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PERSPECTIVE



Local Government Before the Court

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS



View From The Commission

Dear Reader:

Since Ronald Reagan assumed the Presidency, the national debate over federalism has been somewhat like a change in the seasons of the year: the climate changes day by day in fits and starts. Then, when it finally becomes apparent that a new season has arrived, it is impossible to look back and pinpoint the exact day when the old season gave way to the new.

Somewhere over the past 35 months of the Reagan Presidency, the nation entered a new season for federalism. We came to recognize state and local governments as autonomous political entities—with their own revenue raising capacities and spending authorities—rather than just subsidiaries of the national government. Indeed, this has been a remarkable transformation in the thrust of the federalism debate over the past half century, when the relentless gravitation of power to Washington was assumed.

And now it is difficult to pinpoint the exact date when this change occurred. Perhaps it was because Ronald Reagan had campaigned on a theme of devolving power and authority to state and local governments; perhaps it was

his success in getting the Congress to enact nine new block grants in 1981, giving flexibility to state and local officials; perhaps it was his New Federalism Initiative of 1982 which brought the issues of sorting out responsibilities to the forefront of the public debate.

But, like the changes in seasons of the year, I would contend that it was a cumulation of these events—combined with hundreds of actions taken by state and local units of government—which has shifted the focus of debate on our federal system for the foreseeable future.

The examples of how state and local governments are adjusting to this new era—and providing better and more efficient service to an ever more diverse American citizenry—are numerous. For example:

- In California, the Governor and state legislature are now debating a new inter-governmental relationship whereby local governments would have the option to adopt a local sales tax.
- In education, it continues to be the states and their subdivisions which show innovation while the federal government remains an impediment in many areas.
- In Arizona, the State and the City of Phoenix worked out a

financing technique which permits Phoenix and surrounding metropolitan cities to construct freeways without federal dollars.

- And many states and localities continue to develop public-private partnerships in which projects can be accomplished with a limited drain on the public treasury.

In the Winter 1982 issue of **Intergovernmental Perspective**, ACIR Assistant Director John Shannon and Senior Analyst Susannah Calkins concluded that “students of American fiscal federalism may well point to 1981 as the beginning of the ‘do it yourself’ era of inter-governmental relations—a period to be marked by major and sustained constraints on federal fiscal resources with consequent reduction in federal ability to aid and direct state and local governments.”

Shannon and Calkins may well be right. Perhaps it was the election of Ronald Reagan—and his demonstrated commitment to change the way America was governed during his first year in office—which marked a new era for federalism. If so, then the remarkable story over the ensuing two years has been the adaptation of state and local governments in this new season of restored Constitutional balance. We are dem-
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Intergovernmental Focus

General Revenue Sharing Bill Sent to Conference Committee

Legislation to extend General Revenue Sharing (GRS) to local governments for another three years has passed the House and the Senate. The Senate approved renewal at the current funding level, \$4.6 billion. The House voted to increase that funding by \$450 million a year. President Reagan threatened to veto the legislation if Congress increased the level of aid. As this issue of **Perspective** went to press, the measure was in Conference Committee to resolve differences.

Regulatory Reform Hearings Planned

Senator Dave Durenberger (MN), chairman of the Senate Intergovernmental Relations Subcommittee, is expected to introduce intergovernmental regulatory reform legislation addressing the issues raised in ACIR's forthcoming study on regulatory federalism. Hearings will probably be held this winter and, at that time, testimony will be sought on issues surrounding the Commission's recommendations that national policy encourage early and continuing involvement of state and local officials in federal rulemaking covering a wide range of programs having significant intergovernmental regulatory effects. ACIR also recommends (1) doing regulatory impact analyses of proposed rules affecting state and local governments, (2) reducing federal intrusiveness in the use of cross-over sanctions, direct orders, partial preemptions, generally applicable requirements, and other conditions attached to individual federal aid programs, (3) clarifying the extent to which generally applicable requirements apply to block grants, and (4) future federal compensation or reimbursement to state and local governments for the additional direct costs imposed on them by federal statutes and rules.

Supreme Court Advocacy Conference Held

was the October 17 and 18 site of a Conference on Supreme Court Advocacy. Sponsored by the Academy for State and Local Government, the State and Local Legal Center, the National Association of Attorneys General, the National Institute of Municipal Law Officers, and the National Association of District Attorneys, the conference was intended to improve the ability of states and local governments to present their cases before the Supreme Court. Speakers included the Honorable Warren E. Burger, Chief Justice of the United States, who informed the audience that, as a general rule, state and local advocates perform very poorly before the Court and the Honorable William H. Rehnquist, Associate Justice of the Supreme Court.

Opportunity for Intergovernmental Consultation Given to the States

On September 30, 1983, the federal government turned over to the states the opportunity to shape state and local consultations with federal agencies on such things as grant applications, the management of federal lands, and changes at federal installations. That day, final regulations previously published in the **Federal Register** by 23 federal agencies on June 24, 1983, became effective, replacing procedures established under OMB Circular A-95.

