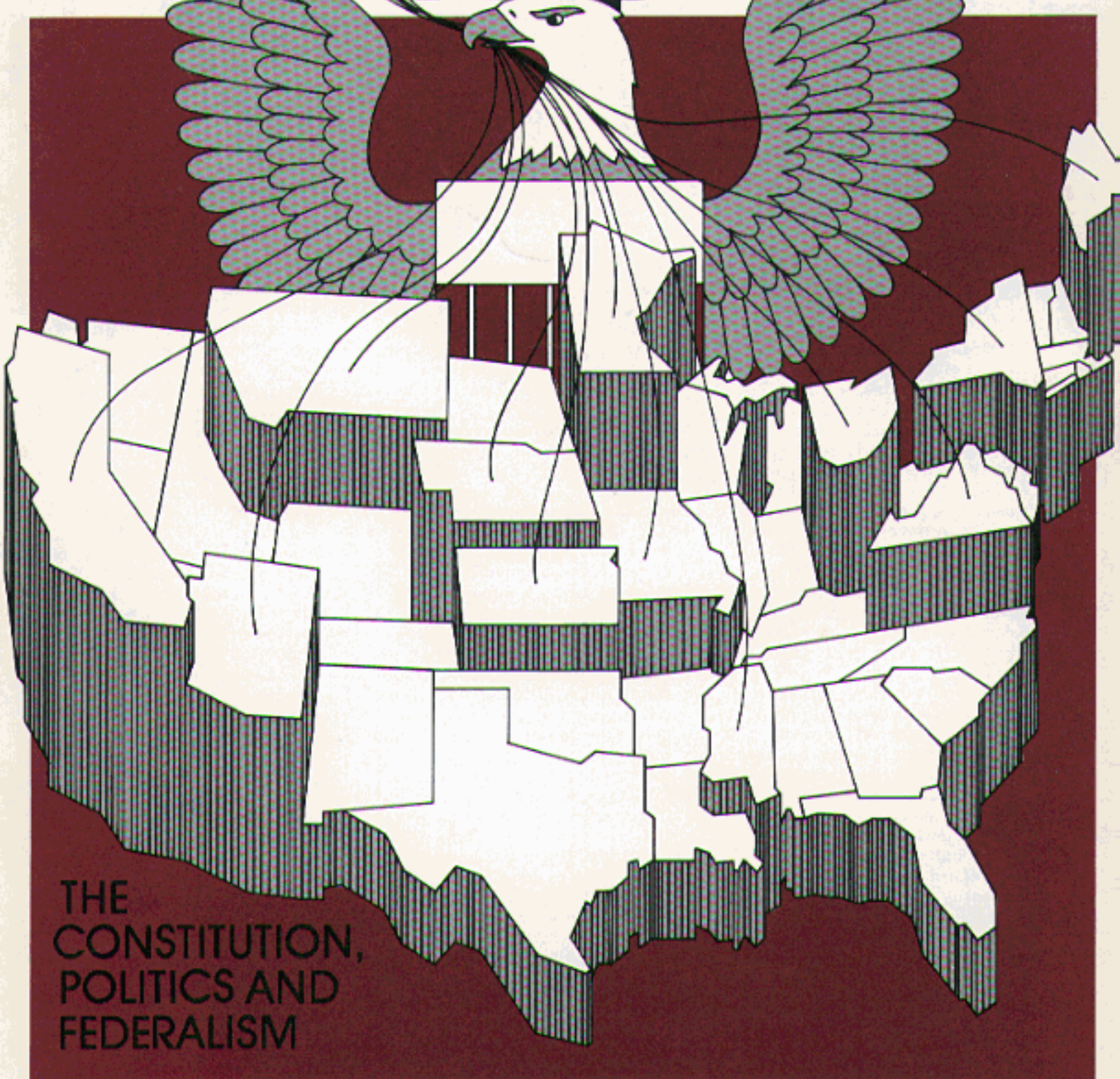


Intergovernmental

PERSPECTIVE



THE
CONSTITUTION,
POLITICS AND
FEDERALISM



View From The Commission

Dear Reader,

On May 13, 1983, at the request of ACIR Chairman Dr. Robert B. Hawkins, several members of the Commission sat down with legal experts to examine what nearly 200-years of Constitutional evolution means for federalism today. The charge was to look the U.S. Constitution straight in the eye to determine what (if anything) could or should be changed to make our system of divided, balanced, and limited government more reflective of federalist values.

Indeed, it was a heady task. The basic assumption, shared by all present, was that the health of a genuine federalism is in peril. The scales had been tilted so heavily towards Washington over the past two decades that very little of traditional state and local concern remains beyond the national government's reach.

Although all present agreed that reform was in order, consensus on just how to accomplish it proved elusive. Little enthusiasm for rewriting the Constitution emerged. One participant said that changing the Constitution was simply "too terrifying" for all concerned.

Reform via the judiciary was also explored. After all, the courts

were supposed to be the "umpires" of federalism. Yet, judicial decisions for nearly half a century have resulted in a virtual blank check for federal regulation of state and local governments. Several among us, however, remained hopeful that the federal judiciary could, on a case by case basis, be part of a federalism solution rather than part of the problem.

Throughout the discussion, political and public educational themes recurred. State and local officials, all agreed, should reassert their political muscle. And, the public should become more aware and mobilized about a system of government that has provided multiple opportunities for participation for almost two centuries.

States still struggle with a negative legacy acquired from the record of some (though not all) on civil rights. But, they are no longer malapportioned, "horse and buggy" operations and, for the most part, are ready and able to fully exercise their Constitutionally-reserved powers. It is now time, in my opinion, to give states the responsibility and opportunity to do so.

In reality, states will probably have to assert themselves as never before in modern times. Fiscal pressure on the federal budget has meant a declining rate of growth in intergovernmental aid: when adjusted for inflation, federal aid to states and localities actually peaked in 1978. It

declined in absolute terms in 1982 and federal grants are projected to continue to account for a decreasing proportion of total federal spending for the foreseeable future. Meantime, most states are raising taxes. The message is clear—the national government will no longer bail us out. We, at the state and local levels, will have to apply bootstraps to maintain a level of services the public has come to expect.

In large part, our discussion in May reflected the work of the ACIR. For almost 25 years, the Commission has steadfastly examined the issues of the times as they relate to the state of American federalism. Obviously, our federal system has survived serious challenges but, as this transcript illustrates, the road ahead will probably not be smooth. I invite you to share part of our day of deliberation on what can be done to restore federalism.

**Governor Bruce Babbitt
Arizona**

PERSPECTIVE

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Intergovernmental FOCUS

House Passes General Revenue Sharing Bill, Considers Formula Changes

On August 2, the House passed General Revenue Sharing (GRS) legislation (H.R. 2780) reauthorizing the program for another three-year period. The measure would entitle local governments to \$5.02 billion a year in revenue sharing funds, the level sanctioned in the First Budget Resolution and a \$450 million increase over the \$4.6 billion annually provided now under this program which is due to expire September 30.

The legislation did not restore state eligibility for GRS funds. No funds have been appropriated to state governments since 1980.

Major debates were generated by efforts to amend the bill. The House rejected one that would have allowed local governments to waive Davis-Bacon wage requirements for GRS-funded projects. Formula changes were proposed by Representatives Lyle Williams of Ohio and Sander M. Levin of Michigan. The Williams' amendment sought to target \$450 million in additional funds to counties where unemployment rates were equal to or in excess of the national rate of the preceding 12 months. The House rejected the proposal by a vote of 154-259.

Representative Levin introduced an amendment to substitute the Representative Tax System (RTS) tax capacity measure for the resident personal income indicator now used in the allocation formulas. The proposed change would have operated only in a modified set of *interstate* distribution formulas; it would not have affected distributions among local governments within each state. Although state governments do not participate, funds are first divided up among state areas.

The Representative Tax System, developed by the Advisory Commission on Intergovernmental Relations (ACIR), is a comprehensive yardstick for measuring the relative tax capacity of each of the 50 state-local systems. It answers this question: How much would each state

collect if every state applied identical tax rates (national averages) to each of the 26 commonly used tax bases?

The Representative Tax System yardstick was created because the most common measure of tax capacity now used—state per capita income—has two serious deficiencies: it significantly understates the tax wealth of energy-rich as well as tourist-rich states, and it overstates the tax wealth of several frostbelt states confronted with declining economic bases.

The Levin amendment would have limited to 10% any increases or decreases caused in a particular state's allocation as a result of using RTS measurements.

The cap was intended to present any disproportionate gains or losses among the states.

In support of using RTS measurements, Representative Edgar (PA) pointed out two principles for targeting General Revenue Sharing funds. First, during difficult economic times, the funds ought to assist those governments with low relative fiscal capacity. By taking tax capacity into account, revenue sharing would recognize that to provide average services and benefits to their citizens, fiscally-poor states would have to impose a much heavier tax burden than fiscally-rich ones. Secondly, revenue sharing ought to go more to those states working the hardest to provide their citizens with public services from their own revenue sources.

Opponents argued that using the Representative Tax System measurements in the GRS formula would result in funding reductions for 11 western states. Representative Weiss (NY) said he feared the change would break up the political coalition that supports revenue sharing.

House members ultimately rejected the RTS amendment by a vote of 192-220. However, they agreed that measuring tax capacity warranted further study and approved language requesting the Treasury Department in consultation with the Department of Commerce, the General Accounting Office, and ACIR to study and develop the Representative Tax

System for possible use in revenue sharing allocation formula and to report its findings and recommendations to Congress within two years.

Although the ACIR has recommended that Congress consider using a better measure of tax capacity, such as the Representative Tax System, formula changes were not proposed when the Commission reaffirmed its longstanding support for the GRS program last March. At that time, the Commission reiterated its belief that the program should be made permanent and that the states' share should be restored.

Senate GRS measure Contains Formula Change

The Senate is in the final stages of considering General Revenue Sharing reauthorization. S. 1426 is awaiting Senate floor action but was not scheduled before Congress recessed August 4. The Senate bill provides a three-year authorization, continuing the program at its current funding level. Included in S. 1426 is a plan proposed by Senator Durenberger (MN) to change the intrastate formula for allocating GRS funds if Congress increases the annual spending level. The Durenberger plan would relax some constraints on maximum and minimum allocations, and would result in municipalities within each state being compared on the same basis. It would remove what Senator Durenberger considers inequities in the existing formula, and would permit poorer municipalities to receive increased revenue sharing funds. In addition, the legislation contains a "hold harmless" provision to assure that no government receiving revenue sharing funds would have its allocations reduced when the formula change occurs. There are also discussions of possible floor amendments that would mandate a study of possible interstate formula changes using the Representative Tax System methodology.

When this issue of *Perspective* went to press, passage of the General Revenue Sharing reauthorization was

expected between September 12, when Congress returns, and September 30, when the program legally expires. It remains uncertain whether the legislation will contain distribution formula changes or whether the local share will be increased.

Legislation Introduced on Municipal Antitrust Immunity

The number of cases alleging violation of the federal antitrust laws has begun to mount against local and, more recently, state governments following the Supreme Court's decisions in *Jefferson County Pharmaceutical Co. v. Abbott Laboratories* (1983), *Community Communications Co., Inc. v. City of Boulder* (1982), and *City of Lafayette v. Louisiana Power and Light Co.* (1968) that have increased the antitrust exposure of these governments.

Four bills amending federal antitrust laws to exempt local governments are pending in Congress. Senator Thurmond (SC) has introduced S. 1578 in the Committee on the Judiciary, of which he is chairman. It would protect localities from antitrust suit when exercising traditional governmental functions but would not cover their proprietary activities. Three bills have been introduced in the House Committee on the Judiciary. Representative Hyde's (IL) measure, H.R. 2981, would give local governments immunity from federal antitrust laws equal to that of the states. The bill sponsored by Representative Fish (NY), H.R. 3361, also would construct a shield from those laws consonant with the states' immunity. Further, it would reduce monetary damages faced by local governments or their officials found in violation of antitrust statutes from treble the proven damages to simply the damages themselves. Representative Edwards' (CA) bill, H.R. 3688, like Senator Thurmond's offers protection for traditional governmental actions, but not for those activities in which localities compete in the market place.

No hearings have been scheduled, although both chambers of Congress are expected to take up the antitrust issue this fall. President Reagan has declared his support for legislation which would exempt local government from federal antitrust law if they are acting under authority of state law and within their governmental or police powers.

New List of Metropolitan Areas Issued

On June 27, 1983, the U.S. Office of Management and Budget (OMB) issued a press release announcing revised definitions of the nation's metropolitan areas and listing all 335 now delineated on the basis of these definitions. A number of metropolitan areas have experienced boundary changes because of the new definitions, but the major changes in the new list have come about with the use of 1980 Census data.

The latest count of metropolitan areas is up by 12 over the 323 figure announced by OMB in June 1981. However, that is only part of the story. Twenty-three contiguously urbanized areas are now defined as "consolidated metropolitan statistical areas." These are combinations of "primary metropolitan statistical areas." The word "standard" has been dropped from the terminology previously used in the titles of metropolitan areas in order to avoid overly lengthy titles for those areas now described as "primary" and "consolidated."

The number of consolidated areas is up by six over the definitions issued in 1981, so the net number of metropolitan areas (the free standing plus consolidated ones) is down by 10 to 280. The number of single county metropolitan areas also has decreased since 1981 by 13, and now stands at 122. The number of interstate metropolitan areas (on a net basis, considering consolidated areas as single units) has decreased by four and now stands at 35.

OMB's new lists of metropolitan areas are available to the general public through the National Technical Information Service, 5285

Port Royal Road, Springfield, Virginia, 22161.

