime Minister as a working committee on the reform of local government. He also met with the chief representative of USIA in the U.S. Embassy.

There is strong interest in establishing an ACIR-like organization in Poland. Its function could be crucial in bringing together elected national and local leaders with the appointed provincial leaders who are struggling to decentralize many of the local functions that were nationalized a half-century ago. McDowell and ACIR analyst Carol Cohen will be returning to Poland in October to follow up on this concept and other methods of assisting the development of local self-government. This follow-up trip will be made under the auspices of the Johns Hopkins University and funded by the Rockefeller Brothers' Fund.

South Carolina ACIR Tax Primer

In a September 18 meeting, members of the South Carolina ACIR

approved publication of a study of the state and local tax system. The study contains a set of 15 recommendations plus nine additional options for reform of the intergovernmental aid structure. The study will be published in November. The research was a cooperative effort involving analysts from Clemson University, and the U.S. and South Carolina ACIRs. This year marks the tenth anniversary of the South Carolina ACIR, and the commission has issued a booklet outlining its reports and recommendations for state and local government. For further information call South Carolina ACIR at (803) 737-1705.

ACIR Helps U.S. Corps of Engineers with National Drought Study

In accordance with an interagency agreement, ACIR has begun working with the U.S. Army Corps of Engineers on institutional studies as part of a three-year National Drought Study called for by the Congress.

As a first step, ACIR has submitted to the Corps a brief report entitled "Intergovernmental Coordination for Drought-Related Water Resource Management."

The report reviews historic efforts at coordinating intergovernmental water policy, management, and operation, and also develops hypotheses for coordination for testing in model drought studies to be carried out by different types of institutions in several parts of the country.

State ACIR Conference

The State ACIR Conference, hosted by the Rhode Island State-Local Relations Commission and coordinated by Craig Zimmers of the Ohio State and Local Government Commission, was held in Newport, Rhode

Island, September 23-25, 1990. Commissioners and staff from the U.S. ACIR and 14 states were represented: Connecticut, Florida, Louisiana, Missouri, New Jersey, New York, North Carolina, Ohio, Rhode Island, South Carolina, Utah, Virginia, Washington, and Wisconsin. Topics of discussion included new or innovative projects, marketing state ACIR recommendations, and the relationship between the Commission and state ACIRs.

In the Next Issue of *Intergovernmental Perspective*

The fall issue of *Intergovernmental Perspective* will feature articles on a set of key intergovernmental finance issues.

- State and Local Budget Policy
- Deductibility of State and Local Taxes
- Earmarking State Revenues
- Representative Tax System
- Needs and Fiscal Capacity
- State Bond Rating Process
- The Coming Changes in Government Financial Reporting

**State Constitutional Law: Cases and Materials
With 1990-91 Supplement**

I congratulate you most enthusiastically upon your "State Constitutional Law." I'd been hoping for some time that a casebook would be published. With the growing interest in reliance by state courts on their own constitutions, it's been very badly needed. I shall certainly encourage any deans I run into to follow the lead of the other law schools already using it.

William J. Brennan, Jr.
Supreme Court of the United States

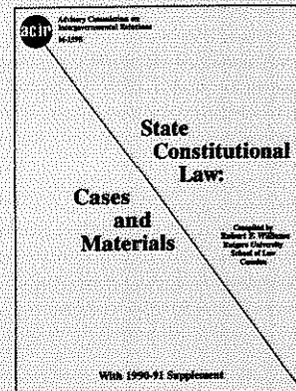
This is a revision and update of the first major collection of court cases, law journal articles, and other materials ever to be made available on a broad range of state constitutional law affecting the 50 states. State constitutional law is being "rediscovered" by a growing number of scholars and practitioners in the legal and political communities. This unique, up-to-date sourcebook fills a gap in the law and political science literature and highlights a new development in American federalism.

This volume was compiled for ACIR by Professor Robert F. Williams, Rutgers University School of Law, Camden, New Jersey.

M-159S 1990 528 pages **\$30**

1990-91 Supplement Available Separately

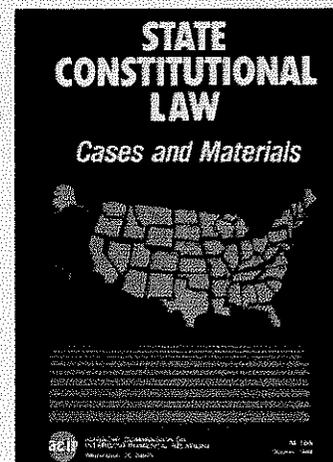
M-172 1990 60 pages **\$7**



**State Constitutions in the Federal System:
Selected Issues and Opportunities
for State Initiatives**

The American federal system rests on two constitutional pillars—the 50 state constitutions and the United States constitution—but for many citizens, state constitutions are out of sight and out of mind. This study examines recent developments in state constitutional law, focusing on issues that highlight the importance, variety, and innovativeness of state developments. The report looks at state government structure, equality, economic and property rights, education, civil liberties, defendants' rights, and workers' compensation.

A-113 1989 136 pages **\$15**



(see page 29 for order form)

Federal Preemption of State Branch Banking Laws under *FIRREA*

Sandra B. McCray

In August 1989, the Congress enacted the *Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA or FIRRE Act)* to “staunch massive losses in the thrift industry” and “restore public confidence in the savings and loan industry.”¹ Estimates of the losses differ depending on the assumptions underlying the estimate. For example, in May 1990, Treasury Secretary Nicholas Brady estimated the cost at from \$89-\$130 billion. That estimate was calculated on a present value basis (i.e., assuming that the bill for the bailout was paid right now). A recent General Accounting Office (GAO) report, which included the interest expense to finance the bailout over a 40-year payout, estimated the cost at \$325-\$500 billion. GAO’s least-cost estimate of \$325 billion is based on optimistic assumptions regarding interest rates and the economic outlook. Given a sharp rise in inter-

est rates or an economic downturn, costs could reach \$500 billion.

In *FIRREA*, the Congress attempted to resolve the thrift crisis by contributing public funds to close insolvent institutions and to recapitalize the thrift deposit insurance fund, and by modifying the regulatory framework governing the industry. The act established the Resolution Trust Corporation (RTC) and charged with overseeing the liquidation of the thrifts closed between January 1989 and August 1992. Although the act primarily affects savings associations, several sections also have an impact on banks.

This article analyzes two sections of the act that affect the dual banking system by preempting state branch banking laws. Section 217 (8) has been interpreted by the RTC as overriding intrastate branching restrictions, and Section 206 (e) contains an explicit congressional mandate to ignore the corporate walls separating commonly controlled banks when one or more of the banks is in danger of failing. By setting up a system of cross guarantees among affiliated banks across state lines, Section 206 (e) effectively transforms bank subsidiaries into bank branches, thereby abrogating state control of interstate branch banking.

Overview of the Dual Banking System

The dual banking system refers simply to the power of both state and federal governments to charter and supervise banks.² Yet, without two fundamental ingredients—state/federal regulatory competition and state control of branch banking—the dual banking system has little substance. Both components have been a part of the dual banking system since its inception. State/federal regulatory competition, whereby state and federal regulators compete to make their charters more desirable, began with the passage of the *National Bank Act* in 1864. Regulatory diversity, which is a direct consequence of the ability of new and existing banks to choose the set of laws and administrators under which they will operate, is the heart of the dual banking system. Supporters of the dual banking system deem this aspect of the system a boon to banks and consumers by encouraging innovation, increasing competition, and preventing economic concentration, as well as curbing arbitrary or discriminatory regulatory practices.³ Among the new products and technologies that have originated in the states are real estate mortgages, checking accounts, electronic funds transfers, automated teller machines, and NOW accounts.

State control over branch banking, the second essential ingredient in the dual banking system, began early in the history of state banking. Initially, most state laws prohibited or limited branch banking in order to prevent undue concentration in the banking system. Branch banking, it was thought, would squeeze out small independent banks, thereby hindering development of the West. Gradually, however, states relaxed anti-branching laws for state-chartered banks, allowing them to branch intrastate. In 1927, the Congress granted similar powers to national banks in the *McFadden Act*. In deference to state control over intrastate branching, this act permits national banks to operate branches within the state in which their home-office city is located only to the extent that state law

allows state banks to branch. Currently, 13 states have laws restricting intrastate branch banking. Typically, these restrictions do not apply to savings associations.

In 1966, the Congress honored state dominion over interstate branching by passing the Douglas Amendment to the *Bank Holding Company Act*, which prohibits the Federal Reserve Board from approving the acquisition of out-of-state subsidiary banks by bank holding companies unless state law expressly allows such entry.

From its inception, the American banking system has been plagued with problems of mismanagement and fraud on the part of bank owners and carelessness and inexperience on the part of regulatory authorities, leading to bank panics and crashes. Typically, following each panic and crash, the Congress added new layers of federal regulation. For the most part, however, the Congress has supported the dual banking system by allowing state banks to avoid much of the added federal regulation.

The staggering losses incurred as a result of the savings and loan failures have altered the traditional congressional response to such crises. Although *FIRREA* does not change the rules affecting regulatory competition between state and federal banks,⁴ the act does override state restrictions on branch banking.

Does *FIRREA* Preempt State Laws Restricting Intrastate Branching?

Section 217(8) of *FIRREA* amended section 13 of the *Federal Deposit Insurance Act* by adding a new subsection (k). This new section describes the conditions under which FDIC may approve mergers, acquisitions, and consolidations involving failed savings associations. According to *FIRREA*, FDIC and the Resolution Trust Corporation, a temporary agency managed by FDIC, are charged with the duty of disposing of thrifts that fail between January 1989 and August 1992. Subsection (k) 1 of the act expressly permits mergers, consolidations, and asset transfers between savings associations and insured banks:

(1) (A) (i) . . . Notwithstanding any provision of State law, upon determination that severe financial conditions threaten the stability of a significant number of savings associations, or of savings associations possessing significant financial resources, the Corporation, in its discretion and if it determines such authorization would lessen the risk to the Corporation, may authorize

(I) a savings association that is eligible for assistance . . . to merge or consolidate with, or to transfer its assets and liabilities to, any other savings association or any insured bank; . . .

Subsection (k) (4) contains the branching provisions.

If a merger, consolidation, transfer, or acquisition under this subsection involves a savings association eligible for assistance and a bank or bank holding company, a savings association may retain and operate any existing branch or branches or any other existing facilities. If the savings association continues to exist as a separate entity, it may establish and operate new branches to the same extent as any savings

association that is not affiliated with a bank holding company and the home office of which is located in the same State.

This latter section has generated intense controversy between federal and state regulators, as well as litigation in three states. RTC has interpreted this section of the act to allow banks that acquire a failed savings association to operate the branches of the association as banks notwithstanding state law limitations on intrastate branch banking. State regulators, however, argue that the subsection is clear and unambiguous. A savings association that is acquired by a bank under the provisions of (k) (1), may continue to operate its existing branches even though it is now a subsidiary of a bank holding company, so long as the savings association maintains its identity as an association. Moreover, if the acquired savings association retains its identity as an association, it may establish and operate new branches just like any other association in the state. According to state regulators, subsection (k) (4) does not preempt state branch banking restrictions.

Ironically, these very state law limitations on intrastate branch banking make a failed thrift worth more to a potential bank purchaser. A bank that purchases a failed savings association and operates its branches as banks gains a competitive advantage over all other banks that remain subject to state branching restrictions. Although RTC's interpretation ostensibly overrides state law only in limited situations involving an emergency acquisition, the override may, in effect, preempt all state branching restrictions. A state can restore a level playing field among banks only by repealing its branching restrictions, thereby removing the competitive advantage created by the federal override. Assuming that most state legislatures will want to maintain regulatory equity among similarly situated entities, the RTC action, if upheld, may force states to repeal their branching restrictions.

In support of its interpretation of section (k) (4) as preempting state branching restrictions, RTC has argued that:

- 1) The branching section of the act [(k)(4)] expressly allows banks to retain and operate as bank branches the thrift branches they acquire; or
- 2) If not expressly authorized in the branching subsection of the act, RTC has power under its general rulemaking authority and the merger subsection [(k)(1)] to authorize emergency transactions "notwithstanding any provisions of state law"; or
- 3) The provisions concerning branching are either ambiguous or silent with respect to bank branching, and RTC may resolve the ambiguity or fill in the silence by issuing regulations interpreting subsection (k)(4).

To date, three federal district courts and one federal appellate court have considered RTC's preemptive actions. In February 1990, the U.S. district court in Colorado temporarily restrained the corporation from consummating a transaction that would have allowed the acquiring

bank to operate the branches of the acquired failed thrift as bank branches in violation of Colorado law. Although RTC complained that it could not dispose of failed thrifts in the state without the power to override state law, the agency in fact did so.⁵ The restraining order was lifted when the transaction was restructured to comply with state law. An action challenging the RTC regulation was heard in September 1990 before the same court. The Colorado district court judge ruled in favor of the state, declaring the overriding regulation void. In June 1990, a U.S. district court judge in New Mexico upheld the RTC override of New Mexico law, finding that the broad general rulemaking authority granted the agency was sufficient to support the preemption.⁶ The latter two cases are on appeal before the 10th Circuit Court of Appeals.