Interest now focuses on state responses to their new responsibility. In a survey taken at the end of August, the Council of State Planning Agencies found that at least 26 states were awaiting further clarifications from the federal government before setting up the procedures necessary for state agencies and local governments to maintain their contacts with the federal agencies on a wide range of programs. Only one state apparently had its substitute procedures in place.

The currently uncertain situation is unlikely to clarify itself soon. Out of four states contacting ACIR since October 1st, one had its new system firmly in place, one was maintaining the old A-95 process for an interim

period of several months while continuing to develop a new system, one felt that a state-designed process was unnecessary, and the fourth designated a nongovernmental organization as the state's single point of contact, asking it to develop a new system by December 1st.

Block Grant Watch

State and local governments and the private nonprofit sector continue to adapt to the administrative and budget changes imposed by the ten block grants enacted in 1981. A forthcoming **ACIR Information Bulletin: Update on Block Grant Implementation** reveals that in fiscal 1983, states made more individual decisions in administering the new programs than during the first year of implementation. Most states did not replace lost federal funds, but increased state financial commitment was considered in several states, and did occur in some.

Much of 1983 has been spent preparing for the latest block grant, the *Jobs Training Partnership Act (JTPA)*, enacted in 1982 for October 1, 1983 implementation. Preliminary data show that most governors gave high priority to the transition between the new job training program and its predecessor, the *Comprehensive Employment and Training Act (CETA)*. Unlike the old *CETA* program, states have a major role in implementing the new block grant. Governors are charged with appointing members of the Private Industry Councils (PICs) and with designating service delivery areas. Consultation with local government officials appears to be proceeding smoothly although conflicts have arisen in several states over the composition of Private Industry Councils and over qualifications for inclusion in service delivery areas. The job training block grant encourages greater participation from the business community through the Private Industry Councils. The goal is to achieve a better match between training programs and available jobs.

BOULDER AND NLC REVISITED: AN INTRODUCTION

by Stephanie Becker

"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," Lawrence Velvel, Chief Counsel to the State and Local Legal Center, told the nation's governors at their annual meeting last August. The importance of the federal judiciary is underscored in the two articles in this issue of **Perspective**. The first, "Antitrust and Local Governments," explores the impact of the Court's 1982 ruling in *Community Communications Co. v. City of Boulder* that increased the exposure of localities to federal antitrust law. The second, "Mass Transit and the Tenth Amendment," looks at applying *Fair Labor Standards Act* to public mass transit workers in light of the Court's landmark decision, *National League of Cities v. Usery* (1976). In this introduction, differences and similarities between *Boulder*, *NLC*, and *NLC*-based cases are highlighted so that the following articles can be viewed in context, both in constitutional terms and in terms of the changing ways in which we are governing ourselves.

Springing from the Same Source, but with Differing Outcomes. Both *Boulder* and *NLC* hinged upon the Court's interpretation of the national government's authority to regulate state and local activities. Although the laws of the United States are the supreme law of the land under Article VI of the Constitution, the national government does not have *carte blanche* to do as it pleases. Federal laws are supreme only as long as they do not conflict with other constitutional provisions. In applying federal antitrust law to localities, the Court found the source of congressional authority to be its charge to "regulate commerce . . . among the several states" (Article 1, Section 8). Generally, the Court has interpreted Congress' commerce-based regulatory powers broadly. In its study on regulatory federalism, the ACIR found that

By 1942, the Court had decided that there were few private sector activities which the federal government could not in some way touch through its power to regulate interstate commerce. Moreover, if a state activity conflicted with or was contrary to a federal endeavor, the state action could be superceded.¹

¹Regulatory Federalism: Policy, Process, Impact and Reform, draft, Advisory Commission on Intergovernmental Relations.

Nonetheless, certain caveats still prevail. The states, under specified circumstances, may restrain trade because of their protected constitutional status. Until recently, cities and counties thought they enjoyed similar protection.

In *NLC*, the Court curtailed Congress' regulatory reach when it warned

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.²

The Court thus exempted traditional state and local governmental activities from federal wage and hour laws.³ The *NLC* case exemplifies how one constitutional provision (in that case, the Tenth Amendment) can conflict with another (the commerce clause). The Supreme Court, in its "umpire" role, has the right to decide which provision will prevail.

In *Boulder*, the Court signaled that the commerce power allowed a federal law to apply to local activities. On the other hand, in *NLC*, the Court stopped another commerce-based foray into local affairs. Although both cases required interpreting congressional power under the same constitutional provision, a distinction should be made. In *Boulder*, the Court's decision was reached on a statutory basis. Unlike *NLC* where the constitutionality of the law itself was questioned and partially struck down, *Boulder* did not raise the issue of Congress' powers under the commerce clause. Congress could, if it so chose, amend the *Sherman Act* tomorrow exempting local governments from antitrust provisions. Congress no longer has the prerogative to amend the *Fair Labor Standards Act* in ways that would violate *NLC*.