State-Local Report

States entered 1983 in the worst fiscal shape in at least a decade. In fact, this year could set a record for tax increases, spending cutbacks, deferrals and other austerity measures in the states, according to surveys conducted by the National Governors' Association (NGA), the National Association of State Budget Officers (NASBO), and the National Conference of State Legislatures (NSCL). These sobering conclusions, as states close their books on fiscal 1983 and gird for 1984, are in sharp contrast to the fiscal environment of just four years ago when many states adopted a range of tax cuts in the immediate after-glow of Proposition 13.

For example, preliminary findings from the NCSL survey reveal that 31 states raised at least one tax, with 18 states increasing key sales and personal income taxes to help raise revenues by at least 5%. The increases are expected to result in higher bills for taxpayers by the start of next year—perhaps as much as \$8-10 billion—and will represent more than double the amount of tax increases of the last two years combined.

According to the NGA-NASBO survey, every state—except Wyoming—initiated some combination of budget-balancing measures, ranging from tax increases and across-the-board budget cuts to furloughing and laying off employees. Despite these actions, however, state year-end balances may reach an all-time low of less than \$300 million nationwide. By comparison, aggregate balances for fiscal 1980 totalled \$11.8 billion. Although some improvement is expected, the outlook nevertheless remains "grim," according to the survey. As Utah Governor Scott Matheson, immediate past chairman of NGA recently noted: "The governors of the '80s are engaged in the game of crisis management. . . . If there's an economic recovery out

there the effects on the states are certainly delayed. Most of us are still trying to control the hemorrhaging."

The findings of the state fiscal reports parallel a survey of city finances released by the national League of Cities (NLC) late last year. The NLC assessment revealed city expenditures growing at a more rapid rate than revenues, a heavier reliance on fees (rather than general tax increases) to raise revenues, and reductions in work forces.

Although budgetary matters predominated in most states, other areas received priority treatment including economic development and recovery plans and technological innovation and education.

According to a Governors' Association task force report presented in July, "technological innovation is a key to increasing productivity of both capital and labor" and the role of the states in the "high tech" field continues to grow. States are increasingly directly involved in local economies, providing incentives and other assistance to selected industries, and fostering public-private partnerships in economic development.

A state survey released earlier this year by the federal Office of Technology Assessment, for example, found over 150 programs targeted to promote "high tech" growth. Nearly 40 of these programs—found in 22 states—were created and financed at least in part by the states themselves. State programs to foster technological development, most evident in the last three years, are increasingly being linked to international trade development, a subject of keen interest at the national, state and local levels.

In 1983, state activities included a range of approaches including:

- extended investment tax credits for business and the creation of a new technology park corporation to increase science and "high tech" training in schools such as in Massachusetts;
- a new "high tech" council and a venture capital fund for new

products and techniques as in Iowa;

- in New Mexico, a \$7.6 million appropriation for technological innovation centers; and,
- creation of a new state research authority in South Carolina.

Several states, such as Massachusetts and New York, also provided seed money to new and developing companies, or have created special task forces to encourage state-of-the-art industries. Other states have initiated programs to train new workers and re-train others for jobs in emerging fields; established new engineering, science and math programs; and authorized tax credits and other incentives for businesses that share their technological know-how with small and new businesses.

Rebuilding public physical infrastructure also has been a focus of recent state activity. Infrastructure banks in New Jersey and Massachusetts are two examples of innovative proposals.

From coast-to-coast, state policymakers also devoted a significant amount of attention to education reform issues including curriculum content and standards, competency testing for both students and teachers, and school finances. Recognizing that education is inextricably tied to economic health and development, state officials took the lead in the national debate on education and accelerated their own efforts to upgrade education. As an indication of the priority status that education held during this year, Governor Matheson observed at the governors' conference: "Every governor I've talked to has told me he is willing to ask for additional taxes for education in his state."

By mid-year, every state had taken some action on education reform issues or had launched high-level reviews of needed reforms. In Arkansas, for example, where the state courts struck down the school finance system, Governor Bill Clinton

named a special commission to not only respond to the court's ruling but to recommend a comprehensive package of reforms for the State's educational system. In Tennessee, Governor Lamar Alexander proposed the broadest package of education reform legislation in the country. Although unsuccessful this first year, the Governor's proposals will be re-introduced in the next legislative session. Meeting in special session, the Florida legislature approved over \$230 million in new taxes to pay for a merit pay plan for teachers, additional math and science programs, longer school days, and tougher graduation requirements. Even those states with the most severe economic and budget problems have acted. In Michigan, for example, school aid was increased nearly 27%. In California, legislation was adopted and funding provided for a new master teacher program as well as for rigorous standards. And in Mississippi, where a sweeping overhaul of the education system was approved late last year, nearly half of the FY 1984 expected budget increase of \$170 million will be dedicated to education.

In addition to these issues, ACIR has been monitoring state activities during the first half of 1983 in several other key intergovernmental areas, including:

State Mandates. State regulatory activities continued to be a major intergovernmental issue during 1983. Studies of state mandates were initiated in several states such as Iowa, New York and Minnesota. In several other states, including Louisiana, Missouri, Michigan and California, state courts ruled on a variety of challenges by local governments to state implementation of statutory and constitutional provisions. The Massachusetts Division of Local Mandated Programs began operation at mid-year and is responsible for ensuring that neither state laws nor regulations impose additional costs upon localities without providing reimbursement. The Virginia Joint Legislative Audit

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and Review Commission conducted an extensive review of state mandates and local financial resources, and recommendations will be presented to the General Assembly later this year. Pennsylvania recently catalogued all state mandates and is in the process of reviewing their current implications and, in some instances, continuing applicability. During a special session in June, the Connecticut legislature enacted a bill that defines seven types of state mandates and requires the State's fiscal analysis office to develop impact statements on bills and amendments that measure first-year fiscal effects on local governments. The bill also created a state mandates interim study committee of the appropriations committee to review the feasibility of a pilot program focusing on new or expanded mandates. Local officials in other states such as Georgia, North Carolina and Tennessee also generated interest in considering the effects of state mandates on local governments.

Local Discretionary Authority.

Several states began to grapple with the troublesome outcomes of the Supreme Court's *Boulder* decision rendered last year that opened local governments to antitrust liability. North Dakota adopted the most comprehensive measure thus far, and Maryland acted to share much of the state's immunity with its localities. Several other states, including Louisiana, Pennsylvania and Virginia, moved to shield their jurisdictions in selected areas of activity, while still others such as Iowa, are studying antitrust immunity within the broader context of tort liability. Legislation to exempt localities from federal antitrust liability is pending in Congress.

Actions in at least two states may have long-lasting effects on home rule authority in those jurisdictions. In Alabama, the legislature approved a constitutional amendment to be submitted to voters in November that would extend home rule to counties on a local option basis. In Illinois, however, Rockford voters opted to

abandon home rule, the fourth locality to do so in that state. The vote is viewed as a setback to Illinois' home rule system since Rockford is the State's second largest city. The opponents of home rule did not claim that the powers had been abused by the City, but rather that the potential for abuse was present, and advocated abandonment of home rule so that voters could act directly through referenda on all proposals for tax increases.

State-Local Relations. Currently, at least 20 states have a functioning state ACIR or similar state-local panel, and the level of interest in such groups grew during the year. For example, New Mexico Governor Tony Anaya established a new intergovernmental coordinating council, and legislation was drafted in several other states (such as South Carolina and New York) to strengthen or codify existing organizations. The Local Government Advisory Council was reactivated by Virginia Governor Charles Robb and will concentrate its efforts in four key areas: local finance, education, economic development, human resources and public safety. The Georgia Commission on State Growth Policy began work on five major topics: tax equity; city-county cooperation; state and local roles in growth and development; mandates; and, the impact of New Federalism proposals. In Maryland, the Commission on Intergovernmental Cooperation was reorganized into the Joint Federal Relations Committee. The Tennessee ACIR completed a major study of the State's property tax system. And, proposals to create an intergovernmental advisory panel were considered in a number of states including Oklahoma, Vermont, Nebraska, Oregon, North Dakota, Minnesota, Kentucky, and Alabama. ACIR staff continues to work with state and local officials in establishing new advisory panels and in assisting existing commissions.

Highlights of other significant state-local development during the year include the following:

- In Indiana, a measure passed that will provide greater local flexibility in procedures granting tax abatement incentives, but a local option income tax bill failed in conference committee on the last day of the legislative session.
- A new department, consolidating the functions of four state agencies, was created in Alabama to administer and oversee a variety of local programs and services. Arkansas, on the other hand, disbanded its local service department; the primary contact point for local officials now will be the Governor's Office of Intergovernmental Relations.
- West Virginia courts forced the state to embark on a major overhaul of its local property tax assessment system that will be addressed by a special legislative commission.
- An interim committee was appointed in Texas to study "sorting out" government responsibilities and revenue capacities. A gubernatorial panel was created in California to address similar issues.
- Annexation policies and practices were on the agendas of over one-fourth of the states during the year, including North Carolina, Florida, Georgia, Virginia, Tennessee, Pennsylvania, Oregon, Washington, South Carolina, California, Mississippi, Iowa, Minnesota and Kentucky. The topic will continue to attract attention, especially as state and local governments seek alternative approaches to growth management, service delivery, and revenue generation.

The Constitution, Politics, and Federalism

GOVERNOR BABBITT: Many of us who are practitioners in government are interested in exploring avenues for reforming federalism because we perceive the system to be dysfunctional. These dysfunctional trends are seriously impeding the ability of us at the state and local level to get on with the business of governance. The problem is essentially this: since 1932 the United States Congress has progressively invaded every single area of American government. The old distinctions between levels of government have been erased, with the passage of each decade, to the point that there is literally nothing too trivial to engage the attention of the national government.

Typically Congress' domestic policy takes the form of a grant-in-aid program which then becomes the dominant force shaping policy at the local level. Potholes in streets, libraries, traffic signals, parks, and health systems are all examples of government functions that were once purely local and are now intergovernmental.

There are, of course, many reasons why this breakdown has occurred. They relate to the evolution of the political system and to changes in the demographics and in the economic structure of the country. But the fact is at the state level and at the local level we find ourselves enmeshed in a system over which we have very little control.

I can give you lots of examples. You have heard of all of them.

My question, and I hope that the direction of this session would be, to speculate about why it is that this process has occurred and whether or not our Constitution has any relevance in 1983 to the rebalancing of the federal system.

ACIR has traversed these issues in some measure over the last six or eight years. We were initially interested in the role of the judiciary. We thought of the judiciary as the referee in the striped uniform, standing in the field, calling the game between the federal and local forces, by invoking on a case-by-case basis whatever restraints remained on national power in the commerce clause, spending power, and the Tenth Amendment.

Our conclusion in a couple of studies was that the referee had really walked off the field. The referee was sitting on the bench, on the sidelines. Effectively, the courts said that the federal team can do whatever it wants in this game.

We then did some work with Article V of the Constitution. Having failed to figure out what can be done to redefine or redraw spheres of authority through the enumerated powers clause, the commerce clause, and the Tenth Amendment, we began looking at whether or not there are any procedural methods in the Constitution to beef up the state and local players, to give them some procedural muscle. This search led us to Article V, part of which is the state-initiated avenue of amending the Constitution by petitioning Congress to call a constitutional convention. We had a brief but intense love affair with the (Ervin bill) because we conceived of it as a way of giving the states real power.

We have flirted with the balanced budget amendment. I don't think we were ever certain about what the constitutional roots of a balanced budget amendment were. I think we looked at it in terms of expediency. We saw it, again, in terms of a rather practical, ad hoc way of slimming down the federal leviathan.

That's a brief tour of where we have been. You are free today to take this discussion in any direction you want. What I would urge you, is, number one, that we, with not too much delay, accept the premise that draws us all here and that is that we do need some kind of rebalancing of the federal system and that it really is

ABOUT THE ACIR ROUNDTABLE

As Governor Babbitt explained in his "View from the Commission," several members of the Advisory Commission on Intergovernmental Relations met with leading legal experts to explore the questions:

1. What basic constitutional principles are necessary to preserve an appropriate distribution of power and responsibilities in a federal system?
2. Has American practice deviated from these principles? If so, how, when and why?
3. Are there specific refinements or amendments to key provisions of the Constitution—such as the commerce and spending powers or the Tenth Amendment—that would strengthen conformance to basic federal principles?
4. Is there a need to devise new constitutional language that would enhance the position of the states vis-a-vis the national government—for example, a balanced budget amendment or procedures to regularize the calling of a constitutional convention? What specifically would be the effects of such changes?
5. Has the federal judiciary adequately fulfilled its role as "umpire" of the federal system? Are changes in the composition or jurisdiction of the federal judiciary necessary in addition to, or as an alternative to, more far-reaching constitutional changes?

These questions were the focus of a roundtable discussion chaired by Governor Babbitt of Arizona, an ACIR member since 1978. Senator Dave Durenberger (MN), who has served on the

Commission since 1981, acted as co-chair of the meeting. It was called by Dr. Robert B. Hawkins, ACIR Chairman. Participants from outside the Commission included:

Professor A. E. Dick Howard
University of Virginia Law School

Professor Lewis B. Kaden
Columbia University Law School

Dr. Phil Marcus
Institute for Educational Affairs

Professor Steve Schechter
Russell Sage College

Professor Gerald Frug
Harvard University Law School

ACIR staff members present included S. Kenneth Howard, Executive Director; John Shannon, Assistant Director for Taxation and Finance; David B. Walker, Assistant Director of Structure and Functions; Carl Stenberg, Assistant Director for Implementation; Timothy Conlan, Research Analyst; Esther Fried, Special Assistant to the Director; and Stephanie Becker, Information Officer.

This issue of *Intergovernmental Perspective* is an edited version of the session's transcript. It was prepared by Stephanie Becker, with assistance from Timothy Conlan, in consultation with the participants.

overweighted to the federal side to the point of serious disruption.