On August 28, 1990, the 8th Circuit Court of Appeals rendered the first appellate decision on the preemption issue. In a 2-1 decision, the 8th Circuit reversed the Arkansas district court and upheld RTC's regulation preempting state law. The court applied the standard set forth in *Chevron v. Natural Resources Defense Council*.⁷ According to the *Chevron* standard, a court that reviews an agency's construction of a statute must consider two questions: (1) Did the Congress directly speak to the precise question at issue; and (2) Did the Congress explicitly leave a gap for the agency to fill? If the first question is answered affirmatively, the agency must follow the dictates of the Congress. If the Congress did not speak to the precise question at issue, the agency can fill the gap by regulation, and courts must uphold the regulation if it is a "permissible construction" of the statute. Using this standard, courts routinely defer to the agency's construction of a statutory provision.⁸

The majority opinion rejected RTC's first argument, finding that the Congress had not spoken directly to the issue of whether banks that acquire savings associations may operate their existing branches as bank branches. Although the reason for this conclusion is not entirely clear in the opinion, it appears that the court viewed the failure to delineate any conditions under which a bank could merge with a savings association and convert the savings association branches to bank branches as evidence that the Congress did not speak to the issue. Having thus disposed of the first question under the *Chevron* standard, the court then upheld the preemptive regulation under RTC arguments 2 and 3 above. The court found evidence of ambiguity in the contradictory arguments made by the litigating parties and evidence of a gap in the failure of Congress to speak to the issue of bank branches.

A dissenting opinion found that the Congress had addressed branching directly, allowing only savings associations to operate branches and foreclosing any inconsistent regulatory action on the issue. Thus, there was no need to move on to the second *Chevron* test.⁹

Broader Preemption Significance

The significance of this preemption issue is broader than its immediate effect on the laws of some 13 states. The RTC position expands the usual standards by which federal agency preemption actions are measured.

First, the RTC argument that its general rulemaking authority is sufficient to allow banks to operate savings as-

sociation branches as bank branches skips a crucial first question in the usual legal analysis of administrative preemption: does the federal statute authorize (explicitly or implicitly) the regulatory action taken by the federal agency (i.e., does the statute authorize RTC to allow banks to operate the branches of an acquired S&L as banks)? In a recent case, which also involved a statutory dual state/federal regulatory scheme, the U.S. Supreme Court reviewed an attempted preemption of state law by the Federal Communications Commission (FCC). In *Louisiana Public Service Commission v. FCC*,¹⁰ the Court held that the *Communications Act* did not give FCC the power to dictate to the states in a area reserved to the states. The Court said, "a federal agency may preempt state law only when and if it is acting within the scope of its congressionally delegated authority . . . [a]n agency may not confer power upon itself."¹¹

Second, to allow a federal agency to define a "gap" as the failure of the Congress to include a statutory provision that the agency believes is needed expands not only the agency's operating power but also its power to preempt state laws. Similarly, to allow a federal agency to find ambiguity in contradictory arguments made by interested parties also expands the agency's preemption power. If used as judicial standards for federal preemption, RTC arguments 2 and 3 leave little room for restraint by federal agencies or for judicial oversight.

It is tempting for courts to relax preemption standards in crisis situations such as the S&L bailout. The danger is, of course, that the precedential value of the relaxed preemption standard will not be confined to subsequent crises.

FIRREA's Impact on State Prohibitions of Interstate Branching

Section 206 (e)(i) of *FIRREA* was designed to prevent multi-bank holding companies from abandoning failing insured affiliates. The act accomplishes its purpose by overcoming the judicial wall between separately incorporated but commonly controlled depository institutions and by establishing a system of cross guarantees among affiliated depositories.

Subsection 206 (e) of *FIRREA* provides:

(A) LIABILITY ESTABLISHED—Any insured depository institution shall be liable for any loss incurred by the [Federal Deposit Insurance] Corporation, or any loss which the Corporation reasonably anticipates incurring, after the date of the enactment of the . . . act in connection with . . .

(i) the default of a commonly controlled insured depository institution; or

(ii) any assistance provided by the Corporation to any commonly controlled insured depository institution in danger of default.

The act does not extend the cross-guarantee liability to bank holding companies or to non-bank affiliates. This congressional mandate links depository affiliates across state lines in a web of warranties, treating the affiliates as branches of one bank rather than as separately chartered banks.

A review of state laws governing interstate banking will illustrate the effect of 206(e). Although all states allow some form of interstate banking through bank holding company subsidiaries, all states forbid interstate *branch* bank-

ing. Thus, an out-of-state bank can branch into a new state only by applying for a new bank charter or by acquiring or merging with an existing bank located in the new state.

State law controls the conditions under which the merger or acquisition can occur. A typical state law requires a finding by the state's bank regulator that the proposed merger or acquisition will not endanger the safe and sound operation of the existing bank. The cross-guarantee provisions, however, may make such an assessment difficult for state regulators. Without such an affirmative finding, the laws of most states require state regulators to reject an application from an out-of-state institution to merge with or acquire an existing bank.

Also, the requirement of cross guarantees can create a regulatory disincentive. Even a well managed bank in a state with a conscientious and competent regulatory body is only as strong as the weakest link in its nationwide chain of affiliates. Under the cross-guarantee system, innocent, independently operated, healthy banks in one state will pay a pro rata share of the losses incurred by an affiliated bank due to the (1) negligence or fraud of the owners of the bank, (2) the permissiveness or incompetence of other state or federal regulators, or (3) adverse economic conditions (thereby importing the adverse conditions from one region into another).¹²

Federal regulators urged adoption of cross-guarantee provisions because of the abuses that arise from conflicting legal and practical consequences of the use of the bank holding company structure. Consider, first, the legal consequences. According to the legal principle of limited liability, every subsidiary corporation is a legal entity distinct and separate from its shareholders. Thus, a parent bank-holding company is not legally liable for the debts or actions of its subsidiary banks, and a bank is not liable for the debts of its affiliated banks. Courts will not breach the separateness of corporations unless the corporations ignore or abuse the principle. Typical abuses that may cause a court to "pierce the corporate veil" and hold a corporation liable for the debts of its subsidiary or affiliate include: (1) misleading representations and actions; (2) illegitimate activities or purposes; (3) failure to observe corporate distinctions; and (4) inadequate capitalization of the subsidiary or affiliate. In sum, the law has erected a wall separating bank holding companies from their subsidiary banks, and banks from their affiliates.

The practical effects of the bank holding company structure differs markedly from the legal consequences. In practice, banks within a multibank holding company generally conduct business as though they were a single corporate entity. For example, profitable banks in a holding company may reduce their federal tax bill by utilizing tax loss carry-forwards generated by unprofitable affiliated banks; data processing services may be provided by a parent or an affiliate; and affiliates may sell their credit card operations to their parent. Frequently, the bigger banks within a holding company generate most of the loan business, while the smaller deposit-gathering affiliated banks provide much of the funding for the loans.

On several occasions, federal regulators have described the abuses that can arise from transactions among commonly controlled institutions. For example, the subsidiary or parent may overcharge its affiliated bank for data processing services or may underpay such affiliate for its credit card operations. Further, a small bank can continue to advance money to its affiliated lead bank, despite the fact that the small bank

knows it is funding loans that are pushing the lead bank toward insolvency. Also, a bank holding company can transfer (at inflated values) bad assets of several affiliates to one bank within the holding company and then allow that "bad bank" to fail. Yet, before the passage of section 206(e), if a bank failed (whether due to poor management, fraud or economic downturns), neither its parent bank holding company nor its affiliated banks were legally liable for the losses, even though they may have contributed to the problem and may have sufficient funds to cover some of the losses without compromising their own solvency.

This dilemma had frustrated federal regulators for some time. The Federal Reserve Board attempted to deal with interaffiliate transactions by adopting its "source-of-strength" regulation and policy, by which bank holding companies must use their resources to provide assistance to their ailing affiliated banks. In a recent case involving a bankrupt Texas bank holding company, the U.S. Court of Appeals for the 5th Circuit struck down the board's source-of-strength doctrine, however.¹³

The legal history of the case goes back several years. In an earlier case, FDIC filed a \$847 million claim against MCorp, alleging that the holding company had siphoned money from at least 12 of its banks before they failed. By the time the Federal Reserve Board filed its suit, MCorp had sought the protection of the bankruptcy court, and the Comptroller of the Currency had declared 20 of MCorp's subsidiary banks insolvent. The bankruptcy court enjoined the board from pursuing enforcement actions against MCorp. On appeal, the 5th Circuit Court held that the board lacked the statutory authority to force MCorp to transfer assets to its failing subsidiary banks. According to the court, the *Bank Holding Company Act* "does not grant the Board authority to consider the financial and managerial soundness of the subsidiary banks after it approves the application [for operation as a bank holding company] . . . such a transfer of funds would require MCorp to disregard its own corporation's separate status; it would amount to a wasting of the holding company's assets in violation of its duty to its shareholders."¹⁴

Critics of the cross guarantee provisions do not dispute the potential for abuse and concomitant danger to the deposit insurance fund that can occur as a result of the bank holding company structure. Critics maintain, however, that the cross guarantee provisions are both too broad and too narrow, as well as inconsistent with another general policy of FDIC that relies on the doctrine of limited liability to protect the integrity of the fund.

First, the cross guarantees are too broad in that they apply to innocent banks as well as those that have participated in risky or fraudulent activities with their affiliates.

Second, the cross guarantees are too narrow in that (1) they apply only to institutions affiliated at the time of failure, thus "creating an incentive for holding companies to sell or otherwise separate the healthy insured institutions prior to a failure"¹⁵ and allowing the holding company to pocket the proceeds from the sale; and (2) they fail to reach the bank holding company itself. This latter omission is serious because a parent bank holding company is not only the entity ultimately in control of the activities of its subsidiary banks but also, as the recipient of dividends from its subsidiaries, it is often the entity with the most significant financial resources. Moreover, according to FDIC Chairman L. William Seid-

man, "holding companies are finding it advantageous or prudent to transfer traditional banking activities and assets (such as data processing and trust operations) to nonbank subsidiaries in order to remove assets from the potential scope of the cross guarantee provisions."¹⁶ Unfortunately, the recent decision by the 5th Circuit Court of Appeals striking down the Federal Reserve Board's source-of-strength doctrine precludes the inclusion of bank holding companies in the cross guarantee requirements, at least after the fact.

Third, FDIC has long required state banks to conduct certain activities—including securities—in separate subsidiaries in order to take advantage of the doctrine of limited liability. By abrogating that doctrine in *FIRREA*, the Congress may have compromised the doctrine's future ability to protect the fund.

With the passage of *FIRREA*, the Congress adopted a solution to the holding company structure problem that breaks with its long tradition of deferring to state control over interstate branch banking. The financial health of a depository institution in one state is now directly tied to the condition of its affiliates in other states. Despite the sweeping nature of the cross guarantee provisions, however, other proposed remedies to the abuses created by the bank holding company structure are not adequate. A less sweeping alternative to the strict liability imposed on all affiliated depository institutions under *FIRREA* might focus on transactions among banks under common control. For example, Section 23B of the *Federal Reserve Act* prohibits member banks and their subsidiaries from engaging in certain transactions unless the transactions are "on terms and under circumstances, . . . that are substantially the same, or at least as favorable to such bank or its subsidiary, as those prevailing at the time for comparable transaction with or involving other nonaffiliated companies."¹⁷

Such "arm's length" examinations require constant and close scrutiny of each interaffiliate and parent/sub transaction, however. The experience of other federal regulators with arm's length examinations has not been reassuring. For example, the IRS is authorized under section 482 of the Internal Revenue Code to conduct arm's length examinations of transactions among U.S. multinational corporations. Recognizing that business transactions among corporations under common control are not neces-

sarily conducted at arm's length and can lead to tax evasion, the Congress gave IRS authority to inject economic reality into intercompany transactions. Using section 482, IRS scrutinizes transactions among commonly controlled corporations, determines whether the parties dealt with each other at arm's length, and, if not, reallocates income and expense among them in order to reconstruct the true taxable income of those affiliates subject to U.S. tax. The section 482 rules of IRS have spawned decades of litigation but no reliable principles to aid either IRS or a taxpayer in determining whether a particular expense or price is one at arm's length. In fact, after decades of conducting costly arm's length examinations, IRS, weary of the battle, is drafting procedures that will remove the necessity of such determinations. Given the inability of IRS, with its team of expert international auditors, to construct and enforce a meaningful arm's length policy, there is no reason to expect federal bank regulators to fare any better.

In summary, the cross guarantee provisions of *FIRREA* appear to be the best interim solution to the holding company problem. In the long run, the Congress and/or the Federal Reserve Board must find a remedy for abuses originating at the bank holding company level.

A bill recently introduced by Sen. Donald Riegle contains one such remedy. SB 3103 would require bank holding companies to maintain the capital of their insured depository subsidiaries. The bill also would extend the cross guarantee liability under *FIRREA* to the nondepository affiliates of insured depository institutions and limit the aggregate liability of nondepository affiliates to 5 percent of the assets of the insured bank at the time of its failure.

Effect on the Dual Banking System and on State Laws

State control over branch banking has been an important component of the dual banking system since its inception. Both sections 217(8) and 206(e) limit state control over branch banking. The former section is, however, the more serious intrusion into state authority. Whereas the provisions to override state law in section 206(e) are the result of a decision by the Congress, those in section 217(8) are the consequence of an questionable interpretation by a federal agency. Moreover, they are not limited to failures of depository institutions. If the RTC suspends state

Finance Data Diskettes

1988 Now Available for State-Local Government Finance Data. The diskettes developed by ACIR provide access to Census finance data in a format not previously available, and are designed for easy use. State-by-state data for 129 revenue and 200 expenditure classifications, population, and personal income are included for state and local governments combined, state government only, or all local governments aggregated at the state level.

Format: *Lotus 1-2-3*

Price: \$225—Six-year set \$100—FY1988 \$60—FY1987 \$25 each—FY1986, 1985, 1984, 1983

A demonstration disk for the State-Local Finance Data is available for \$5.