Boulder and NLC: State-Local Controversy Spawned. In *NLC*, states and their "creatures," local governments, were treated alike, but *Boulder* singles

²426 U.S. 833 (1976).

³Note that in a footnote to *NLC*, Justice Rehnquist said that if Congress had made compliance with the *Fair Labor Standards Act Amendments* a condition of federal aid, instead of a direct order, the judicial story might have had a different ending. The Court has tended to view Congress' regulatory reach under the so-called spending power broadly. As long as they are reasonably related to national purpose, conditions attached to federal grant programs have generally been held to be consistent with the national government's constitutional powers.

out local governments. Nowhere mentioned in the Constitution, local governments have spent nearly a century struggling for home rule. Whether *Boulder* threatens to end the home rule movement in this country, as Justice Rehnquist asserted in his dissent to *Boulder*, or whether it simply means that cities and counties will have to be more careful in their deliberations remains to be seen. It is clear, however, that singling out localities has pitted them against the states in many instances. According to *Boulder*, states can exempt local activities from federal antitrust law, but such grants of immunity may have their own problems. Mayor Tom Moody of Columbus, Ohio, called attention to this conflict at a recent ACIR hearing: "As a matter of fact, we have spent the last 60 years fighting the state and maintaining our integrity under the home rule movement, and we're not about to ask any direction, any mandate, from the state."⁴

Yet another difference between the two cases may create additional problems for states and their political subdivisions. In *NLC*, the distinction was made between "traditional" and "nontraditional" state and local activities. The "traditional-nontraditional" dichotomy raised in *NLC* did not surface in *Boulder*. Presumably, all local activities are potentially open to antitrust litigation unless specifically exempted by state law, and subjected to state supervision. Should states draw *NLC*-type distinctions when and if they grant localities immunity from antitrust law? And should the Congress, if it decides to provide immunity, craft a distinction between purely governmental and purely proprietary activities? As the article on mass transit makes clear, these lines may be difficult to draw and doing so may, as the *NLC* decision itself did, give rise to further court cases.

***Boulder* and *NLC* in a Changing Governmental Context.** The distinction made, but not settled, in *NLC* between traditional and nontraditional governmental activities draws our attention to the changing nature of government. Only a few decades ago, running mass transit systems was overwhelmingly a private activity. Now it is predominantly public. Similarly, regulating

cable television and awarding franchises—the subject of *Boulder*—were not commonplace governmental functions in the not-too-distant-past. Today they are. Conversely, cities are contracting with others to provide public services once rendered directly. Further, cities and counties are entering into a host of private-public partnerships charting new paths for public endeavors.

In part, then, the Court may have been reacting in both *Boulder* and *NLC* to the recent, more entrepreneurial tack local officials have been taking. In economic and community development activities, in energy production, in transportation, even in international trade and a host of other endeavors, local governments are increasingly thinking of themselves as self-reliant entities. "The self-reliant city views itself as a nation,"⁵ wrote the president of the Institute for Local Self-Reliance. The limitations on such "nationhood" are clearly demonstrated in this issue of *Perspective*, however, for as the Court has reminded them, cities are subject to laws they can try to influence, but not necessarily control.

⁴"The Future of the States in the Federal System," a hearing held by the Advisory Commission on Intergovernmental Relations on September 22, 1983.

⁵*The Entrepreneur in Local Government*, ed., Barbara H. Moore, International City Management Association, Washington, DC, 1983, p. 63.

ANTITRUST AND LOCAL GOVERNMENTS

by Jerry Fensterman

Encouraging effective and vigorous competition has been a key public policy underlying this nation's economy for many years. Since they were first adopted over 90 years ago, antitrust laws have been a cornerstone of national efforts to promote economic competition. Until recently, the strictures contained in antitrust legislation were thought to apply only to private parties.

In two recent cases, dramatically breaking new ground, the Supreme Court has ruled that federal antitrust laws, particularly the *Sherman Act of 1890*, apply to local governments. Other Court decisions appear to increase the exposure of the states to certain federal antitrust laws as well. Because these decisions may generate high costs to state and local governments, officials at every level are voicing concern.

Scores of suits alleging antitrust violations by local governments have been filed since the 1982 decision. So far no cases have been decided against those governments, but a former mayor and some private parties have been found guilty and liable for \$2.1 million in damages which, when trebled in accordance with the law, equal a \$6.3 million award. In several other instances local governments have settled out of court to avoid protracted and costly legal battles.

Applying federal antitrust statutes to public entities raises a complex set of intergovernmental questions. Despite the uncertainty facing local governments, some observers believe further clarification or relief should be allowed to evolve through additional court rulings. Until judicial clarification emerges, individual states could provide localities with the kind and degree of immunity they deem appropriate. Others believe that state grants of immunity will come only slowly and may prove insufficient. Also, they fear the courts taking as much as a decade to settle unresolved issues. Those who espouse the latter view also tend to believe that the costs to localities over time will be unnecessarily high and that Congress should amend the law to clarify whether and when local governments are liable for antitrust violations.