Secondly, we then speculate on whether the Constitution should and can be changed to reflect more fully federalist values.

Federalism Reform: Origins and Issues

SENATOR DURENBERGER: As one who came into government service in mid-1960s, at the time when federal grants were beginning to rise rather dramatically, I have some strong feelings about the need to do what we are doing here: that is, to rethink the balance of power among the three levels of government.

I listened to Governor Babbitt say what I have heard him say before, dating Congressional assumption of state and local responsibilities to 1932. I always

thought it was funny for a Democrat to pick on 1932 as the start of this, because as a Republican I picked 1910, when Teddy Roosevelt made that famous speech in some little town in Kansas, and I think that's what kicked all this off.

GOVERNOR BABBITT: I accept that definition.

SENATOR DURENBERGER: Some of you may have read my speeches on the need to find a sense of national purpose as part of any effort to sort out governmental roles and responsibilities. As I reread some of ACIR's work on this subject yesterday, I came away with the feeling that the domestic problems we face today, while severe, are fundamentally different than those we faced earlier in our first two centuries.

Remembering the sectional politics, the racial politics, the economic politics, the propertied versus the non-propertied controversy, and recalling how America

The Judiciary: Part of the Problem or Part of the Solution?

SENATOR DURENBERGER: As I see the problem, the question of reform becomes: What route do you take? Some might advocate taking the judicial route. My observation is that, at least in recent years, the judiciary refills holes created by a Congress which refuses to deal with the issues. For example, in the Montana severance tax case the Court very clearly said, if the Congress would do something, it wouldn't have had to make the kind of decision it did. But we sit around here and nothing happens. In *Sporhase v. Nebraska*,¹ (concerning state restrictions on the interstate transportation of water), the Court reached its decision in the absence of a clear federal statement about the application of the interstate commerce clause to undue burdens by states, because Congress hadn't acted on it.

Now, in response to this, many have advocated extreme constitutional remedies. I reject the constitutional amendment or the constitutional convention approach, however. I would make strong arguments for trying to continue to work on specific reforms within the legislative process, with the goal of getting people to think about the role of the national government. Congress should determine national purposes, not the courts.

PROFESSOR FRUG: I don't believe the judiciary is an umpire in the federal system. I believe the judiciary is an actor in the federal system and in all other systems in which it is involved. I think it is divided by the same ambivalence between a stronger federal government and a stronger state government, and *National League of Cities v. Usery* and the retreat from it reflects that ambivalence, as do the 14th and 11th Amendments.

[Ed. Note: In *National League of Cities v. Usery* (1976), the Supreme Court invalidated expanding the 1974 Fair Labor Standards Act Amendments to include state and local government employees. The Court stated:

Congress may not exercise its power to regulate commerce so as to force directly upon the states its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made.

Subsequently, however, the Court has taken what seems to many a narrow view of what constitutes "essential" decisions and "integral" governmental functions.]

PROFESSOR KADEN: I tend to think there's more promise in the judicial route to reform, both because substantively it's hard to think of how you would change federalism constitutionally and because, as a practical matter, I think the Court had the germ of a good idea in the *National League of Cities* case. If, in fact, the states no longer have as much political influence in Washington, then the correction ought to

“ . . . if Congress is going to preempt, it ought to make it clear what it intends to preempt and why, as well as what the factors were that were being considered.” —Professor A. E. Dick Howard

be some change in the notion of judicial deference and a reinvigoration of the judicial protection of a zone of autonomy for the states.

PROFESSOR HOWARD: Among the various forums in which federalism issues can be advanced, it seems to me the judiciary is clearly the most process oriented. To be sure, members of legislatures and executive branches, indeed of the public at large, understand in some nebulous way the values of federalism, but they just aren't going to respond to that issue in terms of actual politics. Courts, on the other hand, live by process. You have a better hope of at least engaging a judge's conscience a bit. You may not win. *National League of Cities*, it seems, has yielded sequels. Nevertheless, some of the justices and lower courts will be obliged to worry about it. The judicial conscience is pricked a bit. And that's why I would go after the judiciary.

Regarding preemption of state law by virtue of federal statutes or regulation, a great deal of good could be done if the Court were to take seriously the notion that, if Congress is going to preempt, it ought to make clear what it intends to preempt and why, as well as what the factors were that were being considered.

To note a non-federalism analogy, I think a Supreme Court decision like *Fulilove v. Klutznick*,² an affirmative action case, is sheer judicial abdication in the face of altogether inexplicit legislative action. And, *Hutto v. Finney*,³ the attorney's fees case from 1978 is a decision wherein Justice Stevens had to dig into legislative history because Congress failed to say what it was doing.

It surely would not invade Congress' prerogatives for the Court to insist that legislators make it clear what they are doing. The Court's bad habit goes back a long way. The Court simply doesn't take seriously the arbiter's, the umpire's role.

PROFESSOR FRUG: It should be clear we are talking about two different things: trying to create a principle of autonomy on the one hand, and then the judicial strategy on the other.

The second is not the first. The second is just using clever language and lots of different arguments and organizing the state and city leaders to do that, whatever they are.

²448, U.S. 448, (1980).

³437 U.S. 678 (1978).

¹102 S. Ct. 3456 (1982).

For example, the nuclear power case, *Pacific Gas and Electric v. Energy Resources Conservation Development*,⁴ established no important principle in the sense it was merely a case of federal preemption of state law. Congress could add a line tomorrow changing the result. There was no change in the Constitution by the case.

It was just clever arguments. Some of the preemption doctrine which is there can be used to vindicate states' rights.

And there are of course thousands of such maneuvers possible within the system, none of which establish basic constitutional principles, but which win cases.

GOVERNOR BABBITT: It is really political balancing through use of the judicial system.

PROFESSOR FRUG: Political balancing through use of what arguments are available, which will be different arguments in different cases, to upset different schemes. And the end result is not the establishment of any constitutional principle. The end result is winning cases.

PROFESSOR HOWARD: Let me comment on that. First, I see no conflict between the two approaches. To take the lawyerly approach of trying to find case-by-case ways of fine-tuning the balance certainly doesn't conflict with the autonomy principle. One is not a substitute for the other.

Secondly, and perhaps more importantly, if one wins some of those cases which were fought along procedural, seemingly less dramatic lines, such decisions become part of the ongoing debate. They flag the issue. For that reason alone, win or lose, they are more important than I think your argument might suggest.

GOVERNOR BABBITT: In terms of the national debate, the nuclear power case may be a lot more important than *National League of Cities v. Usery*, for example.

SENATOR DURENBERGER: On the other hand, Tuesday morning, on the Environment and Public Works Committee, as we are marking up a bill for the Nuclear Regulatory Commission, Senator Alan Simpson is poised to undo the Court's decision and Senator Pat Moynihan is poised to fight for it.

And they agree that this isn't the place to do it, but it has got to be done. Everybody was ready. Everybody was sitting out in the hearing room just in case we were going to do battle.

A Case in Point: National Uniformity vs. State Discretion

PROFESSOR SCHECHTER: The issue of national uniformity versus state discretion arose in connection with product liability. The fact that most states are governed by their own liability laws, alone, seems to

raise the hair on the back of the neck of some who are simply opposed to the idea of a diversity of standards.

It is my understanding that groups led by manufacturers, seeking uniform federal legislation, pursued legislative relief in Congress. And that has seen the light of day in a Senate bill which would preempt product liability in the interests of uniformity. But the emphasis on uniformity is paradoxical; and the form of preemption has a twist. The bill would create a national standard that becomes operative as law only subject to judicial interpretation by the state courts if the states decide to operate that way. In other words, it is federal law in which state legislative involvement and recourse to a federal judicial forum are foreclosed. This indicates the lengths and, in my opinion, the depths of attempting to satisfy the interest of uniformity.

[*Ed. Note: Professor Schechter's example is a reference to pending legislation in Congress to preempt state product liability laws by federal standards. The measure (S. 44) is preemption with a twist in that it would generally leave judicial interpretation and presumably enforcement of federal standards to the state courts.*]

GOVERNOR BABBITT: It is fascinating. For the layman it is intriguing for two reasons.

One, it proves federalism is in the eyes of the beholder. Here is a presumptively conservative national community known for preaching local values opting for a federal law for its economic benefit.

And secondly, and incredibly, it is mandating that federal law would basically be administered by state judiciaries.

PROFESSOR FRUG: I'm interested whether we should recommend to Senator Durenberger that he oppose or support a national product liability bill from a federalism point of view.

First of all, uniformity is the centralizing argument. And the uniformity argument from a manufacturer's point of view is very strong. We don't want to have 50 different rules in 50 different states. It's a national economy.

But that moves to a federalized system, eliminating local control over what kind of product liability system to have and how to implement it.

This is what I mean by the ambivalence of the position on this issue. From a private point of view, one could understand centralization—we already have central markets and we should have central rules for the central markets.

The Conditional Spending Power and the Courts

DR. WALKER: Although the Supreme Court said in *NLC* that there still are some limits to Congress' regulatory powers through the commerce clause, it has not shown similar restraint in its interpretations of the conditional spending power. The federal courts still rely on the argument stated in decisions dating back to 1922 that a grant is a quasicontractual relationship and, as

“ I think the spending power is the critical power . . . the idea that if you don't want 89 billion dollars, feel free, walk away. And that rhetoric—which is the rhetoric of the courts and the rhetoric of Congress—is something no one in a real sense believes in, I wouldn't think. ” —Professor Gerald Frug

such, is freely entered into by the states and local governments.

PROFESSOR FRUG: I think the spending power is the critical power. I think as a matter of principle it is affected by the voluntary—involuntary distinction. What voluntary means in the spending power area is that if you don't want 89 billion dollars, feel free, walk away. And that rhetoric—which is the rhetoric of the courts and the rhetoric of Congress—is something no one in a real sense believes in, I wouldn't think.

I think it is very hard to try to separate in the Court's mind and other people's minds, the regulatory power which is seen as uniquely intergovernmental, and the power to condition: if you want my money, you have to take my conditions. This is linked to the power money commands in the private sector.

To me the issue is not an issue of principle, but it is an issue of strategy. I don't think that there's going to be a line that really is enforceable, which is going to draw the distinction between what somebody who has money can and cannot say to somebody who doesn't about what you would do with my money—but I think there are just dozens of little nooks within the system which can be part of the strategy, like the relevancy of the conditions.

So that I think you can pick off cases, but I don't think that there's going to be some kind of major constitutional principle evolving out of it. I think we are going to still think that to some extent the federal government, in spending money, should be able to condition its money. For example—it was already suggested—they are going to be able to condition the money on non-discrimination. But on the other hand, they can't go too far. We are going to be ambivalent about that.

But from a strategy point of view, in terms of litigation strategy, I think there's lots of room to maneuver. We have the doctrine of unconstitutional conditions affecting private citizens, in which you cannot condition your spending money on the power to give up constitutional rights: I'll give you money only if you give up your religion. It can't be done.

So, if the federal government cannot condition its money in any way it wants, when it is giving it to individuals, one could make the same kinds of points with regard to states.

Namely, there are states which have interests just like there are individuals who have interests. You can have conditions, but there are things on which you can't condition spending. That is one kind of move that can be made.

GOVERNOR BABBITT: What is a good example of a grant condition that is apparently unrelated to the direct purpose of the grant? That is intrusive in every sense of the word?

I guess my candidate would be the denial of highway construction funds for auto emission noncompliance. Are there some better ones around?

DR. WALKER: The cutoff of moneys from all highway grants if you do not adhere to a 55-mile-per-hour speed limit.

GOVERNOR BABBITT: That's a glorious one.

PROFESSOR FRUG: What do you mean when you say that the 55-mile-per-hour speed limit is not relevant to all the highway fund grants? Just thinking about the argument that one would advance to try to defeat it, one could certainly articulate some connection.

GOVERNOR BABBITT: Let me make this argument. The 55-mile-an-hour speed limit rests on one of two bases: energy saving or life saving. Those are the two public policies involved. What I find so offensive about the 55-mile-per-hour speed limit is that the purpose of these grant conditions is to try to achieve an end that the federal government has the power to do but does not have the desire to do directly.

What should be done directly is very simple. They should set a 55-mile-per-hour national speed limit and say to the FBI: You are the federal law enforcement agency. If it is in the national interest to have a 55-mile-an-hour speed limit, let's have it and let's enforce it. And send the FBI to work.

PROFESSOR FRUG: It is using the spending power on things that are not spending, but elsewhere. They could do it; but tying it to spending is what makes it circuitous. Getting the states involved through the coercion of money. But I take it—talking legal principle for a moment—I take it there is no doctrine at the moment which limits the ability of the federal government to condition spending.

PROFESSOR HOWARD: It seems clear to me that we ought to argue—I would certainly propose we argue—that in any situation where Congress may not use the commerce power directly to deal with certain state practices, it may not use its power indirectly by way of conditioning spending. Such an approach would require the same kind of case-by-case analysis with which we are already familiar under *National League of Cities*.

U.S. SUPREME COURT UPHOLDS STATE

In a June 1983, 5-3 decision, the Supreme Court upheld California's use of the unitary worldwide corporate tax in *Container Corporation of America v. The Franchise Tax Board*. Twelve states, including California, tax multinational corporations in this fashion.

The Court agreed with California's claim that the Container Corp., a U.S. resident, and its 20 foreign subsidiaries were a "unitary business" and as such, was entirely within the reach of state taxing authority. The Court further held that California's apportionment formula, a typical one based on the share of a corporation's payroll, sales, and property in the state, did fairly assign a reasonable portion of combined international income to California. Finally, the Court rejected the corporate appellant's argument that state practice unacceptably conflicted with the constitutionally-guaranteed prerogative of the national government to regulate and "speak with one voice" on matters concerning foreign commerce.