State Government Tax Revenue Data, FY1983-87. This diskette makes the state tax portion of the state-local government finance series available six months earlier than the full series. Four years of tax revenue data (FY1983-87) are included on a single diskette. The revenue fields are basically the same as for the state-local series. The state government tax diskette does not contain any information on local governments, nor does it contain any expenditure data.

Price: \$60 (for FY83-87 inclusive)

(see page 29 for order form)

branching limitations for one group of banks, all other banks are placed at a competitive disadvantage. To restore a level playing field among similar entities, states will be forced to suspend branching restrictions for all banks.

Further, the majority opinion by the 8th Circuit Court of Appeals has significantly expanded the situations under which federal agencies may preempt state laws. If followed by other circuit courts or if upheld by the U.S. Supreme Court, the reduced preemption standards will leave little room for restraint by federal agencies or for judicial oversight, whether applied to state bank laws or other state laws unrelated to banking.

Notes

¹ See S. Rept. No. 19, 101st Cong., 1st Sess 3 (1989) and H.R. Rept. No. 54 (I), 101st Cong., 1st Sess. 307 (1989) respectively.

² For a description of the dual banking system, see Advisory Commission on Intergovernmental Relations, *State Regulation of Banks in an Era of Deregulation* (Washington, DC, September, 1988).

³ Critics charge that the dual banking system fosters a competition in laxity, resulting in a regulatory race to the bottom.

⁴ *FIRREA* did, however, end regulatory competition between state and federal savings associations. According to new Section 28 of the *Federal Deposit Insurance Act*, state chartered savings associations may not (1) engage as principal in any type of activity, or in any activity in an amount, that is not permissible for a federal savings association, (2) directly acquire or retain any equity investment of a type or in an amount that is not permissible for a federal savings association, or (3) directly or through a subsidiary acquire or retain any corporate debt security not of investment grade. Exceptions allow state savings associations to engage in the prohibited activities or investments if FDIC has determined that the activity or investment poses no significant risk to the deposit insurance fund and the savings association is and continues to be in compliance with the new fully phased-in capital standards (applicable to prohibitions 1 and 2 above), if the equity investment is acquired and held by a service corporation (applicable to 2 above), or if the corporate debt is acquired and held by a qualified affiliate (applicable to 3 above). Section 28 thus compels regulatory parity between state and federal savings associations, except when federal regulators specifically allow regulatory competition. One avenue left open to state control is narrow. Apparently, state legislators and regulators may allow state associations to act as agents in offering new products and services to customers, regardless of federal law.

⁵ After issuance of the TRO, RTC restructured the transaction so that each branch office of the acquired thrift would be operated as a separate national bank.

⁶ *Independent Community Bankers of New Mexico v. The Resolution Trust Corporation*, No. CIV 90 532, June 15, 1990.

⁷ 467 U.S. 837 (1984).

⁸ If the Congress has not addressed the precise question at issue in a lawsuit, either a court or an agency entrusted with the duty of administering a statute will be asked to interpret the statute. Given the choice between a judicial construction of the statute and an agency interpretation, the Supreme Court chose the latter, formulating a rule of deference to administrative interpretation. See, e.g., *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356 (1972); *Young v. Community Nutrition Institute*, 476 U.S. 974 (1985); *Chevron U.S.A. v. Natural Res. Def. Council*, 467 U.S. 837 (1984). Note, however, that none of these cases involve preemption of state law.

⁹ The dissenting opinion also criticizes the majority opinion and cites the following legislative history: "The [act] grants to the

FDIC authority similar to FSLIC's emergency authority to arrange acquisitions of failing thrifts. The amendments also remove the procedures under current law that give priority to in-State thrift acquirers of failing thrifts. *The acquisition of failing thrifts by banks or bank holding companies is authorized. A thrift subsidiary of a bank or bank holding company may branch in the same manner as a savings association (not affiliated with a bank holding company) that has its home office in the same state as the home office of such thrift subsidiary.*"

¹⁰ 476 U.S. 355 (1986).

¹¹ 476 U.S. at 374. The Court cited two reasons for using this test for preemption. "First, an agency literally has no power to act, let alone preempt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it. Second, the best way of determining whether Congress intended the regulations of an administrative agency to displace state law is to examine the nature and scope of the authority granted by Congress to the agency."

¹² Subsection 206 (e) (5) gives FDIC authority to exempt any insured depository institution from the requirement of cross guarantees when it determines that the exemption is "in the best interests of the Bank Insurance Fund."

¹³ *MC Corp Financial, Inc., et al. v. Board of Governors*, 900 F2d 852 (5th Cir., 1990).

¹⁴ *Ibid.*, p. 863.

¹⁵ Testimony of L. William Seidman, Chairman, Federal Deposit Insurance Corporation, before the Subcommittee on Financial Institutions Supervision, Regulation, and Insurance Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, March 14, 1990.

¹⁶ *Ibid.*, p. 20.

¹⁷ 12 U.S.C. section 371c 1.

¹⁸ 900 F2d at 862.

Sandra B. McCray is a Colorado lawyer who writes frequently on state tax and regulatory issues. She is an independent consultant and teaches at the University of Colorado Graduate School of Business.

New from ACIR

Representative Expenditures: Addressing the Neglected Dimension of Fiscal Capacity

This information report presents an approach to the measurement of the relative public service needs of the states that is analogous to the Representative Tax System. The fundamental prerequisite for any measurement of service costs—and ability to raise revenue—is that it abstract as completely as possible from the actual tax and expenditure policies of any individual state. Variations in costs among the states will depend on three general classes of factors: legal requirements, prices, and scope of services.

M-174 approx. 150 pages \$20

(see page 29 for order form)

Significant Features of Fiscal Federalism

1990 Edition Volume II

Volume II allows the user to start with the "big picture" of the nation's economy and trends in the national income accounts and then to look at federal, state, and local finances in more detail.

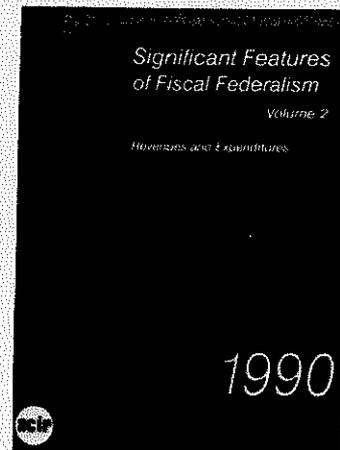
New in the 1990 edition are:

- International statistics on taxes and other revenues and expenditures for OECD countries
- State-by-state debt figures
- Expanded public employment tables
- State Profiles, which give a snapshot of state-local, state, and local revenues and expenditures

Other data include: revenue and expenditure tables for state-local, state, and local governments, by source or function, percentage distribution, per capita, and as a percentage of personal income; historical federal, state, and local fiscal trends; aggregate government fiscal trends; intergovernmental revenues and expenditures; ACIR measures of state fiscal capacity and effort; and state rankings of state-local revenue and expenditure items.

Significant Features, Volume I, contains data on federal and state budget processes and tax systems.

M-169-I	1990	160 pages	\$17.50
M-169-II	1990	280 pages	\$17.50



1988 State Fiscal Capacity and Effort

ACIR developed the Representative Tax System (RTS) and the Representative Revenue System (RRS) to improve on available measures of state fiscal capacity and effort. These measures show state and local government capacity to collect tax as well as nontax revenue. With *1988 State Fiscal Capacity and Effort*, ACIR—in conjunction with Price Waterhouse—continues its tradition of providing information on the relative economic well-being and fiscal performance of the states.

Why use the RTS and RRS?

- They measure governments' *potential* abilities to raise revenues relative to a national average
- They are *comprehensive*, measuring tax and nontax sources
- They are the *only* indicators that measure fiscal capacity on a revenue-by-revenue basis
- They capture states' opportunities for *tax exportation* by estimating actual tax and nontax revenue bases and applying average tax rates

1988 State Fiscal Capacity and Effort—

- Contains tables and graphs on RTS and RRS bases, arranged both by revenue base and by state
- Discusses recent changes in states' fiscal capacities
- Compares RTS and RRS with other capacity measures
- Provides details on the methodology
- Includes historical data

M-170	1990	160 pages	\$20
-------	------	-----------	------

(see page 29 for order form)

1988

State Fiscal Capacity and Effort

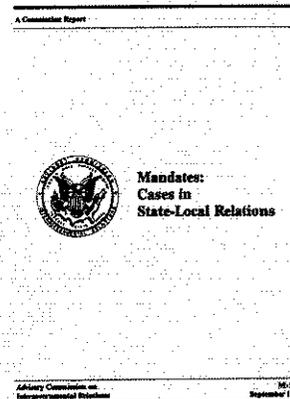


An Intergovernmental Report
M-170

Mandates: Cases in State-Local Relations

This information report on state mandates attempts to shed some light on an increasingly controversial aspect of state-local relations. The current concern centers around several issues, including the decline in federal aid relative to own-source revenues, the shift of more programmatic responsibility from the federal government to state and local governments, questions of accountability, public opposition to rising taxes, and difficulties in meeting mandates. The cases in this report come from seven states—Connecticut, Florida, Massachusetts, New York, Ohio, Rhode Island, and South Carolina.

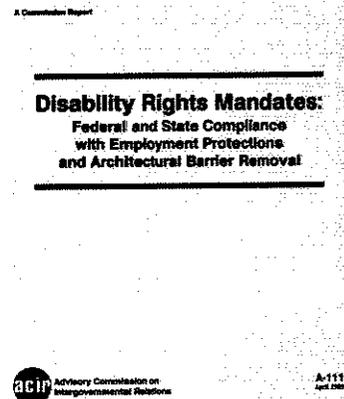
M-173 1990 80 pages \$10



Disability Rights Mandates: Federal and State Compliance with Employment Protections and Architectural Barrier Removal

This policy report examines the question of whether the federal government practices what it preaches by comparing federal and state compliance with disability rights mandates that apply to both governments. The report explores how intergovernmental policymaking may be made more effective and how cooperation can be fostered in the intergovernmental system in order to implement policy nationwide.

A-111 1989 136 pages \$10

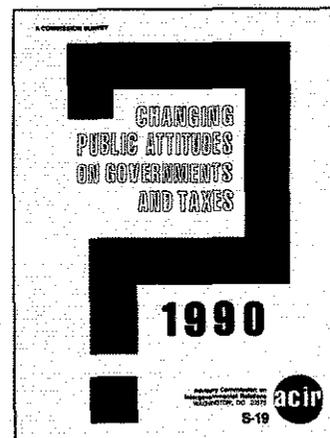


(see page 29 for order form)

1990 Changing Public Attitudes on Governments and Taxes

This staff report contains the 19th annual ACIR opinion survey. The poll has been conducted by The Gallup Organization since 1983. Every year since 1972, citizens have been asked what they think is the *worst* tax, that is, *the least fair*. This year, citizens chose the local property tax as worst, followed closely by the federal income tax. Asked for the second year to identify the government from which they get the *least* for their money, citizens picked the federal government. Other questions this year included trust and confidence in government to handle a range of foreign and domestic issues, the overall performance of governments, and rating of governmental cooperation.

S-19 1990 40 pages \$10



Local Revenue Diversification: Rural Economies

This is the fourth study in ACIR's series on local revenue diversification (the others are on user charges, local income taxes, and local sales taxes). This report singles out a specific type of government rather than a type of revenue. Rural local governments (including nonmetropolitan counties, small towns and townships, and rural school districts and special districts) have been under pressure to diversify revenue sources, but they face unique challenges and formidable barriers, both economic and statutory.

SR-13 1990 60 pages \$8

A STAFF REPORT

Local Revenue
Diversification
Rural
Economies



acir
Advisory Commission on
Intergovernmental Relations

SR-13
March 1990

(see page 29 for order form)

Intergovernmental Digest

States Challenge IRS Taxation of Tuition Trust Funds

Ohio and Michigan are challenging IRS rules requiring tax payments on their college tuition trust funds. Michigan has filed suit in federal court contesting an IRS ruling that the Michigan Education Trust pay corporate taxes on its earnings. The trust has accumulated some \$350 million from more than 40,000 prepaid tuition contracts. The corporate taxes, which the Michigan Trust has paid since 1988, are over and above the deferred federal taxes that student beneficiaries will pay when they withdraw earnings for tuition payments. Michigan argues that its trust should be treated as an essential state governmental function exempt from federal corporate taxes. The Ohio Tuition Trust is also asking IRS to classify these state trusts as exempt essential functions.

IGR Downshift at GAO

In a reorganization move, the U.S. General Accounting Office has sharply reduced the number of staff in its intergovernmental relations group from 45-50 staff years to 10 staff years. This shift parallels similar moves by other federal agencies in reducing their emphasis on intergovernmental issues. The group recently completed reviews of intergovernmental trends that developed during the 1980s and state responses to fiscally distressed localities. The shift in resources will allow GAO to focus on pressing national issues facing the Congress, such as the budget deficit and the savings and loans debacle. The smaller intergovernmental staff will shed some of its peripheral responsibilities and is likely to focus on broader intergovernmental issues, such as the role of OMB in intergovernmental management and the evolution of block grants over the past decade.

States Funding More Wastewater Treatment

According to a new *Clean Water Financing Update* issued by EPA, 44 states have established revolving loan funds to finance wastewater treatment facilities in lieu of discontinued federal grants. The rest of the states are expected to have such funds by October 1, 1990. New York State's program is said to be the biggest. Based on a \$212 million federal capitalization grant in March 1990, the state went to the bond market for a first installment on what is to become a \$4 billion program by the year 2000. The first \$166.5 million bond issue received a Moody's rating of Aa, the second highest, and an A rating from Standard and Poor's, its third highest rating. Both ratings are higher than those received by the city and the state for other purposes. The interest rate was 7.5 percent, and the issue was oversubscribed by more than five times. The EPA Office of Municipal Pollution Control is establishing a *National Environmental Financing Information Network* to help states, municipalities, and EPA offices to identify, evaluate, and implement techniques for financing environmental infrastructure projects.