This article will examine the history of the application of these laws to public entities, the implications for those governments now exposed to antitrust, intergovernmental reactions, and the remaining unresolved questions.

THE LEGAL SETTING

In the case of *Parker v. Brown*,¹ the U.S. Supreme Court held that the *Sherman Antitrust Act* "must be taken to be a prohibition of individual and not state action." In what came to be known as the *Parker* exemption, or "state action" doctrine, this decision was taken to mean that when a state undertakes an action that restrains or displaces competition, it is an act of government and as such it cannot be challenged as violating antitrust laws. Subsequent cases refined the doctrine to ensure, as the *Parker* decision required, that only actions which were truly governmental would be immune from the antitrust laws. Thus it evolved that a state would have to be intimately involved in supervising any state-inspired, anticompetitive activity for the protections of the *Parker* doctrine to apply.

As the legal creatures of the states, local governments were presumably provided consonant immunity, although that presumption stood untested for decades.

¹317 U.S. 341 (1943).

In a series of cases decided during the 1970s,² the Supreme Court began to revisit the state action doctrine, concluding that the mere fact of state involvement with private-party activities did not necessarily insulate those activities from antitrust scrutiny.

In the 1978 case of *City of Lafayette v. Louisiana Power and Light Co.*,³ the Court first extended its reconsideration to local governments. In a 5-4 decision, the Court held that for a city to be protected under the state's cloak of immunity, the city must act directly for the state or pursuant to a "clearly articulated and affirmatively expressed state policy to replace competition with monopoly or regulation." (In another case the Court added, at least for private parties requiring government supervision, a standard requiring active state supervision as well.) Four of the Justices in the majority agreed that local government action lacking direction by the state could be subject to antitrust litigation. In a concurring opinion, Chief Justice Burger set what was to be a short-lived standard: The acts of local government entities that are of a proprietary or a commercial nature should enjoy no immunity. Justice Burger's distinction between proprietary and governmental acts read:

There is nothing in *Parker v. Brown*. . . which suggests that proprietary enterprise with the inherent capacity for economically disruptive anticompetitive effects should be exempt from the *Sherman Act* merely because it is organized under state law as a municipality.⁴

Four years later, on January 13, 1982, the Court handed down a 5-4 ruling in *Community Communications Co., Inc. v. City of Boulder*.⁵ In this case, having to do with regulating cable television, the Court found that: (1) Colorado's grant of home rule powers notwithstanding, Boulder was not itself a sovereign entity entitled to antitrust immunity; and, (2) the State's grant of home rule was neutral with respect to the City's action and did not constitute the "clearly articulated and affirmatively expressed" grant of authority required by the *Lafayette* decision. The *Boulder* decision did not deal with the issue of dividing the acts undertaken by local government into governmental and proprietary categories.

Some 23 states' Attorneys General filed *amicus* briefs on the side of Community Communications Co., Inc. Their support reflects a strong belief in the effectiveness and importance of antitrust laws. Moreover, they share the Chief Justice's feeling that local governments should enjoy no special shield from these laws when their actions warrant scrutiny.

“ To many people's surprise, the *Lafayette* decision brought relatively little immediate discussion and legal activity. The quietude changed markedly after *Boulder*. ”

THE CLIMATE FOR CONSIDERATION

To many people's surprise, the *Lafayette* decision brought relatively little immediate discussion and legal activity. The quietude changed markedly after *Boulder*. Prodded at least in part by Justice Rehnquist's dissenting opinion in which he wrote that the "decision . . . effectively destroys the 'home rule' movement in this country," those involved with or sympathetic to local governments have unleashed a loud cry of alarm and apprehension.

This concern is exemplified by statements made just five months after the Supreme Court handed down the *Boulder* decision. Mayor Janet Gray Hayes of San Jose, CA, stated that "The foremost impact of the *Boulder* decision is that it *is*, today, crippling the implementation of public policy at the local level."⁶ Mayor Thomas Moody of Columbus, Ohio, struck a similar note:

The purpose of the antitrust laws is to deter anti-competitive conduct by private parties, not to dictate the allocation of governmental responsibility between cities and states. We believe that the *Boulder* ruling is more likely to impair the ability of cities to govern than to enhance competition. It is difficult to believe that the public interest will be served by subjecting the regulatory actions of cities to antitrust scrutiny.⁷

The seriousness of these fears was underscored more recently by the fact that when mayors across the country were surveyed by the United States Conference of Mayors (USCM) about the issues of interest for discussion at their 1983 annual meeting, the top priority item was potential liability under antitrust laws. The National League of Cities (NLC) has shown similar concern. NLC held a conference on "Local Government and the Antitrust Laws" just three months after the Court's *Boulder* decision and published a book based on the conference papers.⁸

Boulder's effect at the local level has been both positive and negative. On the positive side, local governments have taken a variety of steps to reduce their vulnerability to antitrust challenges. These steps in-

²*Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975), *Cantor v. Edison Co.*, 428 U.S. 579 (1976), *Bates v. State Bar*, 433 U.S. 350 (1977), and *New Motor Vehicle Board v. Orrin W. Fox Co.*, 439 U.S. 96 (1978).