History. The so-called "unitary tax," which combines incomes from multijurisdiction portions of a corporation or affiliated corporations, is not new. It has been applied for years to multistate corporations. What is new is the Court's explicit approval for its application across national as well as state boundaries.

The unitary technique was first developed by the states to cope with the complexities of multi-state corporate activity. In all 45 states with a corporate income tax, the unitary method has displaced, at least to some degree, the older "separate accounting" technique. Under separate accounting, corporate books have to be prepared for each state in which a corporation operated. In-state net income is computed by adding the value of out-of-state intracorporate exports to actual receipts and subtracting not only actual expenses but also expenses for intracorporate imports from out-of-state. The unitary approach combines multi-state income and then allocates it to a state according to its share of combined corporate payroll, sales, property value, or some combination. The states view their more recent application of these principles across national boundaries as an evolutionary step in keeping with the increasing importance and complexity of multinational corporate activity. However, this approach is at odds with the common practice among national governments; that is, separate accounting methods for multinational firms.

The Supreme Court has decided six important state corporate income tax cases in the last five years. In *Moorman Co. v. Blair* (1978), Iowa's use of a single factor (sales) apportionment formula was upheld. In *Mobile Oil Corp. v. Commissioner of*

Taxes (1980), the Court upheld Vermont's right to base its tax partly on Mobil's dividend received from foreign corporations. The Court's decision hinged on the finding that Mobil and the foreign corporations were part of one unitary business. In the *Exxon Corp. v. Wisconsin Department of Revenue* (1980), the Court backed Wisconsin's assertion that out-of-state Exxon operations were part of a unitary business, and the company's total U.S. income from business operations was subject to apportionment by Wisconsin.

Although the Court upheld unitary approaches in these three cases, the *ASARCO* and *Woolworth* decisions ran somewhat contrary to the general trend of Court tolerance. In these two cases, the Court began to draw tighter boundaries around states' reach over corporate lines. Idaho and New Mexico were not allowed to apportion income received by *ASARCO* and *Woolworth* from foreign corporations, because, in the Court's judgment, insufficiently strong links bound the U.S. and foreign corporations.

Container: Evolution of the Definition of Unitary Business. The 1983 *Container* case also concerned the lines to be drawn between corporate entities that can, and cannot, be considered part of a unitary business. The Court found that among corporate entities, a crucial "Sharing or exchange of value . . . beyond the mere flow of goods accruing out of passive investment or a distinct business operation" had to occur. The Court declared that it would defer to state court findings with regard to unitary operation "if reasonably possible," and indicated that it would not examine all claims of error but rather would determine whether a "State court had applied the proper standards and whether its judgment was within the realm of permissible judgment."

The net result of the *ASARCO*, *Woolworth*, and *Container* cases is a message that states must rely on factual evidence in drawing boundaries around corporations that may be combined as a unitary business, but that the Supreme Court will not review a flood of appeals. The burden will be on state tax administrators to develop pertinent facts, and if need be, on state courts to review the facts.

The "one voice" standard. The crucial finding of the *Container* case was that worldwide apportionment does not, in the absence of contrary federal legislation or treaty, run afoul of the nation's need to speak with "one voice" in foreign affairs. The Court articulated the "one voice" test most specifically in the 1979 *Japan Line* case in which the majority struck down a California local property tax on cargo containers because the containers were simultaneously and fully taxed by Japan. Double taxation of "instrumentalities of

TAXING AUTHORITY IN CONTAINER CASE

foreign commerce" is not permissible, the Court said, and a state tax will be struck down on either this ground or if it impairs international uniformity in an area where one national policy is deemed essential. In *Japan Line*, the Court explained that it gives more weight to the risks of multiple taxation in international than national tax cases, because of the absence of an authoritative international tribunal that could ensure due process protection against unwarranted double taxation.

In *Container*, the majority acknowledged many similarities between the *Japan Line* and current case; furthermore, the majority accepted Container Corporation's argument that double taxation was occurring when judged by the separate accounting method used among national governments. However, the majority said that the risk of double taxation was not to be weighed as heavily in a case involving taxation of income rather than physical "instrumentalities of foreign commerce." In addition, they argued that double taxation could occur even if California used separate accounting; therefore, the California method should not be struck down. Finally, the majority found no necessity for the United States to speak with "one voice" in the *Container* circumstances. There was no clearly prohibitive federal law nor treaty, and no assertive *amicus curiae* brief from the Executive Branch that the "one voice" principle need apply. Further relevant was the fact that California was taxing a U.S. rather than foreign-owned corporation. In support of a more relaxed position on the *one voice* issue, the majority declared that "this Court has little competence in determining precisely when foreign nations will be offended by particular acts, and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the U.S. as a whole to let the states do as they please."

The ACIR view on the *one voice* issue was vindicated by the Court majority in *Container*. In *State Taxation of Multinational Corporations* (ACIR Report A-92, April, 1983), the Commission asserted that "[T]here is no evidence that state tax practices cause harm to the nation." Going beyond the Court, the Commission recommended that "the United States Congress pass no law that will limit state tax practices with respect to multinational corporations or 'foreign source' income."

The Court minority, however, rejected the distinctions drawn by the majority between *Japan Line* and *Container*. Justice Powell argued that the majority "fail[ed] to recognize the fundamental difference between the current double taxation [i.e., inevitable] and the risk [i.e., minimal] that

would remain under an arms-length [i.e., separate accounting] system." Such double taxation, Justice Powell argued, violates the Foreign Commerce Clause and does seriously implicate foreign policy issues that must be left to the federal government. Such double taxation, Justice Powell argued, violates the Foreign Commerce Clause and does seriously implicate foreign policy issues that must be left to the federal government.

Conclusion. Supreme Court cases concerning unitary methods date back more than 60 years. The Court has generally been liberal with regard to the states' use of the unitary method and the associated formula apportionment.

Once the applicability of the unitary principle is established, the Court appears quite tolerant on the matter of apportionment formulas. The Court does not require that all states use the same apportionment formula, only that a state's formula be one that if hypothetically used by all states, would apportion no more than all of a corporation's net income. The Court has required that formulas provide only rough approximations of the taxpayers' income that can be reasonably related to corporated activity and values in the taxing state.

The *ASARCO* and *Woolworth* cases do show, however, that states do not have *carte blanche* in extending their tax reach across corporate and national boundaries. State tax administrators and courts must develop appropriate facts to back state tax outreach.

In *Container*, the Court relied, in part, on the U.S. residence of the Container Corporation to turn back the *one voice* challenge to the California unitary tax. However, foreign corporations with U.S. affiliates may also find themselves embraced by worldwide combination and they may perceive grounds to sue.

The Court has not been predisposed to interfere with states' assertions of tax sovereignty, but it has also deferred to the power of Congress, acting under the Commerce and Foreign Commerce clauses, to regulate state tax practice if it so chooses. The high degree of prevailing state tax sovereignty owes more to the forbearance of Congress rather than the protectiveness of the Court.

The authority of Congress to regulate state tax policy as it bears on issues of foreign commerce remains unquestioned. Legislation has been introduced almost annually since 1965 to conform state to federal practices that apply to multinational corporations. Pressure on Congress to enact legislation, particularly affecting international taxation, will probably grow as a result of the *Container* case.—Al Davis

“ It seems to me it is now virtually impossible to either directly or indirectly, through grant power, legally impinge on anybody’s sovereignty since the protected area of state and local autonomy now seems to be about the size of a dime. ” —Governor Bruce Babbitt

Another analytical problem which I personally find especially elusive—one we have been trying to follow here—is this: Aside from the state subject matter on which the federal condition impinges—whether it be indigenous to state functions or not in the Tenth Amendment sense—there is the question of whether or not the condition attached is somehow relevant to the purpose of the federal program. This question I find much more elusive, very much like asking, as Chief Justice John Marshall once did, what is “necessary and proper?”

Consider the 55-mile-an-hour speed limit issue. It may appear on the face of it not to be relevant to the primary purpose of the bill. But most legislation has secondary purposes, tertiary purposes; once you begin unwinding why legislators voted for bills, there may be multiple purposes. And the condition may well not be relevant to the purposes of some legislator or legislators who voted for the bill because of labor/management relations, or whatever the particular consideration may be.

I have trouble fashioning a rule to deal with that second problem, that of relating condition to purpose. I can easily propose and defend a rule attaching to the first problem, the issue of Congress trying to do indirectly what it may not do directly.

GOVERNOR BABBITT: It seems to me it is now virtually impossible to either directly or indirectly, through grant power, legally impinge on anybody’s sovereignty since the protected area of state and local autonomy now seems to be about the size of a dime.

Can (Should) We Establish Zones of State And Local Autonomy?

PROFESSOR FRUG: I do not think you can develop an idea of autonomy independent of central power. There are too many arguments of national interest that can be articulated.

PROFESSOR HOWARD: Let me tackle that point, if I may? I think of Thurgood Marshall’s idea of “balancing” in equal protection cases. In Tenth Amendment cases, might you have a system where the closer the

measure comes to the core of state sovereignty, interests, or function, the more relevant the condition would have to be to the central purpose of the statute?

I realize how impressionistic such an approach might be, but couldn’t you weigh in from both sides: the greater the one, the greater the other has to be to overcome it?

PROFESSOR FRUG: We have to debate what we mean by core of state interests. It used to be cities financed railroads and now they are into education and tomorrow they’ll be doing computers and running cable TV. I’m not sure that the idea of core of state interests is possible.

PROFESSOR HOWARD: I would be happy to see us come up with a list of 50 functions, ranging from those that are absolutely essential state and local functions—for example, where do we put the state capitol (the hoary example) down to marginal ones.

GOVERNOR BABBITT: The federal government shall not mandate curriculum requirements of any kind in elementary and secondary education. I would like to write that in Article I, Section VIII. I believe that would be highly constructive, in the national interest, to pass a constitutional amendment and add it to the list of reserved powers.

DR. HAWKINS: Didn’t I hear someone saying there are tremendous negative effects to that? For example, if Alabama doesn’t have a good secondary school system, the whole nation suffers. The externality argument can be used to justify anything.

PROFESSOR FRUG: It’s just not in the national interest to allow Arizona to close all of its schools or do whatever it wants.

GOVERNOR BABBITT: Believe it or not, it is in its interest. To allow Arizona to close all the schools is manifestly in the national interest. This is the point. Sometimes you give bodies freedom for the same reasons you give individuals freedom. It induces responsibility. The price Arizona will pay for closing its schools down is we will rapidly on the scale of high-tech centers in the United States go from 3 to 50. That’s why it won’t happen.

The same reasons that Mississippi now has a kindergarten law. Washington didn’t tell them; the people of Mississippi did. And they exercised, however delayed, a certain understanding of the relevance of education.

And the argument of all these federal types is that, although occasionally liberty is misused, the flip side of the liberty is a certain amount of responsibility that you can’t put on people in any other way.

That’s what we see every day in state government. The problem in abdicating to a central power is the withering of responsibility.

My other shorthand answer to you is: we have had 200 years of centralizing power but we can’t go on in a straight line to infinity. The defenders, the rationalizers of the status quo, seem to me to be implicitly saying we

are not uncomfortable with an infinite progression to unity. I am.

Welfare raises one of the most important problems. That is, you have got to be very careful about watching out at the national level for those interests which are not generally shared interests in a community of values. It applies to the whole cluster of civil rights and minority group issues generally. Interestingly enough, even in the Federalist Papers, Madison talks about this issue.

It is an equally powerful rationale for removing certain functions from national control—like law enforcement, education, roads, wastewater treatment, all those areas where you can fairly say to a community: if the collective sense of this polity, which has a roughly equal stake in all these, is that we don't want it, so be it. That's the price of freedom. That's the price of political freedom.

PROFESSOR FRUG: To me it is not an intellectual project of drawing lines or categories or zones of autonomy, but it is a project of creating a power structure in which one understands that the representatives in Washington in fact are representatives in some actual meaningful sense rather than a technical sense of the term.

GOVERNOR BABBITT: Certainly a more fundamental organic way of going at the issue without any question.

PROFESSOR FRUG: To me there is a kind of untapped power, as a political issue in the sense of local control over basic things. Education, I agree, would be high on the list in the current American psyche. This sense is not now mobilized in any meaningful way by state governments or city governments as a way of showing that this is really something that we stand for and that makes a difference to us.

GOVERNOR BABBITT: It's not that easy. Let me give you an example. Take last year's sort of electricity issue, drunk driving. The various states really went after it, as politicians do at a political level when they sense there is an issue, with an enormous amount of energy and creativity and some marvelous, you know, sort of a Brandeisian laboratory model, if you will.

Do you know what happened at the end of that year? Congress rained on the parade. They passed an absurd statute with a bunch of mandates and a bunch of money. It wasn't even really new money. It was money taken out of the highway construction bill. It was an abomination.

PROFESSOR FRUG: Well, let's maybe talk about one particular move that one could make, which comes from *National League of Cities v. Usery*. As the Supreme Court retreats, you could slip the *NLC* doctrine into the Constitution more specifically.

The idea is to create a sphere, a local sphere which is independent, and not governable, by the central authority.

Now, I regret to say that although I very much be-

lieve in local control—and indeed it is central to what I do in my work—I do not believe in the move to constitutionalizing local autonomy.

GOVERNOR BABBITT: Given that, would you as devil's advocate explain what the move could be in its fullest flower?

PROFESSOR FRUG: That would be creating, an area of government—local government and state government—immune from federal control. It is exactly the same idea, in my opinion—or it is an analogous idea—to the idea that there's an area of property rights immune from governmental control.

GOVERNOR BABBITT: Okay. Now presumably the most radical flower on the bush would be to attempt to redraft Article I, Section VIII, to define with some degree of specificity what this intrinsic area of sovereignty is all about.