Insurance Preemption Exemption in Possible Trouble

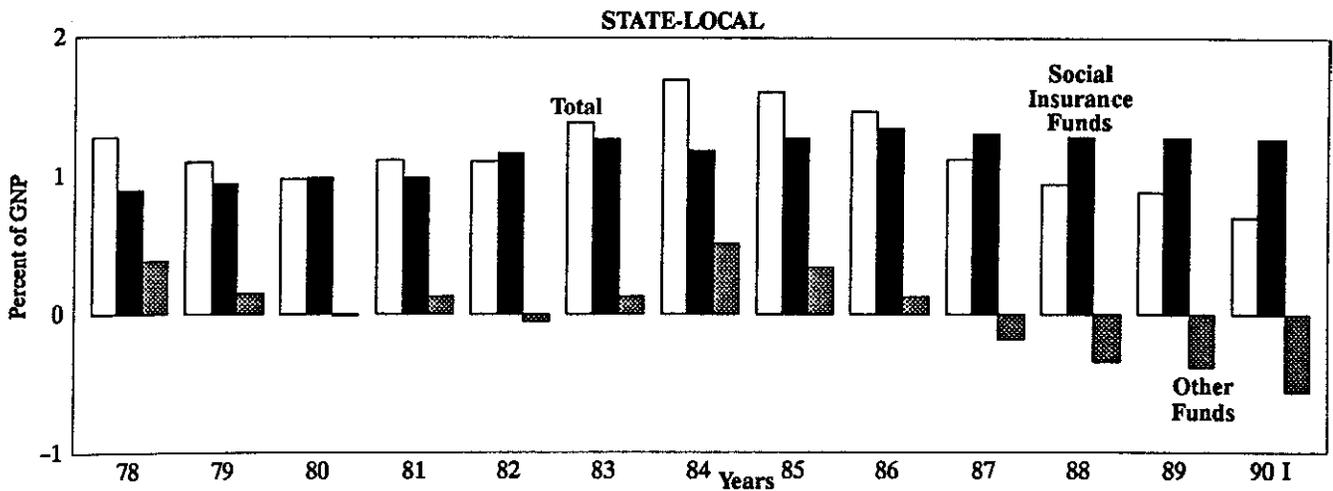
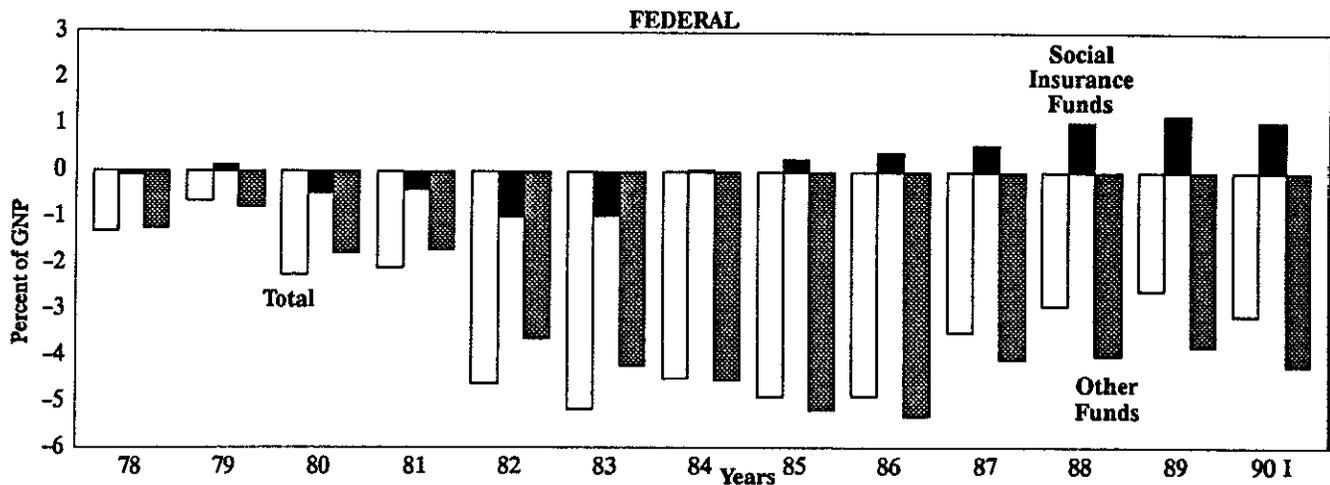
For the last 45 years, federal legislation has exempted the insurance industry from federal regulation, leaving the field clear for the states so long as their regulations avoid discrimination between in-state and out-of-state companies. The House Judiciary Committee, however, has passed and sent to the floor a bill that would significantly alter the present law. The Committee vote, split 19-17, reflected strong cross-pressures from consumer advocates and insurance companies. Many consumer groups believe that some states have not done a good job of keeping the insurance industry competitive. The bill would outlaw price fixing, allocation of territories, and other anticompetitive activities under the federal antitrust laws and allow policyholders to sue the insurance companies even if they are operating in conformance with state laws.

Government Budget Deficits Rising

In the first quarter of 1990, all governments (federal, state, and local) recorded a seasonally adjusted, annualized deficit of \$130.1 billion. The total deficit consisted of a surplus of \$127.6 billion in social insurance funds (mainly Social Security and Medicare for the federal government and employee retirement funds for state and

local governments) and a deficit of \$257.7 billion in other funds. The total federal deficit in 1990 I was \$168.2 billion, up \$34 billion from 1989. The social insurance fund surplus shrank by \$4.5 billion between 1989 and 1990 I (\$63.8 billion vs. \$59.3 billion), and the deficit in other funds rose from \$198 billion to \$227.5 billion. In 1990 I, the total federal deficit was 3.1 percent of GNP, with the social insurance funds running a surplus of 1.1 percent of GNP and other funds running a deficit of 4.2 percent of GNP. In 1990 I, state and local governments combined recorded an annual budget surplus of \$38.1 billion. The total surplus was made up of a surplus of \$68.3 billion for social insurance funds and a deficit of \$30.2 billion in other funds. Since 1984, total budget surpluses have shrunk from 1.7 percent of GNP (\$64.6 billion) to 0.7 percent in 1990 I. Social insurance fund surpluses have ranged between 1.2 and 1.3 percent of GNP from 1984 to 1990 I, while other fund balances went from a surplus of 0.5 percent of GNP in 1984 to a deficit of 0.6 percent of GNP in 1990 I.

Budget Surplus or Deficit as a Percentage of GNP, 1978-1990 I, National Income and Products Accounts Basis



Sources: U.S. Department of Commerce, Bureau of Economic Analysis. *Survey of Current Business*, July 1990, pp. 40, 58; ACIR, *Significant Features of Fiscal Federalism, 1990 Edition, Volume 2*, M-169-II, pp. 38-39.

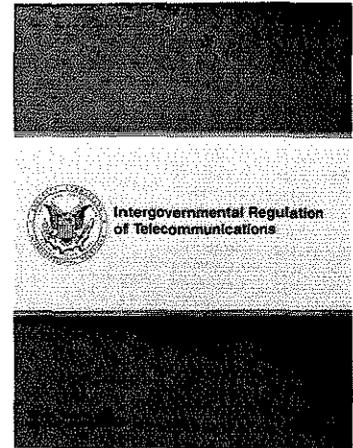
Intergovernmental Regulation of Telecommunications

This policy report examines, evaluates, and makes recommendations on the key intergovernmental regulatory issues that arise as a result of the changing institutional and economic structure of the telecommunications industry.

State regulators are experimenting with new regulatory schemes for the restructured industry, and some have moved ahead of FCC, introducing diversity and flexibility.

Technological advances also are changing the face of telecommunications (e.g., fiber optics and increasing use of digital switches). ACIR concludes that FCC has frequently preempted state law, and that continuation of such a policy may result in a loss of the lessons to be learned from state experimentation.

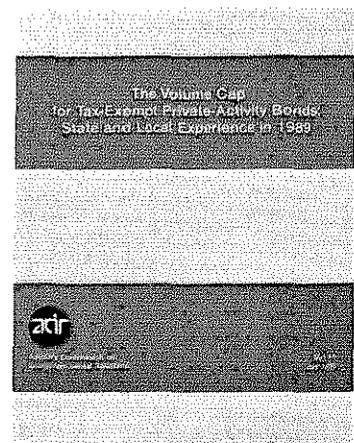
A-115 1990 48 pages \$10



The Volume Cap on Tax-Exempt Private-Activity Bonds: State and Local Experience in 1989

The unified volume cap was adopted as part of the *Tax Reform Act of 1986* and set a limitation for each state equal to the greater of \$50 per capita or \$150 million, effective in 1988. Despite the significance of the legislation, little is known about the states' operations under the cap. The states were surveyed to determine the priorities they use to allocate private-activity bonds between state and local governments, the volume and composition of the bond allocations, and suggestions for reform of the volume cap rules.

M-171 1990 40 pages \$7.50



(see page 29 for order form)

The Eisenhower Years and the Creation of ACIR

Wm. G. Colman
and Delphis C. Goldberg

On the occasion of the Eisenhower Centennial, October 14, 1990, it is appropriate to recall the dramatic changes in intergovernmental relations that occurred during Dwight D. Eisenhower's two administrations and the events leading to the creation of the Advisory Commission on Intergovernmental Relations. These developments included economic, fiscal, political, and administrative changes in the federal system as well as the creation of institutional structures in the executive branch and the Congress for assessing, addressing, and mediating federal-state-local relationships. The successive changes in these relationships from 1953 to 1960 occurred during a period of international and domestic volatility and controversy.

The outbreak of war in Korea in 1950, continuing in 1953, French and British colonial conflict in Southeast and South Asia and Africa, the triumph of Communism in China, and the rise of Soviet nuclear capabilities had replaced the temporary peace with multiple wars and partial remobilization. The Cold War continued unabated during the Eisenhower years, even while Americans were busy raising children, buying television sets, moving to suburbs, and listening to the new Rock 'n' Roll.

Domestically, various developments carried substantial implications for intergovernmental relations:

- The continued urbanization and suburbanization (some called it "Levittowning") of America, accompanied by the start of the interstate highway program in 1954 and direct federal grant assistance to local governments under the *Housing Act of 1954*.
- The U.S. responses to the launching of the USSR's Sputnik, which included the *National Defense Education Act*, marking the first federal aid for K-12 public education instruction.
- The U.S. Supreme Court's mandate to desegregate public schools (*Brown v. Board of Education*) in 1954, which triggered widespread federal-state and state-local controversy, including the dispatch of U.S. troops to Little Rock and Eisenhower's assumption of command of the Arkansas National Guard.
- The initiation of federal aid to states and localities in 1956 for the construction of wastewater treatment facilities.

During the New Deal and the succeeding Truman administration, the role of the federal government in domestic affairs had become much larger through the initiation of a broad series of federal grants to state governments. These grants began to go directly to local governments for airport construction in 1946 and urban renewal and housing in 1949. Legislation establishing or expanding a grant program typically carried requirements and mandates for the recipient governments. This expansion of federal money and control into many areas of domestic policy and governance that previously belonged to state and local governments was becoming a major political and philosophical issue by the early 1950s.

A Commission on Intergovernmental Relations, 1953-1955

Following the Republican Party convention of 1952, its nominee, Dwight D. Eisenhower, retired general and then Columbia University president, met with Sen. Robert A. Taft in New York to discuss the upcoming campaign. Taft expressed several policy priorities, including the establishment by the next administration of a bipartisan body to examine federal-state relationships and to make recommendations for their redirection. Following his inauguration, Eisenhower sent to the new 83rd Congress in March 1953 a proposal to establish a Commission on Intergovernmental Relations. The Congress responded promptly; on July 10, a bill creating the commission was signed into law (P.L. 83-109).

The commission comprised 15 members appointed by the President, with no more than nine to be of the same political party, and five each from the Senate and the House, with no more than three in each case from the same party. The chairman and vice chairman were to be designated by the President. The commission was to have completed its work by March 1, 1954. Its final report went to the President on June 20, 1955, and from him to the Congress on June 28. The commission became known as the Kestnbaum Commission from the name of its second chairman, Meyer Kestnbaum of Chicago, board chairman of Hart Schafner and Marx. The first chairman, Clarence Manion, dean of the Notre Dame University Law School, left after a few months due to White House concerns about his public speech-making, which it was feared would undermine public confidence in the new commission.

Of the commission's 15 presidential appointees, six were governors. One of them, Alfred E. Driscoll of New Jersey, was designated as vice chairman. Three members came from the federal executive branch (Treasury, HEW, and Labor), three from universities, one from city government, and two from the business sector.

The commission's work was comprehensive. Its final report on federal-state-local relations—described as “the first official undertaking of its kind since the Constitutional Convention of 1787”¹—contained a broad yet penetrating analysis of the federal system. Of particular note were:

- 1) Proposed criteria for federal involvement in state and local matters, both regulatory affairs and financial responsibility and participation;
- 2) Proposals for change in 17 functional areas, from agriculture to welfare; and
- 3) Reluctant acceptance of the then prevailing grant-in-aid system.