³435 U.S. 419 (1978).

⁴*Ibid.*

⁵102 S. Ct. 835 (1982).

⁶Testimony of Mayor Janet Gray Hayes, San Jose, California, *Local Government Antitrust Liability—The Boulder Decision: Hearings Before the Senate Committee on the Judiciary*, 97th Congress, 2nd Session (June 30, 1982).

⁷Testimony of Mayor Thomas Moody, Columbus, Ohio, at the same Senate hearing.

⁸*Antitrust and Local Government*, edited by James V. Siena, Seven Lock Press, Inc., U.S., 1982.

clude conducting municipal antitrust audits, improving bidding procedures, eliminating questionable activities, monitoring competitive activities, and acquiring a heightened awareness of any antitrust implications that may lie behind proposed actions. Taken together, these activities may result in a somewhat fairer decisionmaking process at the local level.

Negative results grow directly out of the potential costs of antitrust suits. Although fears are difficult to quantify, the USCM's survey results and the personal testimony of local officials and lawyers suggest a growing caution on the part of local officials. The number of suits filed since *Boulder* has risen and, in at least some of those cases, the legal fees charged local governments have been high. Moreover, officials have begun to report that a prediction made after the decision is being fulfilled: litigation is being threatened more and more to force a change in public policy. Faced with such threats, and at least partially aware of the possible costs of litigation, some public officials have reported changing or postponing decisions rather than risk a suit.

In Charleston, South Carolina, for example, there was a plan to allow only antique carriages and pedestrians within a renovated historic district. However, the excluded bus transit system threatened a suit. Mayor Joseph Riley, concerned about the potential costs to the City and himself, finally recommended against the plan—despite his belief in its public benefits—to thwart antitrust action.

Local governments face an additional problem: in most instances, rulings can be rendered long after an action had been taken. Antitrust laws, including the *Boulder* test of immunity, apply retroactively for four years.

ANTITRUST: A POTENTIALLY COSTLY EXPOSURE

Since *Boulder*, it is estimated that more than 200 suits alleging antitrust violations have been filed against local governments and their officials. Any government action is liable for such a suit, but so far the suits seem to come most often where "high risk" criteria are found: (1) where a lot of money is involved and, (2) where interested parties have had little or no past involvement with the locality nor are they expected to be so involved in the future. To date, cases have been filed in the areas of cable television regulation, land use and zoning, waste collection and disposal, hospital and ambulance service, water and sewage systems, airport services and concessions, utility services, towing services, licenses and concessions, taxicabs, and many others.

Defendants can hardly afford to win, let alone lose, an antitrust suit. The aim is to avoid them altogether, and short of that, to have suits dismissed by summary judgment. Antitrust actions can take a great deal of time—on average longer than many other types of litigation. Further, successful plaintiffs in antitrust suits may win:

- an immediate injunction against the action in question;
- an automatic tripling of the awarded damages (whether this applies to governments remains unresolved);
- payment of their attorney's fees (in recent cases these have run to nearly \$1 million, and may be awarded even if damages are not); and
- payment of the cost of lawsuit.

Moreover, the damages are joint and several—any party found in violation of the law can be held liable for the entire trebled damages. Furthermore, the plaintiff decides from which one or combination of the defendants to collect, and the defendants against whom the damages are attached have no legal right to expect a contribution from any of the other guilty parties nor can a court fashion a damage settlement requiring such a contribution. For example, in a recent case the City was dropped from a \$2.1 million suit, but the former mayor was judged not to have immunity, and the trebled damages, equaling \$6.3 million, are owed by the mayor and the co-defendants. If the judgment stands following all appeals, the plaintiff is entitled to collect a total of \$6.3 million from any combination of guilty defendants in whatever proportion the plaintiff chooses. The mayor could be assessed the entire \$6.3 million individually, with no right to expect any contribution from any other defendant. Conversely, if the plaintiff so chooses, the other defendants could pay the full damages, and the mayor might not pay a penny.

Antitrust litigation entails determining both facts and motivations. Intent is hard to prove so antitrust cases usually involve substantial discovery. It takes time to comb the records and to interview every involved public official and employee at length, and these efforts diminish the time available to deliberate and implement other public policies.

Simply raising the antitrust specter may have a chilling effect, stopping a municipal action in its tracks. The dreaded costs of preparing a defense, both in time and money, can delay, if not reverse, policies threatened by a lawsuit. In some cases—as in the City of Boulder where the pending suit inhibited expanding cable services for several years—the "chilling effect" can inconvenience many people.

ANTITRUST EXPOSURE: WHERE STAND STATE AND LOCAL GOVERNMENTS?

Following *Boulder*, any activity of a local government, its agencies, private contractors, or public officials acting under the color of local governmental authority, is subject to charges of antitrust violation. Local governments can carefully scrutinize their actions to see if they restrict or displace competition, but otherwise their only current recourse is to seek state grants of immunity. The Court has said that states can

shield from antitrust law local actions that issue from affirmatively expressed state policies and are actively supervised by the state. However, questions remain about the standards the Court will apply in determining acceptable state shields of immunity.