PROFESSOR FRUG: Yes. We would start with amending the Constitution to say Congress may not exercise its power to regulate commerce so as to force directly upon the states its choices regarding the conduct of integral government functions.

That's a quotation from *National League of Cities v. Usery*.

The Political Dimension

PROFESSOR KADEN: The original idea, as I understand it, was that the states' interests would be protected in Washington because the states themselves—the political parties and the state government officials—had a significant influence on the federal government. They had certain kinds of structural roles, including the selection of U.S. Senators, the definition of congressional districts and the determination of voter qualifications. But more fundamentally, they had a political role. It was expected that the members of the national legislature would come from the state political process. And that has really changed tremendously in the last 10 or 20 years. At least in my part of the country the local political organizations that used to be the strongest in the country are losing strength steadily.

People are elected to Congress by their own resources, not only financial but their own standing and past activities in other fields. They are elected without strong ties to the political establishment in the state. Some of that is good. It may be related to what some people see as the improved quality of the national legislature. But what it means is that the states' voice in the Congress is less significant, and the political ties linking members of the national legislature with state political parties are not as close as they once were.

At least part of the problem is that most people who study parties are interested in national politics. Therefore, state and local governments are viewed as obstacles and irritations. And it has taken the aftermath of the government reforms in the Democratic party to restore some sense. But there is some interesting sense. And the Democrats' move to establish a new quota for

“ I said it and I believe it: PACs are the United Way of politics. They are important. ” —Senator Dave Durenberger

elected officials at national nominating conventions is the most concrete, important step. It will ensure at least some voice for elected state and local officials in their Presidential nominating process.

GOVERNOR BABBITT: I can't resist the urge to put my oar in on this discussion. I was elected without a party, and that provided many great benefits. I will not elaborate.

The problem is very simply, that you can strengthen party organizations and build them and make them meaningful on two bases only. One is patronage which, thankfully, in the main has gone. I say in the main because there are some qualifications. The other is ideology. And for many diverse and interesting reasons that I happen to sympathize with, a lot of political leaders are not very interested in polarizing political issues—the last thing most politicians want to do is go out and write philosophy books.

PROFESSOR FRUG: The relationship between money and structure, in particular the relationship between PACs and political parties, is central. The idea is that the Congress is supposed to be representative of the states. But, the influence of money in campaigns and the influence of PACs replaces state interests with those of groups. And so it strikes me that this is really quite central to the idea of federalism.

GOVERNOR BABBITT: Do you prohibit PAC contributions?

SENATOR DURENBERGER: No. To understand the PACs you really have to spend a little time dealing with the issue of influence. You have to really go back to where the money comes from.

In so many cases you'll find the oil money goes to Texas and Oklahoma folks that vote an oil constituency. And milk money goes into Minnesota. There's a lot of that.

Despite everything I have read about this, it is not common for PACs to say, "Unless you vote for me all the time I won't help you out." In this kind of environment, I would tell you if I experienced it.

I had a 4-million-dollar campaign. I would not have been able to win without PAC money. I guess thousands and thousands of people who would not otherwise have contributed, contributed. And not only contributed money but wrote letters and became involved.

I said it and I believe it: PACs are the United Way of politics. They are important.

One last observation: The fact that I could only get

about \$200,000 out of \$4 million from the Republican party, nationwide, is awful. That is what kills parties. I think \$210,000-or \$220,000 was my limit.

DR. MARCUS: It takes a lot of resources to run a campaign. Money is not the only one. And money is neither the evil nor the cure for politics.

By changing the rules on campaign financing you end up franchising and disenfranchising other people in the political process. Public financing has greatly increased the advantage of organizations, not only in giving money, but also in mobilizing literate middle-class people with time on their hands to serve as campaign volunteers.

One of the unwitting things that public financing did is to greatly increase the political power of certain interests with national organizations.

PROFESSOR KADEN: It used to be a given that the federal representative would be responsive to state concerns because of where he came from, how he got where he was and what his political roots were. And that simply is no longer true.

PROFESSOR FRUG: In the days in which the towns of Massachusetts controlled the state rather than the other way around, as it is now, the towns of Massachusetts paid their own representatives rather than the state paying them. So the representatives came back for their weekly paycheck and there was a sense of where the money was coming from, and this was not the only thing they did; they had to do 20 other things. But, this was one of them.

GOVERNOR BABBITT: Would you buy a law that said representatives and senators shall be paid by their respective states and not the federal treasury?

DR. HAWKINS: Yes.

GOVERNOR BABBITT: How about a law which says all money must be contributed to political parties rather than candidates?

GOVERNOR BABBITT: The political system doesn't work unless there are some generalizing tendencies in it that move people toward some kind of shared feeling about what is relevant at what level of government.

I submit to you, with patience, that is at the core of the problem right now.

S. I. Hayakawa, in my opinion, will go down in American history for an answer he gave during the California Senate election when he ran. He was in the midst of a crowd of people, getting peppered with all these questions about dog racing going on in California. The Senatorial candidate was asked: Candidate Hayakawa, what do you think about this dog racing issue?

And he said: "Ma'am, I don't give a doggam about dog racing. I am running for the United States Senate." Those answers are rarely given in the American political system.

“ There are a lot of reasons for centralization. I think one of the driving forces for centralization was the denial of local liberty. ” —Dr. Robert Hawkins

DR. MARCUS: That's a step in the right direction.

GOVERNOR BABBITT: Is that constitutional?

DR. MARCUS: Arguably so.

PROFESSOR FRUG: We are talking about *Buckley v. Valeo*,⁵ all over. What does it mean?

GOVERNOR BABBITT: At minimum it means I can spend my own money.

PROFESSOR FRUG: To me one of the fundamental issues is whether the issue of federalism can be solved through legal change—whether it's changing the Constitution or the way the courts act—rather than through a change in the political understanding of people about the importance of local government in their lives. As long as we don't in a real sense believe in federalism, I'm not sure that any changes in these documents or institutions are going to make a difference. Changing rules and institutions can sometimes help. But I believe that you need to organize the localities around issues and integrate together people's daily concerns about things like their education, their work life, their environment, and other issues which may not be on your local but international list, like the nuclear moratorium, which is a very popular local issue although it is not very local in some sense.

And then organize both your campaign financing and some other forms of built-in mechanisms to change the relationship between localities and their representatives.

DR. MARCUS: That's what political parties used to do: organize communities.

DR. HAWKINS: There are a lot of reasons for centralization. I think one of the driving forces for centralization was the denial of local liberty.

PROFESSOR FRUG: You bet. It was a policy choice, something we decided to do.

DR. HAWKINS: Throughout local government, and state government reforms, people wanted to make them bigger, more centralized, with professional administrators to the point where the effective voice of local citizens was, through their parties or whatever mechanism, almost voided because the costs to get anything done were so high.

SENATOR DURENBERGER: Looking at state legislatures, and I would say also at the executive level, obviously we have much improved the quality of our

elected officials. It seems to me, though, at the legislative level that the product of the legislative process has actually gone downhill.

Yes, legislatures have more staff and other resources. But now you have a bunch of bright, energetic, full-time legislators, pretending that they know what the real world is like, running state legislatures in this country. And they think they are going to be President of the United States some day.

You have the same thing happening at the county level and at the city level, and I might add in Congress. Everybody is going to be full-time. But, as soon as you become full-time, you lose sight of the real legislative role. You start filling potholes and providing services. And we are losing. I would suggest, through this system, the policymaking part of it.

Coming to grips with the tougher issues, for example, what's the future of education? It is getting policy back in the hands of school boards, and teaching in the hands of the teachers, rather than everything in the hands of the school boards. And the only way you do that is to turn the whole system around and have people start buying their education rather than having government financing these school buildings to give it to them.

PROFESSOR FRUG: I think Senator Durenberger is saying something significant here in terms of rebuilding the political base. He's saying you have to look at the service provision strategies because even those decisions are inherently political. How do you deliver school services? How do you develop and deliver welfare services? Have you adopted strategies that create independence or do you adopt strategies that encourage dependence?

Until you start opening up avenues at the local level and state level that are real—that have real substance to them—you can make all the changes in the rules you want. It is not going to mean anything.

DR. MARCUS: Tip O'Neill's two rules are that all politics is local and that local politics is sewerage. But his rules are only half right.

PROFESSOR FRUG: He's my representative, so I know what he's talking about.

DR. HAWKINS: About five years ago we had, as part of a series of meetings at the Woodrow Wilson Center, a session on the role of the states, and six governors participated. I asked the governors how many of them perceived themselves as leaders of their parties and political leaders of their states?

They looked at me as if I were asking a question from outer space. Because I think the culture of being a governor in the last 20 years is being an executive, being an administrator, implementing state policy.

Forty years ago governors saw themselves as political leaders, I think. And they were political leaders.

I know in California governors aren't political leaders. When they get elected the first thing they forget about is the political party and political system and start running the state in the most efficient way they

⁵424 U.S.1 (1976).

can, which is part of the problem or part of the solution, depending on how you view it.

PROFESSOR FRUG: There is a cycle of powerlessness in which one loses power and then defers to the people with power, which causes you to lose more power and defer more to people with power. This happens within work places as well as within governmental structures. We are down that road pretty far, I think, in terms of local autonomy.

So that when one thinks about, well, what can one possibly do, one looks to the people to whom we have given this power. The federal government is the first that comes to mind.

DR. HAWKINS: There's another issue which we can't go into today, but which I think is critical. I think the governors get hoisted by their own petard on this one. That issue concerns equity—there are certain equities that are national and almost everything can be put in an equity context.

I think at ACIR we have to look at that issue because I can make an argument where lots of equity issues rather than doing good do tremendous harm. For example, all you have to do is take the example of helping cities rebuild their infrastructure. Well, pretty soon cities expect that the national government is going to rebuild their infrastructure, so you have certain cities that systematically disinvest in their capital facilities.

GOVERNOR BABBITT: You are absolutely right. You see it as the "Crusade to rebuild infrastructure." Perfect example. There is no, not even a pause to ask, with Henry Clay and his successors: Which infrastructure is invested with national interests and why?

DR. HOWARD: Part of our problem is that we lack what Madison had, which was a common enemy. Our founders knew what despotism was. They knew what they didn't want in a kingship. Now we have a view of a more benign centralized power. It brings us Social Security and a lot of other things. Thus, the sales pitch is much more difficult to make regarding what it is we are trying to avoid in this argument, than it would have been or was 200 years ago.

DR. MARCUS: The great gamble at our Nation's beginning, was that this would be a regime or policy with sufficient civic virtue among its citizens that they would care and know what to do about it. The American voters are still smart.

Reform: A Matter of Strategy

PROFESSOR KADEN: I think we are really debating strategy here. The advocates of equal rights, or interpretations of the 14th Amendment that protected individuals against discrimination on the basis of race, did not approach the task from, say, 1950 to 1980, by letting chance determine what cases went before the Supreme Court.

They had articulate strategies and articulate leaders, and they were well staffed. And they were as effective

as any advocates whom the Court saw. If the states and their allies are serious about the development of constitutional doctrine they would approach it the same way.

The state-local legal advocacy center obviously is a first step in that direction. But it is only that. I don't yet see the perception that this is a significant issue, and it ought to be approached as an effort in which coherent strategy can pay off. I think states are woefully represented in the Supreme Court. The Chief Justice came to the National Governors' meeting in January to communicate that same message.

IN DEFENSE OF STATE AND LOCAL GOVERNMENTS

The State and Local Legal Center began operations in March, 1983. It was created by the Academy for State and Local Government, a non-profit organization sponsored by seven national associations of state and local officials. The Legal Center expects to participate in a broad range of Supreme Court matters, including cases involving federal preemption of state laws, taxation issues, grant disputes, officials' immunity cases, and land and water rights.

In a background paper prepared for the National Governors' Association meeting in August, 1983, Lawrence Velvel, the Center's Chief Counsel said:

No branch of the federal government has done more to limit the powers or increase the duties of state and local governments than the Supreme Court. Each year, one-third of the cases considered by the Supreme Court are of direct concern to state or local governments. And each year we lose far more than we win.

That could change, but only if state and local governments begin working together to develop a consistent and realistic strategy for litigating cases in the Supreme Court. For decades we have either ignored the Court, concentrating our effort on Congress or the Executive Branch, or have rested our hopes in Supreme Court cases on inadequate legal arguments. And we have suffered the consequences.

According to Velvel, the Center has compiled a list of over 15 critical areas in which Supreme Court battles between states and localities and the federal government can be anticipated. The Center has filed *amicus curiae* briefs in two mass transit suits since it commenced operation.

ACIR recommended the creation of such a center in 1980 as part of its study, *The Federal Role in the Federal System*. The Commission urged that a state-local legal defense organization "monitor and institute legal action opposing (coercive) conditions attached to federal grants and 'intrusive' Congressional exercise of the commerce power."—Stephanie Becker

For example, in the nuclear safety case that the State of California won, *Pacific Gas and Electric Company v. State Energy Resources Conservation and Development Commission*, Professor Tribe represented the state. They were well represented and it paid off for them.

I think there are two things: the quality of representation has got to improve. And secondly, all of these issues that together form the body of determining whether the states are going to have protected autonomy, some preemption cases, some constitutional cases, ought to be approached on the basis that you can develop an overall strategy and try to implement it effectively. It may take 10 or 15 years. But at the end of the line the state governments are going to be better off than they are today.

PROFESSOR FRUG: The states ought to do it the way the civil rights advocates did it.

GOVERNOR BABBITT: The Legal Defense Fund and the evolution of their cases.

PROFESSOR FRUG: Same quality, same resources and there is no reason it can't be done if there is a group of state officials who believe the objective is worth the fight.

GOVERNOR BABBITT: The problem is that there is a jealously guarded diversity that prevents us from coming together.