Especially important were the Commission's recommendations for enhancing and sharpening federal policy and operational attention to intergovernmental relations in the Congress and the executive branch. These institutional proposals were:

- A staff agency in the executive branch to serve as a “permanent center for overall attention to the problems of inter-level relationships.”
- A special assistant in the Executive Office of the President to give exclusive attention to, and advise the President on, state and local governmental relationships.
- An “Advisory Board on Intergovernmental Relations” formed after presidential consultation with “associations that represent various levels.”
- Intensified attention by the Bureau of the Budget (BoB) to intergovernmental relations.
- Assistant secretaries (for intergovernmental relations) in some departments.
- Intensified attention to intergovernmental relations by the Congress, including the possi-

ble creation and maintenance of “active subcommittees on intergovernmental relations in the Committees on Government Operations.”²

President Eisenhower moved promptly to implement the proposals for the executive branch. Former Arizona Governor Howard Pyle had been appointed as administrative assistant to the President in early 1955 and subsequently concentrated on intergovernmental relations. Kestnbaum also joined the administration as a special assistant in October 1955. A staff person for intergovernmental relations was designated within the administrative management side of BoB and a similar focusing of responsibility was initiated within those departments and agencies having extensive fiscal or other involvement with state and local governments. (In 1959, on the departure of Governor Pyle, Robert E. Merriam, a special assistant to the President for interagency affairs, assumed the additional intergovernmental role.)

Eisenhower's Philosophy

The President subscribed personally to an intergovernmental philosophy that coincided with the thrust of the Kestnbaum Commission's report. In a May 13, 1958, letter to Speaker Sam Rayburn, Eisenhower specifically endorsed a key principle enunciated in the report:

Leave to private initiative all the functions that citizens can perform privately; use the level of government closest to the community for all public functions it can handle; utilize cooperative intergovernmental arrangements where appropriate to attain economical performance and popular approval; reserve national action for residual participation where state and local governments are not fully adequate and for the continuing responsibilities that only the National Government can undertake.³

In a speech at Williamsburg, Virginia, to the 49th annual National Governors' Conference on June 15, 1957, Eisenhower drew comparisons between the increasingly centralized power of the federal government and what he called “the dark background of Eastern Europe . . . the results of extreme and dictatorial concentration of power” and predicted that “if present trends continue, the States are sure to degenerate into powerless satellites of the National Government in Washington.” He went on to say that although he was opposed to federal expansion he had found it necessary to “urge federal action in some areas traditionally reserved to the states,” mentioning “temporary” aid for school construction as an example. He then called on the governors to join with his administration in creating a joint task force for action, with three responsibilities:

- To designate federal or federally related functions that states were ready to assume and finance.
- To recommend the revenue adjustments, including transfers of federal tax sources, required to enable such assumption.
- To identify emerging functions likely to require federal or state assumption in the future and to recommend appropriate divisions of program and fiscal responsibility.⁴

On the following day, the Governors' Conference authorized its executive committee to help the administration

form such a task force. Its membership was completed and its formation announced on July 20. There were seven federal members (the secretaries of the Treasury, Labor, and HEW; the director of BoB; and three presidential assistants, including Pyle and Kestnbaum) and ten governors. Treasury Secretary Robert Anderson and New Hampshire Governor Lane Dwinell were co-chairmen of the committee.

The Joint Federal-State Action Committee, 1957-1959

In its two years of existence (being supplanted by the permanent ACIR in late 1959), the committee reviewed a number of issues and made two major recommendations:

- 1) Amendment of the *Atomic Energy Act* to grant the states a greater share of the responsibility of promoting and regulating the powerful uses of atomic energy, which was passed by the Congress in 1959.
- 2) Assumption by the states of full administrative and financial responsibility for vocational education programs and local waste treatment facility construction (i.e., repeal of these two major grant programs), to be accompanied by repeal of 40 percent of the 10 percent federal tax on local telephone service.⁵ The second recommendation went to the heart of the President's Williamsburg challenge to the governors to join with the administration to identify one or more grant programs for federal divestiture to the states along with commensurate revenue sources.

Hearings held by the House Intergovernmental Relations Subcommittee in February 1959 disclosed that the relinquishment of 40 percent of the telephone tax would provide the wealthiest states with considerably more revenue than the grants they would lose, while the poorer states would obtain far less revenue than they would need to continue the vocational education and waste treatment programs; this despite the fact that the federal government would have given up about \$150 million of revenue in exchange for being relieved of \$84.5 million in grant expenditures. Consequently, the Joint Action Committee's proposal would not have met the presidential objective of an equitable trade of revenue sources for cessation of grants. The committee's co-chairmen acknowledged that they had not been able to find a way to correct this imbalance.⁶ The Congress rendered the proposal moot by repealing the telephone tax in its entirety.

The committee made other recommendations, including one for future study. These included: (1) state inclusion of radiation hazards in workers' compensation laws; (2) tightening of federal regulations governing the transportation of migrant laborers; (3) improved coordination of federal and state estate and inheritance taxes; (4) congressional action to recognize state legislative jurisdiction over federal lands within the state; (5) transferability of funds among federal public health service grants; and (6) federal payments in lieu of taxes to state and local governments.

Congressional Actions on Intergovernmental Relations, 1955-1959

Following its transmittal to the Congress, the final report of the Kestnbaum Commission was referred to the

Government Operations committees of each house. On the House side, the committee chairman referred the report to the Intergovernmental Relations Subcommittee, chaired by L.H. Fountain (D-NC). The Senate committee had no such counterpart subcommittee, so the full committee handled the report.

Although relations between the federal government and the states and municipalities had been within the scope of the House and Senate committees on Government Operations from 1946 onward, the central concern of both had been legislative oversight of federal departmental and agency operations. The study of intergovernmental relations via subcommittees did not begin until 1955 in the House and 1962 in the Senate. When the Kestnbaum Commission report was assigned to the House Intergovernmental Relations Subcommittee, Fountain initiated reviews of the report and brought in as a consultant former commission staff member D.C. Goldberg. The subcommittee had two objectives: first, to discharge its general responsibility for studying federal-state-local relations, with particular emphasis on grant programs, and second, to evaluate the Kestnbaum recommendations and ascertain what action was and/or should be taken concerning them. Questionnaires were sent to relevant federal departments and agencies, all governors, and selected state, city, and county officials soliciting their views on existing allocations of responsibility for intergovernmental programs and any reallocation they felt was desirable. Replies were compiled and published.⁸

Subcommittee hearings in Washington and at eight regional locations were held in 1957-58. Testimony was solicited from all 48 governors and from a representative sample of state legislative leaders, mayors, and county officials. Some 121 witnesses were heard and statements were received from others. Hearings for federal officials administering federal grants were held in Spring 1958. The subcommittee report of the hearings and its own findings and recommendations were approved by the full Committee on Government Operations in August 1959.⁹

With few exceptions, the subcommittee found favorable acceptance throughout the nation of the grant-in-aid process and of most existing grant programs. However, dissatisfaction was expressed about some of the conditions attached to grant programs. Contrary to the allegation frequently voiced that federal administrative expenses were excessive, the subcommittee found no evidence of such so-called freight charges. It also found the grant system to be a useful vehicle for harnessing cooperative governmental efforts in the accomplishment of national legislative purposes.¹⁰

Among its other findings, the subcommittee reported:

- To a considerable extent, the growth of federal activities was attributable to state constitutional and statutory limits on their powers and those of their local governments. Urban areas also were not fairly represented in the state legislatures.
- Grant program expansion was attributable partly to the "failure" of the states to meet urgent public needs. Other factors included the low fiscal capacity of some state and local governments, the increasingly interstate character of socioeconomic activity, extensive federal legal power and fiscal capacity, and the tendency of interest groups to concentrate their efforts on the federal government.

- Strengthening of state government was an important objective deserving much more attention.
- Strengthening the states by devolving federal revenue sources was of limited utility because the need for public services was often greatest in low fiscal-capacity states and responsibility cannot be created by a trade-off of grants and tax sources. The initiative must come from the states and localities.
- General agreement with the Kestnbaum Commission's interpretation of federalism and its views concerning grants was evident, but while the recommendations had stimulated some federal improvement in grant procedures, they had little effect on the states. The states showed little interest in assuming a more activist service and regulatory role.
- Occasional studies and ad hoc committees were useful, but were not an effective substitute for continuous review of intergovernmental programs and problems from the standpoint of the federal system as a whole.
- A "broadly based Advisory Commission on Intergovernmental Relations, drawing its membership from the Congress, the executive branch, governors, state legislatures, mayors, county officials, and private citizens"¹¹ should be established.

A bill to implement the recommendation for an Advisory Commission on Intergovernmental Relations was drafted by the subcommittee and refined in consultation with other committees of the Congress regarding possible jurisdictional questions, such as exemption of the proposed commission staff from the civil service laws. The subcommittee staff also met with the executive directors of a number of interest groups, including organizations of state and local government officials that would be affected by the proposed legislation.

Although it was clear that Chairman Fountain would be the principal House sponsor of the legislation, with the support of Rep. Florence Dwyer (R-NJ), the ranking minority member, it was important to obtain active Senate sponsorship as well. Sen. Edmund Muskie (D-ME) agreed to assume this role. As a former governor of Maine and a respondent to the subcommittee questionnaire, he had a special interest intergovernmental relations.

Identical bills to establish an Advisory Commission on Intergovernmental Relations were introduced in the House on May 6, 1959, by Fountain and Dwyer (HR 6904 and HR 6905). A companion Senate bill (S. 2026) was introduced by Muskie for himself and 25 cosponsors.

Joint hearings were held on these bills in June 1959 by the House Intergovernmental Relations Subcommittee and by the Senate Committee on Government Operations represented by Senator Muskie. The witnesses included members of Congress, governors, mayors representing the American Municipal Association and the U.S. Conference of Mayors, the National Association of County Officials, and members of the former Kestnbaum Commission. Testimony and statements favoring the legislation were received from 22 governors.

At the joint hearings, Meyer Kestnbaum stated: "I am sure I need not remind you that the Commission in making its report had in mind the fact that its study was only the beginning of a real inquiry into the whole subject. . . . [T]he idea

of a commission that will give the President and the Congress the benefit of careful, incisive research and examination of the many problems that face us in that area is sound and . . . can fulfill a very important and useful function."¹²

Because the proposed commission would be somewhat competitive with the Joint Federal-State Action Committee, in which the governors were still participating, Muskie and Fountain thought it desirable to obtain the support of the National Governors' Conference, meeting that year in San Juan, Puerto Rico. Although Robert Merriam, representing the White House at the meeting, raised some questions, the Conference adopted a resolution in support of the establishment of an ACIR.

The Fountain bill (HR 6904) was reported favorably by the House Government Operations Committee on July 31, with five amendments to incorporate recommendations made by witnesses in the joint hearings and by the director of the Bureau of the Budget. The administration's recommendations included: (1) enlargement of the number of nominees to be submitted by the state-local organizations for presidential appointment to the commission in order to afford increased flexibility to the President and (2) provision for presidential designation of the chairman and vice chairman of the commission from among its members.

After being reported by the committee, HR 6904 was placed on the House suspension calendar (two-thirds vote, limited debate, no substantive amendments). This approach succeeded, and by a vote of 335-31 the bill passed the House on August 17. The companion Senate bill was passed without opposition on September 10, with an amendment by Senator Mundt (R-SD) providing four county representatives instead of the two provided in the House bill.

The ensuing House-Senate Conference agreed to three county representatives, with a total commission membership of 26. Six members were to be appointed by the President—3 from the executive branch and 3 public members; 3 each appointed by the Senate President and the House Speaker; and 14 appointed by the President from lists numbering twice the number of membership slots—4 governors, 4 mayors, 3 state legislators, and 3 elected county officials. The lists were to be submitted by the National Governors' Conference, jointly by the American Municipal Association and the U.S. Conference of Mayors, and the National Association of County Officials. For the congressional members, the governors and the mayors, two were to be from each political party. Not more than two of the state legislators and county officials could be from the same party. Following acceptance of the conference report by both houses, HR 6904 was sent to President Eisenhower.

Maurice Stans, Director of the Bureau of the Budget, advised a presidential veto. Some BoB staff believed that accountability would be confused by making the commission an independent agency responsible to both the President and the Congress, rather than being part of the Executive Office as proposed by the Kestnbaum Commission. HEW Secretary Arthur Fleming also advised a veto. Eisenhower wavered, but Robert Merriam urged and subsequently persuaded the President to approve the bill on the ground that a Democratic Congress would not allow its representatives to participate and vote in a forum subservient to presidential control. In all probability, the President was influenced also by the huge House and Senate majorities in support of the bill, making a

veto override likely. President Eisenhower signed HR 6904 on September 27, 1959, as Public Law 86-380.

The New Commission: Eisenhower's Appointments and the First Year's Work, September 1959-January 1961

During October and November 1959, the designated organizations of state and local government officials submitted their slates of nominees to the White House. The House speaker and Senate president proceeded with their appointments: Senators Muskie, Mundt, and Sam Ervin (D-NC); and Representatives Fountain, Dwyer, and Wilbur Mills (D-AR). Robert Merriam was the key figure in advising the President on his appointments. Frank Bane, a Democrat and former executive director of the Council of State Governments, was named chairman, and James Pollock, a Republican and professor of political science at the University of Michigan, was named vice chairman. The other public member was John Burton, a Republican from Cornell University, who had served on the Kestnbaum Commission. Other members were:

Governors—Robert Smylie (Idaho), Ernest Hollings (South Carolina), Abraham Ribicoff (Connecticut), and William Stratton (Illinois);

Mayors—Gordon Clinton (Seattle), Norris Poulson (Los Angeles), Anthony Celebreeze (Cleveland), and Don Hummel (Tucson);

State Legislators—Elisha Barrett (New York), Leslie Cutter (Massachusetts), and John Noble (Missouri);

Elected County Officials—Edwin Michaelian (Westchester Co., New York), Edward Connor (Wayne Co., Michigan), and Clair Donnenthirth (Plumas Co., California);

Federal Executive Branch Secretaries—James Mitchell (Labor), Arthur Fleming (Health, Education, and Welfare), and Robert Anderson (Treasury).