Although most attention since *Lafayette*, and especially since *Boulder*, has been focused on the plight of local governments, several Supreme Court cases also have chipped away at the degree of antitrust immunity enjoyed by states and their officials. The most important of these cases is *Jefferson County Pharmaceutical Co. v. Abbott Laboratories* (1983).¹⁹ The Court, by a 5-4 majority, held that the State of Alabama is not exempt from the proscriptions of the *Robinson-Patman Act*—a section of federal antitrust law specifically directed at price discrimination—when offering pharmaceutical products through government pharmacies or hospitals

for resale in competition with private suppliers.¹⁹ State purchasing experts have expressed concern that the decision limits the ability of state and local governments to make purchases through competitive bidding, and may lead to an increase in the cost of doing state and local business. The decision was a narrow one, but its implications may be broader. States can usually make bulk purchases at discounted rates. Often, however, neither state purchasing agents nor the sellers know the ultimate use of the products involved. With the potential for litigation in which private parties may also be named, suppliers may be inhibited in granting discounts, and costs to the states may rise commensurately.

Although states themselves are shielded from dam-

¹⁹ See *Intergovernmental Perspective*, Spring 1983, Vol. 9, No. 2, "Should State and Local Governments Be Treated Like Businesses When Engaging in Proprietary Activities?," p. 28.

¹⁸ 51 L. W. 4195 (1983).

TRACING THE EVOLUTION OF MUNICIPAL ANTITRUST LIABILITY

Parker v. Brown (1943) 317 U.S. 341

California's raisin prorate program establishing an elaborate marketing system for raisins, which largely eliminated competition among producers, was not a violation of the antitrust laws. This case is the historical genesis of what is commonly known as the State antitrust exemption or immunity. The Court reasoned that the *Sherman Antitrust Act* was directed towards individual, and not State, conduct.

Goldfarb v. Virginia State Bar (1975) 421 U.S. 773

The Fairfax County Bar Association's minimum fee schedule, which was enforced by the Virginia State Bar, was found to be an unlawful price fixing scheme in violation of the antitrust laws. The Court found that since the State of Virginia did not compel keeping of such a schedule, the *Parker* immunity did not apply.

Cantor v. Detroit Edison Co. (1976) 428 U.S. 579

Detroit Edison's dispensing of free light bulbs to consumers of electricity within its system, thereby creating a monopoly in the area of light bulbs and restraining trade thereof, was found to be a violation of the antitrust laws and not exempted by the theory of *Parker v. Brown* because of the fact that the State was regulating the utility.

Bates v. State Bar (1977) 433 U.S. 350

The Arizona Supreme Court's rule prohibiting lawyer advertising was not a violation of the antitrust laws and was protected by the immunity of *Parker v. Brown*, since the Arizona Supreme Court had the ultimate State authority in commanding and compelling compliance by members of the State Bar. However, the advertising was allowed on a First Amendment theory.

City of Lafayette v. Louisiana Power & Light Co. (1978) 435 U.S. 389

The City of Lafayette could only be exempt under the antitrust laws (*Parker v. Brown*) if the alleged anti-competitive activities fell within the State authorization or were within the intended scope of the powers that authorized the local agency to operate a public utility. In short, cities can be liable for violation of the antitrust laws. Because the opinion was broken down four in favor, four against, and one who concurred in favor, it is difficult to discern precisely what activities will or will not fall under the prohibitions of the *Sherman-Clayton Acts*. In either event, there has to be some involvement of the State compelling the anticompetitive activity.

California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc. (1980) 445 U.S. 97

California's statutory plan for wine pricing was found to constitute resale price maintenance and, therefore, was a violation of the *Sherman Act*. The *Parker v. Brown* exemption was not applied. Although the State's policy was forthrightly stated and clear in purpose, it was not actively supervised by the State, thereby allowing the wine producers to continue price maintenance by whatever prices they submitted to the Board.

Community Communications Co. v. City of Boulder (Jan. 13, 1982) 50 U.S.L.W. 4144

Boulder, Colorado (a chartered city) moves to stop expansion of local CATV to look at a possibility of greater competition from other cable companies. [The Court ruled that the City's moratorium is not exempt from antitrust scrutiny under the "state action" doctrine of *Parker v. Brown*. Without reaching the "active state supervision" test, the Court held that the delegation of home rule powers to the City does not satisfy the "clear articulation and affirmative expression" of policy test.]

ages under the Eleventh Amendment of the U.S. Constitution, state officials may be individually liable for damages (*Scheuer v. Rhodes*).¹¹ Plaintiffs may be entitled to injunctive or other equitable relief against state actions that violate antitrust laws (*Ex Parte Young*).¹² Further, plaintiffs may be able to recover attorney's fees from state governments (*Hutto v. Finney* and *Maher v. Gagne*).¹³ The latter point may prove very important. Recovering attorney's fees provides a two-fold incentive in favor of bringing suit: (1) it increases the chances for a "free" trial which may encourage potential plaintiffs; and, (2) given the greater likelihood of capturing full payment, highly qualified counsel are more likely to make themselves available.