[Ed. Note: The State-Local Legal Defense Center was formed in 1982 to monitor cases of state and local interest and provide legal assistance, when resources permit. The formation of such a center was financed by the public interest groups representing state and local officials and private foundations.]

Changing "The Rules of the Game"

DR. HAWKINS: I think we have to keep our constitutional scholars honest here, in this sense: I think we have just come through maybe 20 years where policy was king. Everything is a matter of public policy. And nobody wants to make a distinction, it seems to me, between setting the rules and playing the game. Everybody is so busy playing the game they never pay attention to how you allocate authority and what effect the allocation of authority has on the conduct of public enterprises.

And it seems to me in a sense, if you go back to the Founders, that they had a very clear distinction between two kinds of activities in the political sphere. One is setting the rules and one is playing the game. And I don't think that it is as determined as some people want to make us believe, that basically judges to what they do because they are responding to these great social trends.

Just let me give you an example. In California, we have an imbalance between state and local governments. And one of the reasons we have an imbalance is because the state Supreme Court nine times out of ten rules that a state law regulating the size of a coin that

goes into a parking meter is of general statewide concern.

Now, if you look at public opinion polls, the people of California want a return of local authority. Overwhelmingly. And yet there is no way through the state legislature and the state courts that you can secure a change to local authority.

It appears there's going to be something on the ballot next year.

PROFESSOR FRUG: I agree that the problem is not a constitutional rewrite. It is the political organization of the locality to send the message. And I think there's a lot of untapped power that could be organized and a lot of unmet messages that could be sent.

DR. HAWKINS: It is not an either-or proposition. I'll bet you ten to one that we can write a new home rule document in California that will pass, that changes the nature of the rules of the game because in California we can get at the constitution. We can just bypass the legislature. For the last two years there was a proposed home rule doctrine to strengthen the locals' hand but it couldn't be passed. The reason is the legislature doesn't want strong local rule because in a sense it is a zero-sum game. You are taking power away and giving it back to locals. A lot of locals don't like it because you are giving a lot of power to citizens for maintaining and controlling their own governments, but you have to do both of them.

GOVERNOR BABBITT: In essence, then, the problem is how do you persuade the fiscal, the judicial, or the political process people, that the rules have an independent value; that an intergovernmental system must give some homage to the rules of the game?

The reason I think we are always rolling upstream is because of what happened in 1960. The concept of state sovereignty was identified with the denial of civil rights and racism. In the public mind there has been that connotation ever since. The popular image, when you start talking about the rules of the game, is that they are reactionary. That's historical fact.

PROFESSOR FRUG: It taught us from one perspective that the rules of the game are one way to play the game. One of the ways the game can be played is by changing the rules.

DR. MARCUS: If you go back to the original debate between the Federalists and anti-Federalists, the persuasive argument of the Federalists was that people would accept national government because they would see that national government is better government. And to an increasing degree in this century that's the popular opinion precisely for the reasons the Governor put his finger on: the civil rights question.

But also what has begun to happen at the state level, and I have worked with four legislative reference bureaus, is that there is a gradual improvement in the quality of people who are attracted to state government. So it is possible again to make use of that older argument to point out to people that local government and

ARTICLE V: THE STATE-INITIATED APPROACH TO CONSTITUTIONAL AMENDMENT

Not since 1787, when the Articles of Confederation were thrown out and a new Constitution formed, have we as a nation held a constitutional convention. Yet, the U.S. Constitution itself provides that Congress shall call such a convention upon the request of two-thirds of the states (Article V). The state-initiated approach to constitutional amendment was thought to be a necessary precaution because, James Madison wrote in *Federalist* No. 43:

It guards equally against that extreme facility, which would render the Constitution too mutable; and that extreme difficulty, which might perpetuate its discovered faults. It, moreover, equally enables the general and the State governments to originate the amendment of errors, as they may be pointed out by the experience on one side, or on the other.

The most recent attempt to utilize the convention approach to Constitutional amendment is being prompted by concern over mounting federal deficits. To date, 32 state legislatures (two short of the two-thirds required) have passed resolutions supporting a Constitutionally-mandated balanced federal budget (the majority of the 32, however, called for a constitutional convention only if Congressional action were not forthcoming). The state resolutions were undoubtedly an important factor in stimulating Senate action last year. On August 4, 1982, the Senate approved Senate Joint Resolution 58 to amend the Constitution to require a balanced federal budget. If the Senate resolution had been passed by the House as well, it would have required approval by three-fourths of the states before becoming part of the Constitution. Because the measure failed to gain House endorsement, however, the initiative is still with the states where it is reportedly under active consideration in four legislatures.

No one really knows what would happen if at least two more states act on the balanced budget amendment. Although Congress has received over 350 different convention calls, they have been on widely varying subjects and no single topic to date has been endorsed by the necessary two-thirds of the states.

In fact, only a few times in our constitutional

history have we come close to the number of states necessary to put the call for a constitutional convention in effect. Typically, Congress takes some action before 34 states join in the call. For example, Congress proposed the direct election of U.S. senators as the 17th Amendment after 26 states petitioned for a convention on the matter. An attempt was made to prohibit implementing the Supreme Court's one-man, one-vote apportionment ruling for state legislatures. By the mid 1960s, 32 states had passed resolutions calling for a convention on reapportionment, but the movement failed to gain further momentum, at least in part because newly apportioned legislatures had come into power.

State actions on the reapportionment issue did serve to arouse some congressional concern. In 1967, Senator Sam Ervin (NC) introduced a bill to help clarify the so-far unused procedure. Following hearings, and subsequent modifications to the bill, the Senate took favorable action in 1971. The House took no action, however. Two years later, the Senate again responded favorably to what was then known as the Ervin bill, but again the House desisted.

The Advisory Commission on Intergovernmental Relations endorsed the Ervin bill in principle in 1973 and reaffirmed its position again in 1980, stating:

The Commission believes that the power conferred upon the legislatures of two-thirds of the states to petition for a Congressional call for a constitutional convention to draft correcting amendments should be accorded the same degree of dignity, feasibility, and legal clarity as the more familiar Congressional initiating option.

Senator Orrin Hatch (UT), Chairman of the Subcommittee on the Constitution, has introduced S. 119, a bill similar to that originally proposed by Senator Ervin. According to one Subcommittee staff member, "At issue is *not* whether you are for or against a balanced federal budget. It is not even whether you are for or against a constitutional convention. The issue is when and if 34 states call for a convention, do you have chaos or an orderly Congressional response?"

—Stephanie Becker

state government can indeed be very good government, and superior in meeting some of their interests than national government.

DR. HAWKINS: I wanted to ask you a question Governor. How many of your fellow governors are really sympathetic to this notion of the rules of the

game?

GOVERNOR BABBITT: We are firm in spirit and weak in flesh. It is very tough. Because in the abstract, everybody is for it. But once the rush to the federal trough begins, we all waive the rules.

Changing the U.S. Constitution

DR. HAWKINS: An issue that interests me on the question of constitutional change is why are people like Dick Howard—at the drop of a hat, willing to write a new Constitution for the State of Virginia?

PROFESSOR HOWARD: Only once in his lifetime. He's not likely to do it again.

DR. HAWKINS: And in California, people will sit around and write constitutional amendments. All over this country, in states—there is absolutely no fear or trepidation of going out and being constitution makers. Why is it we are all so chary to sit down and think that we just shouldn't even try to come up with federal constitutional amendments?

PROFESSOR FRUG: Too terrifying. It is much more terrifying. The idea is that a state constitution isn't a lot different from state legislation. Some of them are four or five volumes.

But the idea that somebody is going to get his hands on the 14th Amendment or First Amendment or the power of the presidency, power of Congress, or power of the Supreme Court is very terrifying.

It seems a lot more important than moving the state system around. Which is important. I'm not suggesting it is not. But changing the nation's Constitution is much more terrifying.

GOVERNOR BABBITT: Is there even a wisp of sentiment for repealing the 17th Amendment?

[Ed. Note: the 17th Amendment to the U.S. Constitution provided for the direct election of U.S. Senators. Prior to the amendment, they were elected by the state legislatures.]

PROFESSOR FRUG: Not a wisp.

PROFESSOR KADEN: No. Even though I'm sympathetic with the objective, it's hard to see how that would be a net plus for governance. It is hard to make the case that you would get a better national legislature that way.

GOVERNOR BABBITT: I'm not saying better. I'm saying more responsive. I understand there are many different values. Another question: Do you have any support for the Article V movement which is a slightly different way of asserting the role of state legislatures? In the absence of the control of the 17th Amendment, one thing state legislators can do is petition for a constitutional convention, and it has at points in the last century been very effective. As the threshold of two-thirds is approached, there is response from Congress.

The reason it is not really effective is because most of the petition movements are met with the threat of a wide-open convention, which raises all of your concerns.

The counter of that is the Ervin bill which says: Congress has the power to pass implementing legislation

which would get at those issues by allowing states to call a constitutional convention exclusively for the purposes specified in the petitions.

PROFESSOR FRUG: I have a proposal to introduce to your constitutional convention of states, which is to eliminate the distinction between governor and being senators in this sense:

We will elect two people who we will call governor and lieutenant governor who will share two responsibilities, which we'll call governor and senator. The idea is, if you want to have the states represented in the Senate, we want to have somebody who is actually involved in the business of the states in the Senate.

GOVERNOR BABBITT: Well, that's fascinating.

DR. HAWKINS: Senator Durenberger, would you like to respond?

SENATOR DURENBERGER: What do we do with the other senator?

DR. HAWKINS: Another proposal is to pass a constitutional amendment limiting Congress to six-month sessions. For example, people think that's facetious, but I take it seriously. Local officials in California will tell you their problems with the State began when we underwent legislative reform and got full-time legislators. Because full-time legislators no longer really live in their districts, they no longer understood the problems in a concrete sense and started relying on staff and abstract information.

The Re-Emergence of Constraints: Fiscal Pressure

PROFESSOR SCHECHTER: In looking at the practical constraints on today's political leaders, in terms of what seems to be a long range popular mandate, it may well be that many of the objectives voiced here—to disentangle the intergovernmental system and restore some limits on government—will occur over the next decade as a result of overarching fiscal constraints rather than systematically-sought constitutional constraints. The task, it seems to me, is to make the kind of constitutional and political choices that shape this so-called "winding back" process.

GOVERNOR BABBITT: How do you use fiscal issues as a way of forcing a discussion of the respective roles and responsibilities of layers of government?

SENATOR DURENBERGER: If we could come to grips with tax reform in this country in some meaningful way, I think we might find some of the answers to problems in the intergovernmental system. We are very close to the point where almost as much money is going out through tax loopholes in federal income taxes as is coming in through the tax system. There is a tremendous opportunity there to raise revenues. We then use the tax side combined with the federal revenue sharing mechanism.

That also gets us to the need to come to grips with what formulas do. I think we are now making some progress on the representative tax formula. We need to get the Administration to think a little bit about tax formulas and the inequities in tax formulation the way they think about the budget responsibility.

[Ed. Note: Senator Durenberger's reference, "The representative tax formula," is to a measure of relative state tax capacity studied and developed by the ACIR to portray varying abilities of the states to tap resources for tax purposes.]

GOVERNOR BABBITT: The feeling that, as essentially a non-constitutional issue, as a pragmatic, real-life issue, that any method of imposing fiscal restraint on the United States Congress would automatically force an ordering of priorities. That has been the hope of all of those who have dealt with this. Let me give you two examples.

The balanced budget amendment, in the eyes of many, was an attempt, by setting a higher threshold of passage, to force an ordering of priorities. I believe in the minds of many the Reagan tax cuts were perceived that way. The theory was if you can open up a large enough deficit, you will force people on the expenditure side to do some reordering. That has not proven to be the case in any large way. But it was a noble experiment.

Now, are there in fact any kinds of procedural or fiscal devices which will force the Congress into this sort of ordering exercise? The budget resolutions are another nice example of something I think was intended for precisely that thing.

DR. SHANNON: Aren't we writing off too easily the fiscal restraint effect on the federal aid system? Just a few years ago, the ACIR became very concerned that federal aid programs were multiplying at an ominous rate. The aid system was likened to a rogue elephant that would soon trample down all of the state and local power preserves.

Now that Washington policymakers are caught in a growing fiscal squeeze, we are witnessing an amazing turnaround on the federal aid front. After having risen steadily for a quarter of a century, federal aid as a percent of state-local expenditures has dropped from 26% to 20% in the last four years and the number of funded aid programs has declined from approximately 540 to 420 in the last two years. While there has not been a commensurate retreat on the regulatory front, it appears clear that the federal regulatory tide has crested.

The important thing is the reappearance of fiscal constraint with its beneficial "sorting out" effect on our federal system. Relatively less federal financing is going into state and local programs and relatively more federal financing is going into strictly national programs—defense, social security, medicare, and paying the interest on a trillion dollar U.S. debt.