The commission's membership reflected a wide range of views. Following the appointment of an executive director (Wm. G. Colman) at its second meeting, a work program was adopted at the third meeting (May 25, 1960), comprising the following projects:

- 1) Coordination of state and federal estate and inheritance taxes;
- 2) Modification of public health service grants;
- 3) Investment of idle cash balances by state and local governments;
- 4) Periodic congressional assessment of federal grants to state and local governments;
- 5) Intergovernmental responsibilities for mass transportation;
- 6) State restrictions on local governments;
- 7) Structure and improvement of the real property tax;
- 8) Cooperative tax administration; and
- 9) Development of improved measures of state and local fiscal capacity and tax effort.

The first two of these projects were carryovers from the Joint Federal-State Action Committee. Reports on the

first three were completed during the course of the year and were considered, modified, and adopted at the fourth meeting, January 18-19, 1961, the last full day of the Eisenhower administration.

Relations among the commission chairman, staff, and the Eisenhower White House were cordial and cooperative throughout. Robert Merriam was the principal point of contact, and he related most effectively with the commission, the two congressional subcommittees, and the organizations of state and local governments. Beginning in 1969, Merriam served with distinction for eight years as chairman of ACIR. At the time of his death in 1988, he was serving as vice chairman of the Eisenhower Centennial Commission.

One can speculate on the possibility that his military background and a belief in clear and orderly delegation of authority played at least as large a part in President Eisenhower's policies as did his political philosophy, which he sometimes depicted as fiscally conservative and socially liberal. One of the major accomplishments during his eight years in office was to bring to political, administrative, and public attention the inherent values of the American system. In so doing, Dwight D. Eisenhower served the nation well.

Notes

¹ Commission on Intergovernmental Relations (Kestnbaum Commission), *A Report to the President for Transmittal to the Congress* (Washington, DC, June 1955), p. v.

² *Ibid.*, pp. 86-89.

³ *Ibid.*, p. 6.

⁴ Joint Federal-State Action Committee, *Report of the Joint Federal-State Action Committee to the President of the United States and to the Chairman of the Governors' Conference* (Washington, DC, 1960), pp. 44-45.

⁵ *Ibid.*, pp. 2-5.

⁶ U. S. Congress, House of Representatives, *Hearings before the Intergovernmental Relations Subcommittee*, 85th Congress, Second Session, February 18, 1958, pp. 27-28.

⁷ Joint Federal-State Action Committee, pp. 4-5. Latter four addressed in ACIR reports: *Coordination of State and Federal Inheritance, Estate, and Gift Taxes*, January 1961; *State and Local Taxation of Privately Owned Property Located on Federal Areas*, June 1961; and *Modification of Federal Grants-in-Aid for Public Health Services*, January 1961.

⁸ U.S. Congress, House of Representatives, *Sixth Report of the Committee on Government Operations*, 85th Congress, First Session, June 1957, pp. 5-6; and *Staff Report on Replies of Federal Agencies to Questionnaire on Intergovernmental Relations*, 84th Congress, Second Session, August 1956.

⁹ U.S. Congress, House of Representatives, "Federal-State-Local Relations: Federal Grants-in-Aid," *Thirtieth Report of the Committee on Government Operations*, House Report 2533, 85th Congress, Second Session, August 8, 1958.

¹⁰ *Ibid.*, p. 47.

¹¹ *Ibid.*, p. 51.

¹² U.S. Congress, House of Representatives, *Report (to accompany HR 6904)*, House Report 742, 86th Congress, First Session, p. 4.

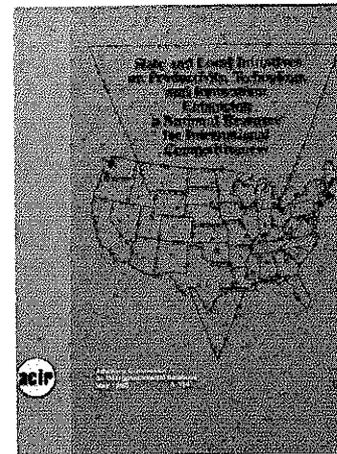
Wm. G. Colman is a consultant on state and local government. Delphis C. Goldberg was a professional staff member of the House Committee on Government Operations' Subcommittee on Intergovernmental Relations and Human Resources.

State and Local Initiatives on Productivity, Technology, and Innovation: Enhancing a National Resource for International Competitiveness

The Omnibus Trade and Competitiveness Act of 1988 established in the U.S. Department of Commerce a Clearinghouse for State and Local Initiatives on Productivity, Technology, and Innovation. ACIR assisted Commerce in determining appropriate roles for the Clearinghouse that would be of greatest support to state and local competitiveness initiatives. This volume includes:

- **Three guides to published directories**, national clearinghouses, and program developers and administrators in the fields of productivity, technology, and innovation
- **Four research papers**, with extensive reference sections, on a survey of trends in state policies and programs, the transfer of federally developed technology to the private sector, experiences of other clearinghouses in science and technology and economic development, and sources of information for small technology-based business
- **ACIR's report to the Department of Commerce**
- **ACIR's findings and recommendations** on the setup, operations, and funding of the Clearinghouse

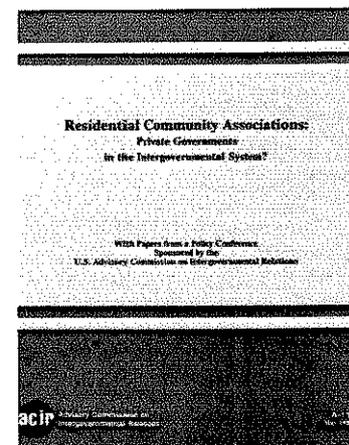
A-114 1990 200 pp. **\$25**



Residential Community Associations: Private Governments in the Intergovernmental System?

Residential community associations (RCAs), having territorial scope and authority to levy mandatory assessments, regulate behavior, and provide public services, such as streets, may be the fastest growing form of "local government" today. This policy report examines the growth and characteristics of RCAs and the opportunities and problems they pose for state and local governments.

A-112 1989 128 pages **\$10**



(see page 29 for order form)

Federalism and German Reunification

Wolfgang Welz

When the reunification of Germany suddenly became feasible with the opening of the Berlin Wall on November 9, 1989, there was an unspoken consensus among leading politicians in both East and West Germany that a unified Germany should be federal. Chancellor Helmut Kohl expressed this explicitly on November 20, when he proposed to the West German *Bundestag* a ten-point plan for overcoming the separation of Germany. The ultimate goal of his plan was to create a "new federal state of the Germans" (*ein neuer Bundesstaat der Deutschen*). A clue that the East German government was moving in the same direction could be found in Prime Minister Lothar de Maiziere's first State of the Union address, in which he stated that reestablishment of the East German *Laender* would be a precondition for German reunification.

Behind this preference for federalism in both parts of Germany, however, are specific differences in the reasons why East and West Germans favor a federal system. Federalism, particularly the participation of the *Laender* in the national legislature, is valued above all in West Germany as a decisive element in checking and controlling the power of the national government. The division of powers in the West German parliamentary system do not permit efficient control of the executive branch. The Chancellor and the heads of the departments are members either of the majority party or of the leading party coalition in the *Bundestag*. The executive branch and the parliamentary majority are, therefore, an "action unit," which limits the span of control of the minority parties that make up the parliamentary opposition.

Other positive elements of federalism, such as the political autonomy of the *Laender* and the protection of cultural, social, and economic diversity of the *Laender* and regions, are generally regarded as less important. There are, of course, differences between and among the *Laender*, especially between those in the south and those in the north, and between the large *Laender* and the so-called "city-states" (*Stadtstaaten*), which consist only of metropolitan areas. These differences, however, have been significantly reduced by a strong pull to uniformity created in part by socioeconomic necessities (e.g., the need for a common market) and in part by constitutional provisions that require a "uniformity of living standards in the federal territory" and "a reasonable equalization between financially strong and financially weak *Laender*" (Articles 106 III, 107 II). Furthermore, there is often strict uniformity in *Laender* regulations due to increased voluntary coordination among the *Land* governments. This trend toward a "unitary federal state"¹ is, on the whole, accepted by West Germans who, with the possible exception of the Bavarians, do not strongly identify with their *Bundesland*.

In East Germany, where there are more cultural and ethnic divisions than in West Germany, there is a stronger sensitivity to the classic concerns of federalism. This is perhaps best exemplified in the amendment to the constitution of a unified Germany that was recently proposed by the Sorbians (a Slavic ethnic group). The amendment would legally guarantee both the protection and the promotion of ethnic minorities. Moreover, there is a conviction that strong *Land* and local governments will help to guard individual liberties, which were abolished by the government of the "Socialist Unitary State," as East Germany was called in its communist constitution.

Federalism and Constitutional Reunification

The first important step toward reunification was the treaty (*Staatsvertrag*) of May 18, 1990, which created an economic, monetary, and social union. With this treaty, both countries entered into a "contractual community" (*Vertragsgemeinschaft*) to standardize their legal and economic systems. However, for unification to be completed, the procedural requirements of the West German Basic Law had to be met. The Basic Law provides two possible procedures for reunification: the accession of East Germany (Article 23) and the voluntary merger of both countries via the adoption of a common constitution "by a free decision of the German People" (Article 146).

The Social Democrats and the Greens preferred the adoption of a new constitution because this procedure was

seen by them as being more democratic. Moreover, it would treat the East Germans as equal partners and would avoid the impression of an economically forced annexation. The Christian Democrats and the Free Democrats, however, favored accession because it would be more practical and less time consuming. Eventually, the coalition of Christian Democrats and Free Democrats won, primarily because the East German government was anxious to achieve reunification quickly.

As a result, the unification will be accomplished via Article 23, which states that the West German Basic Law "shall be put into force in other parts of Germany (e.g., in East Germany)" after they have formally declared to join the Federal Republic. This declaration was announced by the East German parliament on August 22, 1990. The West German government is now constitutionally obligated to accept the declaration, which provides for unification on October 3, 1990.

With the accession of East Germany, the West German Basic Law simultaneously will lose its provisional character because the constitutional reunification order (*Wiedervereinigungsgebot*) will have been met.² With the retention of the Basic Law, it is guaranteed that united Germany will be a federal system. After the unification, there may be amendments to the German Constitution, but no amendment is permitted to abolish the so-called "eternal" provision of the constitution. This provision states that "amendments of this Basic Law affecting the division of the federation into *Laender*, the participation on principle of the *Laender* in legislation . . . shall be inadmissible" (Article 79 III).

Reestablishment of the East German *Laender*

Even among West Germans, it was almost unknown that until 1952 East Germany was composed of five *Laender*: Saxony, Saxony-Anhalt, Thuringia, Mecklenburg, and Brandenburg. These *Laender* participated in national affairs through the *Laenderkammer*, which was composed of delegates from the *Laenderparlamente*. But the *Laenderkammer* was neither a co-equal branch of the national parliament (*Volkskammer*) nor a "second house," as are, for instance, the West German *Bundesrat* and the U.S. Senate, because the *Volkskammer* could easily override the votes of the *Laenderkammer*. Considering that, from the very beginning, the East German government was run completely by the *Sozialistische Einheitspartei*, the federal arrangement was nothing more than a disguise for Communist rule.

The lack of serious interest in federalism in East Germany became very clear in 1952. The *Laender*, including East Berlin, were reconstituted in 15 districts (*Bezirke*), in the course of which the old *Laender* boundaries were often ignored. The *Laender* were never legally abolished, but they became insignificant as political entities.

Nevertheless, many East Germans remained committed to their *Laender*. This became evident in the recent constitutional debates. The argument was made that restoration of the *Laender* within the old boundaries of 1952 would not be appropriate because of changes in the social-economic structures of the areas during the past 38 years. The East German government discovered that any restructuring of the *Land* boundaries along functional lines would not be accepted by the people, who no longer wanted to be identified as citizens of East Germany, but as citizens of their *Land*.

This had to be taken into consideration by the *Volkskammer*, which on July 22, 1990, enacted the law for the

creation of the *Laender* (*Laendereinführungsgesetz*). This law provides for the five *Laender*: Mecklenburg-Vorpommern, Brandenburg, Saxony-Anhalt, Saxony, and Thuringia. However, because the new boundaries do not match those of the old *Laender* in 15 counties (*Kreise*), the question of which border territories should go to which *Land* had to be settled in advisory referenda.

Further correction of the boundaries is possible. The *Laendereinführungsgesetz* explicitly states that all cities and townships can join the *Land* to which they belonged in 1952. This has to be requested by advisory referenda and submitted to the respective *Land* government for its concurrence. The boundary changes so created must be settled by compacts between the *Laender*. By now, about 140 cities and townships have made such a request.

East Berlin has been given the semi-autonomous status of a *Land* until unification is accomplished. After that, it remains to be decided if Greater Berlin (composed of East and West Berlin) will be combined with Brandenburg to form the *Land* Berlin-Brandenburg.

The first elections for the *Land* parliaments (*Landtage*) are scheduled for October 14, 1990. The election system provides for proportional representation combined with single-member districts. The candidates of small parties, however, can gain a seat only if their party gets at least 5 percent of the votes of the *Land* electorate, or gains at least one seat in three districts. Exempted from this 5 percent clause are ethnic minorities, if they enter the election with their own candidates, as is done, for instance, by the Sorbians.