POST-BOULDER CONTROVERSY: SHOULD THERE BE A LEGAL SOLUTION?

Local and, to a lesser extent, state exposure to antitrust litigation may or may not be viewed as a problem of sufficient proportions to require a legal solution. In this instance, as in many others, where you stand depends on where you sit.

To many, federal antitrust laws and their role in maintaining economic competition should override other concerns. There are 50 states and about 80,000 units of local governments. Cumulatively they could undermine the health of the economy by creating unnecessary monopolies and promulgating restrictive regulations. Some who espouse this view, however, decry the Court's vagueness in *Boulder* on what constitutes appropriate and effective state action to provide immunities to local governments. They recognize that clarification is needed, lest the states spend a great deal of time crafting immunities that may later be found insufficient.

Those who view *Boulder* with alarm and seek legislative redress raise several points. First, the Congress clearly did not have local governments in mind when it passed the *Sherman Act*; it was concerned with the actions of a handful of large companies. From this vantage point, Congressional intent was either misconstrued or poorly applied in *Lafayette* and *Boulder*.

Secondly, they maintain that it is inappropriate for the states to decide how and when federal law should apply to localities. Similarly, they view state grants of home rule authority as seriously undermined by *Boulder*.

Moreover, in a more practical vein, proponents of this position argue that these decisions make it considerably more difficult to run a government. Mayors now hesitate before making decisions that could leave them, their cities, or both open to years of protracted litigation and millions of dollars in costs.

Finally, clarifying how the states may extend the shield of state action to local governments may offer little comfort. Localities still must expend the effort necessary to propose and win an immunity from a state

for each particular proposed activity. In the nearly two years since *Boulder*, only a handful of states have provided meaningful grants of immunity to their local governments.

In short, to those who insist upon a legal remedy, the possibility that local governmental actions may create monopolies or unnecessarily restrain trade does not offset the potential costs to localities, both in money and in effectiveness.

REMEDIES

If all or parts of this issue are sufficiently serious to require some type of action, what powers do the different actors possess and how might they exercise them?

The States. As noted earlier, the power to provide immunity to local governments now resides with the states. The states may grant immunity to local governments equivalent to their own. To date, about six states have provided their local governments with some degree of immunity since *Boulder*. North Dakota's shield is at both the simplest and the broadest:

All immunity of the state from the provisions of the *Sherman Antitrust Act* . . . is hereby extended to any city or city governing body acting within the scope of the grants of authority (contained in North Dakota Century Code sections granting powers to cities, home rule cities, or city governing bodies). When acting within the scope of the grants of authority . . . a city or city governing body shall be presumed to be acting in furtherance of state policy.¹⁴

Maryland has also protected a broad range of county and municipal activities from federal antitrust laws, including the power to displace or limit economic competition in port use and development; in public transportation, water, and sewerage systems; in waste collection services and waste disposal services; in granting franchises and concessions on public property; and, in economic development and redevelopment.

Tennessee passed a law allowing and enhancing active state supervision of municipal or county activities affecting municipally-owned or operated energy production facilities, resource recovery facilities, or solid waste disposal programs. The State of Pennsylvania adopted a bill granting municipal governments authority to contract for cable communications services without violating federal antitrust laws, the precise issue on which the *Boulder* case turned. Virginia, one of the first states to act, protected the right of Fairfax County *only* to regulate cable communications services. Louisiana has shielded a few of its local governments from federal antitrust laws when regulating ambulance services.

For local governments, and to some degree for the states, this approach is problematic. The pitched battles waged in many states prior to enacting home-rule enabling legislation attest to the controversial nature of local autonomy. Even if there were no controversy over

¹¹ 416 U.S. 232 (1974).

¹² 209 U.S. 123 (1908).

¹³ 437 U.S. 678 (1978) and 448 U.S. 122 (1980), respectively.

¹⁴ North Dakota Century Code Section 40-01-22.

the degree to which competition should be protected from local government actions that restrain or displace it. substantial time and resources will be required at both the state and local levels of government to secure immunity and then to supervise the affected activities.

The Congress. The laws in question are Congress'. Changes in antitrust statutes do not tend to come easily, but Congress can amend them in any way it sees fit.

As it now stands, following the Court's review, the states decide what local government actions are or are not covered under the *Sherman Act*. It is not apparent that Congress intended to make such a delegation to the states.

What kind of immunity could Congress grant if it so desired? Four bills with different answers to this question were introduced in the First Session of the 98th Congress: Senator Thurmond's (S. 1578), Representative Hyde's (H.R. 2981), Representative Fish's (H.R. 3361), and Representative Edwards' (H.R. 3688).