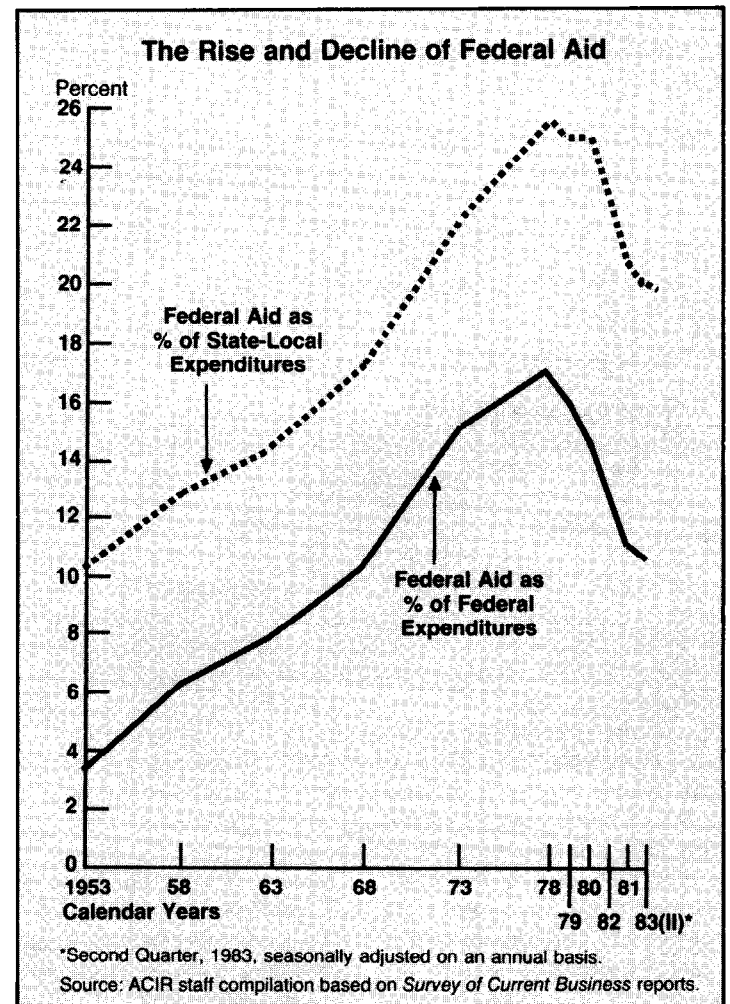
This "new federalism" is not the nice, neat, and orderly "sorting out" process that political scientists and reformers would like to see; rather, it is a slow, federal

retreat dictated by fiscal stringency. When state and local officials were confronted in 1981 and 1982 with the severest recession since the the Great Depression, they were forced to make their own painful adjustments—cutting back programs and raising taxes in order to make ends meet. In the good old days of easy federal money, state and local officials could always expect the federal cavalry to come charging over the hill and relieve them from the siege of recession with aid from Washington. Now there is a growing realization that we are in the do-it-yourself era of fiscal federalism—a period that is likely to last for several years.

PROFESSOR FRUG: I only question the idea of whether or not fiscal restraint of the national government is in the interests of the states.

GOVERNOR BABBITT: I believe it has been in the interest of the states. Having just raised taxes, let me just say for even this limited circulation—by and large the exercise has been salutary.

PROFESSOR FRUG: What I was going to say was that a compressed revenue source for the federal government leads to less revenue from the federal government to the states and raises the question of the ability of states to raise income in a national economy.



“ “ At this point, as you'd expect, Congress has schizophrenic views. ” ” —Senator Dave Durenberger

The flight of capital from one part of the country to another and the flight of capital outside the United States becomes a problem for the states. And the issue, as far as I'm concerned, is whether or not in the long haul local revenue generation of that kind is a possibility.

GOVERNOR BABBITT: There are many functions in which the states really are not begging their neighbors, in which the traditional functions supported from state taxes are supported very adequately and with no adverse competitive impacts.

This group has identified some areas where you get this ratcheting downwards, beggar your neighbor kind of thing where there is an overriding national interest. Then, if you are going to change the balance, you get into this issue of revenue shares based upon the taxing capacity of the states.

There are many ways to impart equity into the system even at the same time you are saying to the states: Do more for yourselves. And then you are saying that there ought to be room for differing value judgments in the 50 states about what is important and what isn't.

SENATOR DURENBERGER: At this point, as you'd expect, Congress has schizophrenic views.

You will find some who believe the spending cuts have gone as far as possible and want to raise taxes to close the federal deficit. You can also find those, sometimes the very same individuals, who want to raise taxes to fill the gap created by the spending cutbacks.

You'll not find this group using Reaganomics anymore to defend tax cuts. Instead, they deplore the inequity that is involved in just the modest reduction in spending that has occurred in the past two years. For example, if I cut Medicare, I don't save anybody any money out there. I save the federal budget some money, but I shift the costs of health care off onto somebody else.

Secondly, you can walk through the present tax system and intelligent people can find two sets of benefits: one, the tax rate reduction and indexing in particular are, or will be, of benefit to low and median-income families. But you can also find in spite of the reduction in marginal rates the continuation of loopholes that still are of incredible benefit to those that pay the reduced marginal rate of taxation.

So it is much easier for those who have to raise taxes out there at the state and local levels to complain about the second of those two tax benefits, rather than the first.

On the other side—and I think this is why Governor Babbitt thinks his experience in raising taxes was a good one—is the example of education.

I think the \$1 billion add-on to the federal budget for education was a last gasp in the intergovernmental aid system. I don't know how it happened. It did. But that is the end.

What is now happening, at least in my state, besides being the forerunner on tuition tax credits, is a very interesting bill from a very liberal Democrat in our State to begin instituting an education voucher system. The system would start with the economically disadvantaged, racially disadvantaged, and move on to other groups.

So changes in the delivery systems, whether income security systems or other systems, are going to take place not at the national level, but at the state and local levels. In response to that, it is my theory that we can develop an income tax-based financing mechanism that will integrate the intergovernmental financing system.

GOVERNOR BABBITT: To me, an historical perspective on federal spending pretty accurately shows where we are today.

In 1930 government spending at all levels was approximately 10 percent of GNP. By 1950 it was up to about 25 percent, with a heavy defense component which was not even there in 1930.

In 1983, that percentage, with a smaller defense component than 1950, is now hovering somewhere between 35 and 40 percent, depending on the arithmetic you do.

That can lead you to all sorts of exercises. But one is whether or not there aren't some systematic interests served by talking about ways of putting pressure against further expansion; again, for many different ends.

A balanced budget amendment is the obvious one. Another is to limit federal spending as a percentage of GNP—one which I personally liked better than the balanced budget.

In summation, let me just pose a series of questions that remain unanswered. The approach of the bicentennial of the U.S. Constitution in 1987 makes this a particularly timely period in which to raise them. First, what are the limits to the national government's reach into state and local affairs? What is the meaning of limited government generally in the latter part of our century? And, finally, can we reconcile our political, parochial, regional and state interests to meet the challenges ahead while still preserving the virtues of a federal system?

Commission Urges Local Jail Reform

Many of the nation's 3,493 local jails are in a state of crisis, agreed members of the Advisory Commission on Intergovernmental Relations at their June 16 meeting. Seven witnesses testifying before the ACIR on the morning of the June meeting all stated that indeed the local jail crisis exists and suggested specific steps to put these local houses of corrections in order.

Commission members did not dispute the fact that a substantial number of local jails are overcrowded, frequently house inappropriate populations, and sometimes do not meet basic constitutional standards. They did, however, reject the view that a stronger federal role is the answer to these problems. Although the Commission recommended continued federal efforts in the areas of corrections research and development, and in training and technical assistance, members felt that the solution to the local jail crisis was first and foremost a strong state-local partnership. Specifically, the Commission urged a series of steps the states should take to alleviate some of the burdens for which local governments have primary responsibility:

- adopt guidelines for removing certain populations from local jails when practicable—for example, the young, the mentally ill and the publicly inebriated are all too often, research reveals, placed in jails as a last resort;
- adopt sentencing guidelines based on legislatively-predetermined population maximums in state and local facilities;
- fairly compensate localities for housing state prisoners;
- encourage localities to make increased use of community-based alternatives for punishing offenders of less serious crimes and to expand the use of pretrial release when there is a

reasonable expectation that public safety will not be threatened. Also, states should enact defendant-based percentage bail laws to ease the financial burden of bail on poor defendants; and,

- allow local correctional facilities to contract with private companies so that inmates can produce certain goods and services as long as they are not directly competing with private sector goods and services.

Fundamentally, the Commission recognized that jails are a local problem and that setting basic standards for jail operations is a local responsibility. Localities should upgrade their jail personnel practices and management where necessary and improve inmate access to educational facilities.

ACIR's study, *Jails: Intergovernmental Dimensions of a Local Problem*, revealed that, of all the forces influencing corrections, federal judicial intervention has had, and continues to have, the biggest impact. In recent years, the courts have made extremely specific rulings demanding compliance with court-designed plans. "One of the major problems with court orders is that they are aimed at specific constitutional violations as opposed to the systemwide reforms that are almost always required," Baltimore County Councilman John O'Rourke stated at the ACIR hearing. On behalf of the National Association of Counties, O'Rourke said that the courts' role should be less intrusive. ACIR members agreed and called for a more balanced, less prescriptive federal judicial role with regard to local jails. The Commission stated its belief that federal (and state) courts should confine their role to ensuring that appropriate legislative and executive officers produce reasonable plans for bringing unconstitutional institutions into compliance. In consultation with local officials, states should, if they have not already done so, set standards to protect basic constitutional rights of inmates. Finally, where lacking, states should

establish state correctional commissions to develop comprehensive policies.

President Names New ACIR Members

In June, President Reagan appointed five members to the Commission. They include Governor Scott Matheson of Utah, Governor Dick Thornburgh of Pennsylvania, Assemblyman William Passannante of New York, and Mayor Ferd Harrison of Scotland Neck, North Carolina. The President also reappointed Governor Bruce Babbitt of Arizona, an ACIR member since 1978. The newly appointed or reappointed members will serve two-year terms on the Commission.

In addition, on September 22, President Reagan announced he is appointing three new members of the Advisory Commission on Intergovernmental Relations, and reappointing Dr. Robert Hawkins as Chairman. The new members are:

- Lee Verstandig, Assistant to the President for Intergovernmental Affairs, will succeed Richard Williamson as one of three Executive Branch members of ACIR. Prior to his appointment as a senior White House staff member in May of this year, Verstandig served in the Environmental Protection Agency and the Department of Transportation. He was an administrative assistant and legislative director to Senator John Chafee (RI) from 1977 to 1980, and, before joining the Senator's staff, spent 17 years in the academic community. He holds a Ph.D. from Brown University where he was Associate Dean of Academic Affairs and Dean of Special Studies from 1970 to 1977.
- Sandra R. Smoley, currently president of the National Association of Counties (NACo), replaces Peter Schabarum of Los Angeles County as one of three elected county officials on the

Commission. She has served on the Sacramento County Board since 1972 and was board chair in both 1975 and 1979. Smoley was president of the County Supervisors Association of California and was vice chair of NACo's Legislative Urban Roundtable before being elected NACo fourth vice president in 1980.

- Kathleen Teague joins the ACIR as one of three private citizen members. Teague has been the Executive Director of the American Legislative Exchange Council since 1977. The organization of about 1800 state legislators is dedicated to the principles of limited government and free enterprise.

President Reagan first appointed Dr. Robert B. Hawkins to the Commission in 1981 as a private citizen member and as chairman in 1982. He is president of the Sequoia Institute in Sacramento, California.

Commission Meeting to Highlight Role of the States

At its meeting September 22 and 23, the Commission will consider research findings, issues and recommendations stemming from its major study on the role of the states, *The States Transformed: Expanded Roles, New Capabilities*. ACIR's staff report documents the unprecedented rate at which states adopted and implemented, institutional and procedural reforms over the past 20 years.

In conjunction with the Commission's review of state performance and areas where further change may be desirable, a hearing on the future of states in the federal system will be held. Prominent former state and local officials will share their views on challenges the states are likely to face in the years to come. Journalist and author Neal Peirce will moderate the panel discussion and provide his thoughts on future issues. ACIR staff has identified five areas of concern for the near future, including: (1) Major anticipated shifts in the states' role; (2) The states' influence in the



New Council of State Governments' Executive Director Carl W. Stenberg (left) shown with Connecticut Rep. Timothy J. Moynihan, CSG chairman, and Frank Bailey, outgoing CSG executive director.

federal system; (3) The extent to which states remain diverse entities in spite of widespread reforms; (4) The states' roles and responsibilities towards local governments, and; (5) Policy implications of state reform according to available research.

ACIR has had a long-standing interest in state governments. Over 235 recommendations to the states have been adopted over the years. Of these, 34 have been selected for review by ACIR members because of their continued significance in the 1980s. In addition, the Commission will consider a staff issue report on the implications of the Supreme Court's decision in *Community Communications Co. v. City of Boulder* (1982) that increased the antitrust exposure of local governments. Also, a staff report on two cases expected to be before the Court in its 1983-84 Term has been prepared for Commission review. These cases are being brought to determine whether the *Fair Labor Standards Act Amendments of 1974* should apply to public mass transit workers.

Stenberg To Leave ACIR

Carl Stenberg, ACIR Assistant Director of Policy Implementation is

leaving the Commission to become executive director of the Council of State Governments. Dr. Stenberg has been on the Commission staff since 1968, first joining as a senior analyst in the Structure and Functions Section, and then becoming one of three Assistant Directors in 1977. He served as acting executive director of ACIR during the first quarter of 1982.

New Measure of Metropolitan Fiscal Capacity Shows Regional Shifts

by Paul F. Burnham

ACIR's annual estimates of state tax capacity suggest that the same methodology, known as the Representative Tax System, can be applied usefully to substate areas. A new ACIR working paper, "Measuring Metropolitan Fiscal Capacity and Effort: 1967-1980," presents estimates of the fiscal capacity of 69 Standard Metropolitan Statistical Areas (SMSA's) for the years 1977 and 1980. In contrast with more common measures of fiscal capacity such as per capita income, the Representative Tax System methodology accounts for a variety of tax bases (e.g., property, income, and sales). Using this method, the fiscal capacity of an SMSA is derived by estimating the size of each SMSA's tax bases and calculating the expected revenues that would be generated if the national average tax rate were applied to each base. To compare across metropolitan areas, these estimates of total fiscal capacity are divided by the population of all SMSA's in the United States so that a score of 100 means that the fiscal capacity is exactly equal to the national per capita average.