In every *Land*, the legislative representatives are organized in one chamber, and the number of seats in the legislature is based in each *Land* on its population. According to this, Brandenburg will have 88 representatives, Mecklenburg-Vorpommern 66, Saxony 160, Saxony-Anhalt 98, and Thuringia 88.

The first *Landtage* also will serve as the constitutional convention of their *Land*. This function includes not only the adoption of the *Land* constitution (*Landesverfassung*) but also the power to decide the site of the *Land* capital (*Landeshauptstadt*). As far as one can now see, it seems almost certain that Potsdam will become the capital of Brandenburg, Dresden of Saxony, and Erfurt of Thuringia. Whether Halle or Magdeburg will become the capital of Saxony-Anhalt and if Schwerin or Rostock will become the capital of Mecklenburg-Vorpommern is still controversial.

Political Representation of the East German *Laender* in the United Germany

Considering the upcoming reunification, the East German national parliament has not provided for the restoration of the *Laenderkammer*; instead, the parliament has passed a transitional provision. The *Land* prime ministers and the mayor of East Berlin have a suspensive veto in national legislation, which can be overridden by the *Volkskammer* with a two-thirds majority. After reunification, the East German *Laender* will become members of the *Bundesrat* through which the West German *Laender* now "participate . . . in the legislation and administration of the Federation" (Article 50). Unlike the U.S. Senate, the members of the *Bundesrat* are not selected by direct popular election. They are, rather, members of the *Land* governments, which appoint and recall them. Because the members are subject to instruction by their *Land* govern-

ment, the *Bundesrat* is sometimes called "an assembly of *Land* ambassadors."³ The Basic Law provides that "each *Land* shall have at least three votes; *Laender* with more than two million inhabitants shall have four, *Laender* with more than six million inhabitants, five votes." (Article 51 II). The votes of each *Land* can be cast only as a block vote.

If this apportionment formula is applied to the *Bundesrat* of the united Germany, each East German *Land* would have four votes. In total, the East German *Laender* would get 20 votes, increasing the total number of votes in the *Bundesrat* from 45 to 65.

Critics have suggested that retention of this formula will intensify the misrepresentation of some of the large West German *Laender*, considering that the distribution of votes is already far from proportional to the populations of the *Laender*. They point out that North Rhine-Westphalia alone has as many inhabitants as all the East German *Laender* together. In addition, if the current formula is maintained, the East German *Laender* will have 30.8 percent of the votes in the *Bundesrat*, although their portion of the population of the united Germany is just 21.4 percent.

It is not surprising, therefore, that the large West German *Laender*, in particular, have taken reunification as an opportunity to try to alter the distribution of the votes in the *Bundesrat*. They have proposed an amendment to the Basic Law that would provide a new apportionment formula for the *Land* votes in the *Bundesrat*. *Laender* with up to 2 million inhabitants would have three votes, those with 2-3 million inhabitants four votes, those with 3-5 million inhabitants five votes, those with 5-7 million inhabitants six votes, those with 7-12 million inhabitants seven votes, and those with more than 12 million inhabitants eight votes.

The new formula is intended above all to guarantee the absolute veto power (*Sperrminoritat*) of the larger *Laender* over constitutional amendments in the reunited Germany. Under the current formula, these *Laender* would lose their veto power, which, instead, would accrue to the East German *Laender* and Greater Berlin.

If the new formula is implemented, North Rhine Westphalia (16.9 million inhabitants) would have eight votes; Bavaria (11.1 million inhabitants), Baden Wurttemberg (9.5 million inhabitants), and Lower Saxony (7.2 million inhabitants) would have seven instead of five votes; Hesse, with a population of 5.6 million would have six votes instead of four; Saxony (4.9 million inhabitants), Greater Berlin (3.5 million) and Rhineland Palatinate (3.7 million) would have five instead of four votes. There would be no change for Schleswig Holstein (2.6 million), Saxony-Anhalt (3.1 million), Brandenburg (2.6 million), Thuringia (2.5 million), and Mecklenburg-Vorpommern (2.3 million), each of which would have four votes. The small *Laender*, Hamburg (1.6 million), Saarland (1.1 million), and Bremen (0.6 million), would continue to have three votes each. The total number of votes in the *Bundesrat* would increase from 45 to 78.

It is very likely that the proposed amendment will be enacted because both the East and the West German governments agreed to it in the second state treaty on August 26, 1990. Even so, for the amendment to clear all barriers to passage, it must be approved by two-thirds of the members of the *Bundestag* and receive two-thirds of the votes of the *Bundesrat*. This constitutionally required approval will not be unconditional. The smaller West German *Laender* already have expressed very clearly that their approval can

be attained only under the condition that in case of a new delineation of territory in the united Germany, the consent of the affected *Laender* must be obtained. As a result, the recent debate about restructuring the West German *Land* boundaries for technocratic reasons (e.g., administrative efficiency) seems to have ended before it really started, because the smaller *Laender* will block any major changes in borders affecting them.

Financing the Federal System of the United Germany

Considering the backward economy of East Germany and its international debts of 31.5 billion marks, it is not astonishing that the question of how to finance unity has turned into a political battleground. This is true especially because the East German *Laender* will be unable to carry out their governmental activities without financial aid. According to preliminary estimates, their presumptive tax revenues will amount to just one-fourth of the revenues raised by the West German *Laender*.

The East German *Land* governments, therefore, will probably have to operate frugally. The likelihood of enhancing their own-source revenues by raising taxes or adopting new taxes is very limited. In the German federal system, the power to levy taxes (*Steuerfindungsrecht*) is reserved almost entirely to the national government. Most taxes are fixed, either by type or by proportion, to a level of government by the constitution or by agreements between the national government and the *Laender*. The national government has exclusive use of the excise taxes, such as the tax on oil, on tobacco, on alcohol, as well as a few other taxes. The *Laender* have exclusive title to such taxes as the wealth tax, the automobile tax, the inheritance tax, and a few others. Local governments have only two exclusive taxes: the property tax and the tax on local businesses. All of these exclusive taxes taken together constitute about 20 percent of total tax revenues.

The vast majority of all tax revenues (about 75 percent of the total internal revenue sources) comes from shared taxes, distributed among all three types of government. These taxes are the income tax, the corporate tax, and the value added tax. While the national government and the *Laender* share equally the revenues from income taxes and corporation taxes (a share of the income tax has to be accrued to the local governments), the shares of the national government and the *Laender* of revenue from the value added tax are determined every second year by a federal statute requiring the consent of the *Bundesrat*. (The current distribution formula provides 65 percent for the union and 35 percent for the *Laender*.)

Despite unification, the West German *Laender* have decided that the East German *Laender* will not be immediately included in the distribution of shared taxes. West German *Land* governments claim that their revenue losses would amount to between 4-5 billion marks for each of the following four years if they had to share their portion of the value added tax with the East German *Laender*, as required by the currently valid formula. They have suggested that until the end of 1994 the East German *Laender* should receive about 40 percent of the share due to them. Beginning in 1995, their respective shares would be fully allocated to them. This compromise was adopted by the second state treaty, which also fixed the participation of the East German *Laender* in the system of subnational fiscal equalization (*horizontaler Laenderfinanzausgleich*).

As directed by the Basic Law, a certain percentage of the revenues of the financially strong *Laender* are granted to *Laender* "whose per capita revenue . . . is below the average of all the *Laender* combined" (Article 107). If this constitutional provision is applied immediately after reunification, all West German *Laender*, even the financially weak ones, will have to grant supplementary shares to the East German *Laender*. Therefore, the West German *Land* governments unanimously rejected the immediate participation of the East German *Laender*, withholding equalization payments until 1995.

Both compromises will force greater fiscal responsibilities onto the East German *Land* governments, especially, because borrowing as an avenue of revenue enhancement also is more or less blocked.

The East German *Laender* are legally entitled to borrow, as are the West German *Laender*, which are heavily indebted (in 1986 their debts amounted to 262 billion marks). However, given the enormous costs to the East German *Laender* of adopting the vast body of West Germany's social, economic, and environmental regulations and of major infrastructure repair, there is too little leverage left to use borrowing as a tool to finance government functions. Although the West German government has drafted provisional regulations to give the East German territory the breathing space necessary to modernize its antiquated industries, the upcoming transformation of the 12-nation European Community on December 31, 1992, into a single regional market will put additional financial pressure on the East German *Land* governments. The Brussels-based European Commission, which serves as the executive branch of the Community, not only has set the end of 1992 as the deadline for applying Community food, veterinary, chemical, and pharmaceutical standards in the five East German *Laender* but also demands the immediate application of its nuclear safety rules.⁴ Even if the European Community contributes about 4.5 billion marks in social, regional, and farming subsidies to the East German *Laender* for the next three years, the united Germany, due to its increased population, will have to pay the Community an additional 3.4 billion marks a year in dues, which are based on population.

Together, both the national and the *Land* governments of West Germany are expected to carry the main financial burden of restoring the East German *Laender* to reasonable fiscal health. As a beginning, West Germany has established a financial pool called "German Unity," which provides for 115 billion marks to smooth the accession of the East German *Laender*.

Outlook: German Federalism in the 1990s

With the integration of five new *Laender* into the federal system, the condition of German federalism may best be characterized as ambiguous. A prime example of this ambiguity is the decision about the location of the capital of the united Germany. Although the East and the West German governments have agreed through the second state treaty that Berlin will become the capital, it still remains to be decided when Berlin will become the permanent site of the federal government. As far as one can see now, Germany will have two capitals for a while: Berlin as the "ceremonial" capital, where the office of the President (which, unlike to the U.S. President, has primarily ceremonial functions) and only a few federal agencies are located, and Bonn as the "adminis-

trative" capital, where the office of the Chancellor and most agencies of the federal executive branch are located. The *Bundestag* will probably meet in both cities.

However, what is certain is that the difficulties of decisionmaking in the *Bundesrat* will increase considerably due to the socioeconomic disparities between the West and East German *Laender*. New regional and sectional conflicts will emerge. The current North-East gap may be joined by an East-West gap. Moreover, because of the cultural and ideological differences between the West and the East, which have been clearly demonstrated by the abortion battle during the reunification debates,⁵ partisan politics may become more salient in the *Bundesrat*. It is true that the *Bundesrat* is supposed to represent *Land* interests rather than party interests, but if there are different majorities in the *Bundesrat* and in the *Bundestag*, as occurred from 1972 to 1982, political conflicts will probably more often spring from diverging party interests. In the future, the parties are expected to represent more often regional, sectional, or cultural interests; consequently, the issue of sorting out responsibilities between the national government and the *Land* governments may come alive again. Furthermore, because of the enormous amount of money needed to close the financial gap between East and West Germany, the question of how to finance *Land* and local governments will be one of the cutting-edge issues of German federalism in the years ahead.

The most serious challenge for the future of German federalism, however, is the continuing process of European integration, which is somewhat contradictory. On one hand, there will be a loss of power of the *Laender* as well as of the federation to the European Community. On the other hand, there are attempts to create and to keep regions as political entities within the Community. As was proposed by a resolution of the European Parliament in 1988, each region should even have its own parliament and its own government. The decisive question is whether a "Europe of regions" will compensate for the powers lost by the *Laender*.

Notes

¹The concept of the "unitary federal state" was developed by Konrad Hesse in *Der Unitarische Bundesstaat* (Heidelberg: C. F. Mueller, 1962). This concept probably has had the most significant impact on the West German theory of federalism.

²The West German Constitution is called the Basic Law (*Grundgesetz*) because it was adopted only for a "transitional period" (e.g., until the reunification of both Germanys).

³Hans-Georg Wehling, "The Bundesrat," *Publius: The Journal of Federalism* 19 (Fall 1989):54.

⁴Alan Riding, "Common Market Prepares for German Unity," *New York Times*, August 26, 1990.

⁵Abortion is illegal in West Germany except in cases of rape, or where medical or social factors, such as poverty or the health of the pregnant woman, dictate. In East Germany, abortion is legal in the first 12 weeks of pregnancy. After 12 weeks, it is illegal with the same exceptions as in West Germany. The second state treaty will allow East Germany to retain its liberal abortion law until at least 1992. See Ferdinand Protzman, "Germanys Facing Abortion Battle," *New York Times*, August 26, 1990.

Wolfgang Welz, University of Freiburg, Germany, was a visiting scholar at ACIR during July-September 1990.

Recent ACIR Publications

(not advertised elsewhere in this publication)

State Regulation of Banks in an Era of Deregulation, A-110, 1988, 36 pp.	\$10.00
State Taxation of Banks: Issues and Options, M-168, 1989, 48 pp.	\$10.00
A Catalog of Federal Grant-in-Aid Programs to State and Local Governments: Grants Funded FY 1989, M-167, 1989, 40 pp.	\$10.00
Residential Community Associations: Questions and Answers for Public Officials, M-166, 1989, 40 pp.	\$5.00
Hearings on Constitutional Reform of Federalism: Statements by State and Local Government Association Representatives, M-164, 1989, 60 pp.	\$5.00
State and Federal Regulation of Banking: A Roundtable Discussion, M-162, 1988, 36 pp.	\$5.00
Assisting the Homeless: State and Local Responses in an Era of Limited Resources. Papers from a Policy Conference, M-161, 1988, 160 pp.	\$10.00
Devolution of Federal Aid Highway Programs: Cases in State-Local Relations and Issues in State Law, M-160, 1988, 60 pp.	\$5.00
Metropolitan Organization: The St. Louis Case, M-158, 1988, 176 pp.	\$10.00
Interjurisdictional Competition in the Federal System: A Roundtable Discussion, M-157, 1988, 32 pp.	\$5.00
Local Revenue Diversification: Local Sales Taxes, SR-12, 1989, 56 pp.	\$8.00
Readings in Federalism—Perspectives on a Decade of Change, SR-11, 1989, 128 pp.	\$10.00
Local Revenue Diversification: Local Income Taxes, SR-10, 1988, 52 pp.	\$5.00
State-Local Highway Consultation and Cooperation: The Perspective of State Legislators, SR-9, 1988, 54 pp.	5.00

ACIR PUBLICATION AND DISKETTE ORDER FORM

Mark your selections on this form and return **WITH CHECK OR MONEY ORDER** to:

ACIR Publications, 1111-20th Street, NW, Washington, DC 20575

ALL ORDERS MUST BE PREPAID.