All SMSA's with populations of one million or more are included in the report, as are the largest SMSA's in all but six states. There is insufficient data to include the new SMSA's in Vermont and Wyoming, and the heavily oil-oriented tax structure in Alaska makes results in that state difficult to interpret. Data difficulties also forced the exclusion of Connecticut, New Hampshire, and Maine.

The most striking patterns with regard to fiscal capacity are regional in nature. These patterns are shown in Figure 1 which uses the estimates for the 69 SMSA's in 1977 and 1980 to depict fiscal capacity in 1977 and the change in fiscal capacity between 1977 and 1980. The contours of this map divide areas in which SMSA capacity or growth in capacity are above average from areas in which SMSA capacity or growth in capacity are below average.*

The regional pattern in the level of 1977 fiscal capacity favors SMSA's in four categories.

- 1) areas in the northern half of the country west of Lake Michigan,
- 2) areas along the California coast,
- 3) suburban areas along the eastern seaboard, and

*Although state figures from *Tax Capacity of the Fifty States* were used to guide the placement of contours in areas where no SMSA's were sampled, no inference concerning areas outside of SMSA's should be drawn from this map.

- 4) areas heavily oriented toward tourism (e.g., Las Vegas and southern Florida).

In addition, SMSA's such as Houston, Atlanta, Cleveland, and New York City had higher than average fiscal capabilities in 1977.

Each of these categories has a different reason for its high fiscal capacity. The reason for the high fiscal capacity in tourist areas is the most obvious: governments in these areas can tax tourists as well as residents.

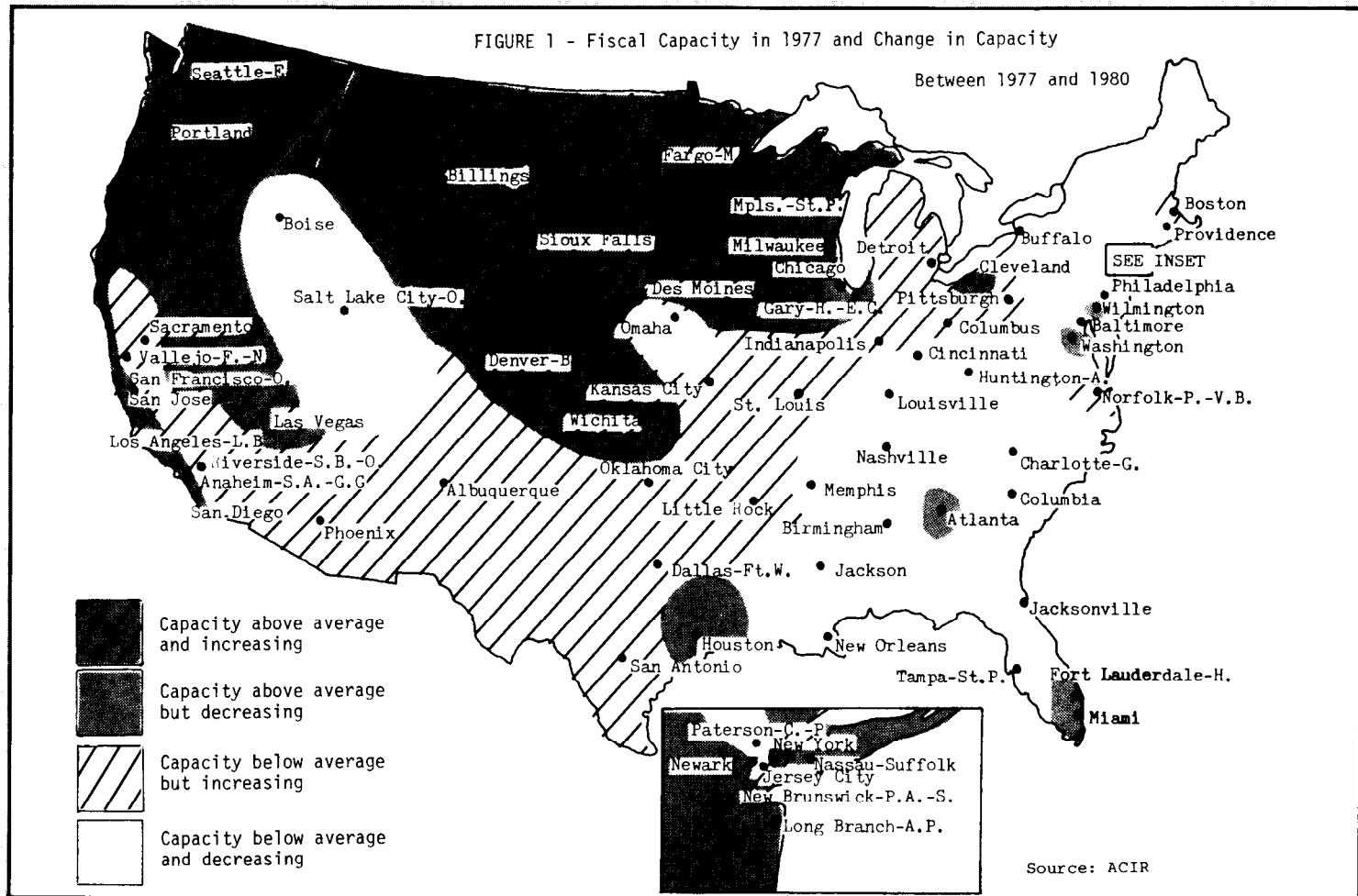
Along the eastern seaboard the effect of suburbanization on fiscal capacity is pronounced. Of the seven SMSA's with at least 79% of their population outside central cities, all but one had fiscal capacities over 100. Of the remaining six SMSA's, only one had a fiscal capacity over 100. This pattern is not unexpected given the well documented shift in tax bases toward suburban areas. This same pattern probably does not show up outside the eastern seaboard because few SMSA's elsewhere in the country are as suburban in nature as SMSA's like Nassau-Suffolk or Long Branch-Ashbury Park whose economic center, New York, is in another metropolitan area.

The California coast, in addition to attracting tourists, has unusually high property values even when the relatively high income in that area is taken into account. Furthermore, the property values continue to grow faster than incomes. As a region, SMSA's along the California coast have the highest fiscal capacity in the nation and were still growing in 1980.

The high fiscal capacities of SMSA's in the northern half of the country west of Lake Michigan are due to a number of factors. Perhaps the most important is that retail markets in this part of the country tend to be very large, and overlap very little with competitive markets. Most individuals living here have few choices as to where to shop because of the distances involved. Thus, retail sales tend to be heavily concentrated in SMSA's, giving them larger-than-average sales tax capacities.

The second variable depicted in Figure 1 is the change in fiscal capacity between 1977 and 1980. The pattern here is not complicated. For the most part, the tax bases seem to be moving west even faster than the population (although there is no indication here that the southwest is gaining in tax capacity any faster than the northwest). The biggest surprise is that several SMSA's around the Great Lakes seem to be gaining in relative fiscal capacity in spite of their sluggish

FIGURE 1 - Fiscal Capacity in 1977 and Change in Capacity



economies. This phenomenon may be due to the population leaving faster than the tax bases are shrinking.

Because fiscal capacity is calculated on a per capita basis, the exodus of people faster than tax bases would result in a rising tax capacity measure. The opposite phenomenon may explain the gap in Utah, Idaho, and eastern Texas where the tax bases seem to be growing more slowly than the population.

Changes in fiscal capacity between 1977 and 1980 suggest these modifications in the categories of SMSA's with above average capacity:

- 1) Although the generalization that heavily suburban SMSA's on the eastern seaboard tend to have greater tax capacities than other SMSA's in that region is still valid, it is no longer true that they have higher capacities than most SMSA's throughout the country;
- 2) The region referred to as the California coast that in 1977 had an extraordinarily high property tax base can now be expanded to include virtually the entire area west of the Sierra Nevada and Cascade Ranges; and,

- 3) The energy rich areas of Texas can be identified as a new region with high fiscal capacity, in spite of the absence of severance tax bases from the estimates.

The top and bottom five SMSA's in terms of fiscal capacity in 1980 are listed in Table 1. For additional information, copies of "Measuring Metropolitan Fiscal Capacity and Effort: 1967-1980" are available from ACIR upon request.

TABLE 1
Extremes in 1980 Fiscal Capacity¹

1. San Francisco-Oakland CA	151.7	65. Huntington-Ashland WV-KY-OH	79.2
2. Houston TX	143.9	66. Providence RI-MA	75.8
3. Anaheim-Santa Ana-Garden Grove CA	136.6	67. Columbia SC	73.2
4. San Jose CA	132.3	68. Jersey City NJ	69.6
5. Los Angeles-Long Beach CA	127.0	69. San Antonio TX	67.0

Source: ACIR

¹Note that a score of 100 would represent the national per capita average fiscal capacity.

And Briefly: Books

The following publications are recent reports of the Advisory Commission on Intergovernmental Relations, Washington, DC 20575.

Changing Public Attitudes on Governments and Taxes (S-12). ACIR's 12th annual survey of public opinion of governments and taxes revealed that the public finds increasing sales tax to be the least objectionable tax to raise if governments must find additional revenues. The poll, conducted for ACIR by the Gallup Organization, shows that the federal income tax was, for the fifth year in a row, found to be the "least fair" by those questioned. This year's results are organized in tables with explanatory notes. Results of previous surveys are provided in appendix tables.

Tax Capacity of the Fifty States, 1981. This report is the fourth by ACIR assessing the fiscal capacity of the states using the Representative Tax System (RTS) measure. The RTS combines 24 state-local tax bases into a composite index reflecting a state's tax capacity. Because the same set of tax rates is used for every state, estimated yields vary only because of differences in underlying tax bases. There has been increased interest in the RTS and other sophisticated measures of fiscal capacity in

recent years because such measures—unlike per capita income—take into account the ability of energy-rich states to tax those resources through severance tax and leasing fees. Tables for each state provide detailed statistics on that state's tax capacity and effort.

Staff working paper "Measuring Metropolitan Fiscal Capacity and Effort: 1967-1980." ACIR's annual estimates of tax capacity using the Representative Tax System for the 50 states suggest that the same method can usefully be applied to substate regions. This report presents estimates of fiscal capacity and effort for 69 metropolitan areas for the years 1977 and 1980 and is the first time the RTS measure has been applied to substate areas.

In Brief: Jails: Intergovernmental Dimensions of a Local Problem. This **In Brief** summarizes the Commission's research findings and lists recommendations from the Commission's report on local jails.

In Brief: Regulatory Federalism. This **In Brief** summarizes the Commission's findings and recommendations from its report entitled **Regulatory Federalism: Policy, Process, Impact and Reform.**

The following publications are available directly from the publishers cited. They are not available from ACIR.

Rebuilding America, Vol. 2: Financing Public Works in the 1980s, by Roger Vaughan, Council of State Planning Agencies, 400 North Capitol Street, Washington, D.C. 20001. \$14.95.

State-Local Relations: A Partnership Approach, by Joseph F. Zimmerman, Praeger Publishers, 521 5th Avenue, New York, New York 10175. \$28.00.

Municipal Year Book, 1983, International City Management Association, 1120 G Street, N.W., Washington, D.C. 20005. \$52.50.

Being Governor: The View From the Office, edited by Thad L. Beyle and Lynn Muchmore, Duke University Press, 6697 College Station, Durham, North Carolina 27708. \$29.75.

Financing State and Local Economic Growth, edited by Michael Barker, Duke University Press, 6697 College Station, Durham, North Carolina 27708. \$37.50.

State Taxation Policy and Economic Growth, edited by Michael Barker, Duke University Press, 6697 College Station, Durham, North Carolina 27708. \$31.75.

Infrastructure: A Bibliography, by Robert J. Reinshuttle, Council of State Governments, Iron Works Pike, P.O. Box 11910, Lexington, Kentucky 40578. \$5.00.

Federal Aid to Big Cities: The Politics of Dependence, by James W. Fossett, The Brookings Institution, 1775 Massachusetts Avenue, N.W., Washington, D.C. 20036. \$5.95.

The Book of America: Inside 50 States Today, by Neal R. Peirce and Jerry Hagstrom, W.W. Norton and Co., 500 5th Avenue, New York, New York 10110. \$24.50.

Interstate Compacts and Agencies, Council of State Governments, Iron Works Pike, P.O. Box 11910, Lexington, Kentucky 40578. \$15.00.

New Federalism From the Local Perspective; hearing, U.S. Congress, House of Representatives, Committee on the Budget, Task Force on Federalism/State-Local Relations, U.S. Government Printing Office, Washington, D.C. 20402.

Economic Development: A Survey of State Activities, Council of State Governments, Iron Works Pike, P.O. Box 11910, Lexington, Kentucky 40578. \$15.00.

State Urban Enterprise Zones: A Policy Overview, National Conference of State Legislatures, 1125 17th Street, Denver, Colorado 80202.

State Governance of Education: 1983, Education Commission of the States, Suite 300, 1860 Lincoln Street, Denver, Colorado 80295. \$6.00.

The Consequences of Cuts, by Richard P. Nathan and Fred C. Doolittle, Princeton University Press, 3175 Princeton Pike, Lawrenceville, New Jersey 08648. \$7.95.

Property Tax Issues for the 1980s, Academy for State and Local Government, 444 N. Capitol Street, N.W., Suite 349, Washington, D.C. 20001. \$7.00.

Policy by Indirection: Legislating Intergovernmental Fiscal Policy in the Federal Tax Code, Academy for State and Local Government, 444 N. Capitol Street, N.W., Suite 349, Washington, D.C. 20001. \$5.00.

A Federal Flat-Rate Income Tax: Simplicity or Chaos for State and Localities, Academy for State and Local Government, 444 N. Capitol Street, N.W., Suite 349, Washington, D.C. 20001. \$5.00.

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