Report	Quantity	Price	Amount	Report	Quantity	Price	Amount
M-174	_____	\$20	_____	A-115	_____	\$10	_____
M-173	_____	\$10	_____	A-114	_____	\$25	_____
M-172	_____	\$7	_____	A-113	_____	\$15	_____
M-171	_____	\$7.50	_____	A-112	_____	\$10	_____
M-170	_____	\$20	_____	A-111	_____	\$10	_____
M-169-II	_____	\$17.50	_____	A-110	_____	\$10	_____
M-169-I	_____	\$17.50	_____	SR-13	_____	\$8	_____
M-168	_____	\$10	_____	SR-12	_____	\$8	_____
M-167	_____	\$10	_____	SR-10	_____	\$5	_____
M-166	_____	\$5	_____	SR-9	_____	\$5	_____
M-164	_____	\$5	_____	S-19	_____	\$10	_____
M-162	_____	\$5	_____	Diskettes:			
M-161	_____	\$10	_____	S&L Set	_____	\$225	_____
M-160	_____	\$5	_____	S&L 88	_____	\$100	_____
M-159S	_____	\$30	_____	S&L 87	_____	\$60	_____
M-158	_____	\$10	_____	State 83-87	_____	\$60	_____
M-157	_____	\$5	_____				
				Total Enclosed			_____

Name _____
 (please type or print)
 Organization/Company _____
 Address _____
 City, State, Zip _____

Federal Government

THE RING OF POWER: *The White House Staff and Its Expanding Role in Government.* By Bradley H. Patterson, Jr. Basic Books, 10 East 53rd Street, New York, NY 10017, 1988.

This book is a comprehensive account of the 20 offices that make up the modern White House staff. Based on interviews and a variety of official and unofficial sources, the author portrays the office in handling crises and in its role as implementor, coordinator, and communicator of the President's will. Patterson calls the Office of Intergovernmental Relations the "Ombudsman for Federalism." He traces the work of staff members for more than 30 years in various capacities—from the 1955 recommendations of the Kestnbaum Commission through the development of the New Federalism initiative in 1982 calling for a major reform of the federal system ("fortified" by studies from ACIR). Patterson outlines the widely varying responsibilities (and locations) of the office under Presidents Eisenhower through Reagan.

Federalism

STATE AND LOCAL GOVERNMENT IN A FEDERAL SYSTEM: *Cases and Materials.* 3rd Edition. By Daniel R. Mandelker, et al. Contemporary Legal Education Series. The Michie Company, P.O. Box 7587, Charlottesville, VA 22906, 1990. 805 pp.

The authors of this casebook are of the view that the study of state and local government "should be built on a framework of the tripartite distribution of powers, both vertically and horizontally: the federal-state-local levels of government and their interrelationship, the legislative-executive—legislative-judicial branches of government and their interaction. The states are seen as playing a pivotal role in the federal system. There has been major updating in the chapters on federalism and governmental liability for this edition. Other chapters include the governmental system as a whole; local government powers; interlocal relationships; state and local finance; public officials and employees; the state legislature; the judicia-

ry; the chief executive; and citizen action through the courts, voter initiatives, and referendums.

Finance

A STUDY OF NORTH CAROLINA TAXES AND THEIR IMPACT ON TAXPAYERS. By Lucille Howard. League of Women Voters of North Carolina Education Fund, 215 North Dawson Street, Raleigh, NC 27603, 1990. 105 pp.

Using ACIR's measures of state fiscal capacity and public opinion polls on taxes, and other research, the League of Women Voters undertook to evaluate how state government obtains revenue, the pros and cons and impact of changes in the tax system, alternative revenue sources, and methods of reimbursement to counties. The study emphasizes a balance between point of collection and per capita distribution of state-shared taxes. The report includes chapters on tax purposes, principles, and other considerations; state taxes; local taxes; highway funds; state-local systems; and proposals for change.

DRAFTING FEDERAL GRANT STATUTES. *Studies in Administrative Law and Procedure 90-1.* Administrative Conference of the United States, 2120 L Street, NW, Washington, DC 20037, 1990. ix, 285 pp.

Over \$100 billion a year of the federal budget is spent in the grantmaking process, which, at a minimum, is difficult to understand and harder to evaluate. Too often, administrators are constrained by poorly crafted statutes. To bridge this gap, the Administrative Conference prepared this guidebook to aid congressional staffs, agency legislative counsel, lobbyists, or others involved in drafting grant-related legislation on subjects ranging from dispute clauses to addressing third-party rights to writing maintenance of effort provisions to sanctions for noncompliance. According to the Conference, this guidebook could help produce better crafted statutes, reduce divergences, improve agency administration, and avert needless uncertainty and even litigation.

FISCAL CAPACITY OF PUBLIC SCHOOL SYSTEMS IN TENNESSEE. By Harry A. Green and Virginia Gregory. Tennessee Advisory

Commission on Intergovernmental Relations, 226 Capitol Boulevard Building, Suite 508, Nashville, TN 37219, 1990. 84 pp.

This report uses the representative tax system concept developed by ACIR to estimate fiscal capacity for school systems. The report defines the concepts and outlines the difficulties of applying them to school systems. It includes sections on equalization, tax exporting and fiscal burden, tax bases, capacity and revenue disparities, and the education needs-revenue disparity.

THE STATE FISCAL AGENDA FOR THE 1990s. By Steven D. Gold. National Conference of State Legislatures, 1050 17th Street, Suite 2100, Denver, CO 80265, 1990. xvi, 1578 pp.

This book draws on and extends recent finance research by NCSL, drawing together the major conclusions of six reports and detailing expenditure issues facing the states, the fiscal environment of the 1990s, approaches to enhancing the stability and controlling the size of state budgets, methods of increasing the efficiency and effectiveness of state governments, and the state-local agenda. Among the important policy choices are those concerning education, health care, prisons, children's services, transportation, taxes, and budget policy. Four major areas of the state-local agenda requiring attention are sorting out responsibilities between states and localities, state aid programs, local tax reform, and mandates on local governments.

TAX BASE SHARING: *An Evaluation of Its Use and Potential in the State of Ohio.* State and Local Government Commission of Ohio, 77 South High Street, Room 714, Columbus, OH 43266-0535, 1990. 146 pp.

This report begins with a discussion of the concept of tax base sharing and a review of its use in the United States. Tax base sharing started with the Minnesota Fiscal Disparities Act of 1971, and that plan still serves as the model. The report includes data from a commission survey of local governments regarding their experience and knowledge of tax base

sharing, a discussion of legal bases for developing such an arrangement in Ohio, and an assessment of three tax base sharing initiatives in the state, especially the Montgomery County program.

AN ANALYSIS OF THE EFFECTIVENESS OF THE LOCAL GOVERNMENT FISCAL RESPONSIBILITY ACT. Citizens Research Council of Michigan, 625 Shelby Street, Detroit, MI 48226-4154, August 1990. 16 pp.

At the request of the Michigan Commission on Intergovernmental Relations, the Citizens Research Council evaluated the effectiveness of legislation that provides a mechanism for state intervention in the affairs of local governments and school districts when they encounter a serious fiscal emergency. The law was passed in 1988 and was modified and extended to school districts in 1990. Although such intervention was possible previously through the courts, there is now a multistage procedure overseen by the governor, which can result ultimately in the appointment of an emergency financial manager. The report outlines the new procedure and concludes that some issues—such as the appropriate triggers for starting the process and additional steps when the law fails to resolve a local emergency—need further consideration.

Intergovernmental Relations

DEFINING STATEWIDE VS. LOCAL CONCERNS: Can It Be Done and Is It Necessary? and Constitutional Provision Supplement. Connecticut Advisory Commission on Intergovernmental Relations, 80 Washington Street, Hartford, CT 06106, 1989. 61 pp. and 112 pp.

In 1987, the commission issued a report on home rule that concentrated on the basic philosophies of home rule and the status of state-local relations in Connecticut. This supplement to the report seeks to develop the issue of "statewide vs. local" concerns. It focuses on the other 49 states to determine if they have a working definition of statewide vs. local and the impact that court decisions have had on these powers. The report also examines the general treatment of local government in state constitutions. Elev-

en states that are generally considered to grant broad discretionary powers to local governments were studied in some depth. The study examined constitutions and court decisions, but did not include state statutes on municipal corporations.

FEDERAL-STATE-LOCAL RELATIONS: Trends of the Past Decade and Emerging Issues. U.S. General Accounting Office, Washington, DC 20548, March 1990. HRD-90-34, 66 pp.

This report notes that federal-state-local relations have changed significantly in the past decade, with both positive and negative effects on the capacity of state and local governments to carry out their responsibilities across a range of domestic programs and policies. The report discusses how changed federalism policies and federal budgetary retrenchment have worked to broaden the role of the states in the intergovernmental system while federal regulatory trends have lessened state discretion but not state responsibilities. The report links these factors to three emerging issues: the broadening fiscal gap between wealthier and poorer communities as a result of reduced federal subsidies to local governments and increased state authority over some kinds of federal aid, mounting tensions between federal, state, and local governments over federal regulatory programs, and possible slowing—or even reversal—of the trends in state prominence if the combination of federal budgetary retrenchment and expanding regulation places too much fiscal pressure and program responsibility on the states.

Local Government

HOW CITIES AND COUNTIES ACHIEVE EFFECTIVE PARTNERSHIPS. Coalition to Improve Management in State and Local Government, School of Urban and Public Affairs, Carnegie Mellon University, Pittsburgh, PA 15213, 1990. 10 pp.

This paper is based on the "success story" reports of four teams of city managers and county administrators on the development of closer city-county relationships. The consensus of the reports, which were presented at an ICMA workshop, is that city-county cooperation is

indispensable for dealing effectively with today's important local issues, such as solid waste management, affordable housing, children and family services, law enforcement, transportation, and drug control. The workshop participants noted that to be effective, cooperation must be fostered as part of the public responsibility.

FLORIDA LOCAL GOVERNMENT INFORMATION SYSTEM MANUAL. Volumes I and II. Revised Edition. Advisory Council on Intergovernmental Relations, c/o House Office Building, Tallahassee, FL 32399-1300, 1989. 146 pp.

The Florida Local Government Information System (FLGIS) was designed to provide access to financial and demographic information on counties, cities, and special districts. There are four major subsystems: revenues and expenditures, general and fiscal data, bond finance, and socioeconomic and demographic data. Volume I contains information on governmental accounting practices and explains the data in each subsystem. Volume II is the user's guide, which also contains the classification and coding schemes for the system.

Service Delivery

THE DELIVERY OF HUMAN SERVICES WITHIN NEW JERSEY. New Jersey County and Municipal Government Study Commission, 142 West State Street, Trenton, NJ 08625, 1990. xxiii, 150 pp.

This report identifies the state-local, intralocal, and public-private portions of the overall human service delivery system as being most in need of financial and organizational improvements. The report recommends strengthening the movement toward comprehensive county human service departments, expanding the system of public-private interaction through advisory councils led by 21 county Human Services Advisory Councils, eliminating state billing of county governments for state programs, ending state mandating of local governments' payments to welfare recipients, transferring municipal responsibility for welfare administration to the county, and creating a wholly permissive role for municipal governments in human service management.

**Members of the
Advisory Commission on Intergovernmental Relations
September 1990**

Private Citizens

Daniel J. Elazar, Philadelphia, Pennsylvania
Robert B. Hawkins, Jr., *Chairman*,
San Francisco, California
Mary Ellen Joyce, Arlington, Virginia

**Members of the
U.S. Senate**

Dave Durenberger, Minnesota
Carl Levin, Michigan
Charles S. Robb, Virginia

**Members of the
U.S. House of Representatives**

Richard K. Armey, Texas
Sander Levin, Michigan
Ted Weiss, New York

**Officers of the Executive Branch,
U.S. Government**

Debra Rae Anderson, Deputy Assistant to the President,
Director of Intergovernmental Affairs
Samuel K. Skinner, Secretary of Transportation
Richard L. Thornburgh, Attorney General

Governors

John Ashcroft, Missouri
Booth Gardner, Washington
George A. Sinner, North Dakota
Stan Stephens, Montana

Mayors

Victor H. Ashe, Knoxville, Tennessee
Donald M. Fraser, Minneapolis, Minnesota
Robert M. Isaac, Colorado Springs, Colorado
Joseph A. Leafe, Norfolk, Virginia

Members of State Legislatures

David E. Nething, North Dakota Senate
Samuel B. Nunez, Jr., President, Louisiana Senate
Ted Strickland, Colorado Senate

Elected County Officials

Harvey Ruvlin, Dade County, Florida
County Commission
Sandra Smoley, Sacramento County, California,
Board of Supervisors
James J. Snyder, Cattaraugus County, New York,
County Legislature

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, DC 20575

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE, \$300

BULK RATE
U.S. POSTAGE
PAID
PERMIT G-34
WASHINGTON, DC