All four bills deal with two main questions. First, which activities will be made immune from federal antitrust laws and which will not? The Hyde and Fish bills, respectively, propose that local governments be granted immunity "to the extent states are exempt from the operation of such laws." The other two bills would exempt only governmental "regulatory powers" or "conduct which is an exercise of the sovereign power of the state." Both draw a distinction between proprietary and traditional governmental functions.

The second major issue with which all four are concerned is defining the types of governments exempted. On this point Representatives Hyde, Fish, and Edwards agree: all general and special-purpose political subdivisions should be exempted. Representative Hyde's bill would also exempt all territories and possessions of the United States. Senator Thurmond's bill differentiates between special- and general-purpose governments, protecting the latter and leaving the former fully exposed to antitrust laws.

Congressman Fish includes one issue on which the others are silent: damages. His bill proposes that any government or its officials facing an antitrust suit should be subject to simple damages, not trebled ones. This issue is unsettled now. The majority opined in *Boulder* that, "as in *Lafayette*, . . . we do not confront the issue of remedies appropriate against municipal officials."¹⁵

Ironically, although all of these bills would codify the degree of exemption provided, certain legislative solutions could leave local governments more vulnerable than they now are. A local government can now go to the state and, perhaps, obtain affirmative state action exempting either governmental or proprietary activities or both. This approach would be preempted under two of the pending bills. Also, lower courts are tending to construe *Boulder* liberally and local governments may

A SAMPLING OF MUNICIPAL ANTITRUST CASES SINCE BOULDER

Gold Cross Ambulance v. City of Kansas City, Mo., 538 F. Supp. 956 (W.D. Mo. 1982).

Plaintiff alleged that the award of an exclusive franchise to operate an emergency ambulance service within the city limits violated antitrust laws.

HELD: State statute authorizing municipalities to contract with companies to provide emergency services was a sufficient state action exemption under *Parker*.

Central Iowa Refuse Systems, Inc. v. Des Moines Metropolitan Area Solid Waste Agency (S.D. Iowa, 1982).

Antitrust action brought by company alleging that requiring all solid waste haulers to deposit waste at the agency's disposal facility was anti-competitive. [The issuance of revenue bonds to finance the project was considered contingent upon the requirements.]

HELD: State authorizing action permitting municipalities to finance regional waste disposal agencies and to fix fees was sufficient state action exemption.

Pueblo Aircraft v. City of Pueblo, 679 F.2nd 805 (10th Cir. 1982).

Antitrust suit brought by an unsuccessful applicant for concession space at a municipal airport.

HELD: State statute authorizing municipalities to acquire and operate municipal airports and declaring such operations governmental functions is sufficient to establish state action exemption under *Parker* and *Boulder*. The Supreme Court has denied certiorari.

Town of Haille v. City of Eau Claire, 700 F.2nd 376 (7th Cir. 1983).

Antitrust action brought by towns against a city which required the towns to annex to the city in order to tie into the sewer system.

HELD: State law giving cities broad discretionary powers over sewer systems immunizes the city's annexation policy. No active state supervision needed for state-action exemption to apply. State need not mandate or compel anticompetitive conduct; all that is needed is authorization or contemplation of anticompetitive conduct.

¹⁵*Community Communications Co., Inc. v. City of Boulder*, 50 LW 4148, footnote 20.

fare better under these rulings than under the forms of immunity legislation might provide.

The Administration. President Reagan has declared his support for legislation providing local governments with some exemption from federal antitrust laws. In a letter written to Seattle Mayor Charles Royer when he was NLC president, President Reagan stated that:

I share your concerns about intrusions into state and local autonomy.

. . . we should extend the present state action exemption to local governments provided that two conditions are met: 1) local governments are acting under the authority of state law, and 2) localities are acting within their government (police power) capacity¹⁶

Speaking for the Justice Department, William Baxter, Assistant Attorney General, Antitrust Division, told a Congressional Committee:

The Administration is firmly committed to the concept of federalism, which lies at the core of our constitutional system. Its intent is to develop policies wherever possible that will help to restore the Tenth Amendment to its rightful stature, affording state and local governments the flexibility and freedom from federal interference they require to carry out their responsibilities. Thus, any potential for application of the antitrust laws in a manner interfering with the relationship between states and their political subdivisions is cause for significant concern.¹⁷

Baxter continued, "There is a fundamental difference between public officials, who are politically responsible to the electorate, and purely private businesses, which are responsible only to their owners."¹⁸

Local Governments. Local governments, obviously, have no direct power to affect the degree of their antitrust immunity. They do have the ability, however, to reduce their potential for being sued. A locality can protect itself by opening up meetings to the public, by creating a record that explains why a contemplated activity is necessary even though it may restrain competition, and by auditing older regulations to see where and how past actions may have created a liability. None of these steps guarantees immunity from antitrust liability but they may lessen exposure to litigation.

The Courts. Those who take power away may grant it anew. As the final arbiter, the Court has the power to revisit *Boulder* and, in doing so, can answer whatever unresolved questions it chooses to face among

those raised by the selected cases. Court watchers have predicted that it could take as long as a decade for the justices to clarify municipal antitrust exposure.

Thus far the lower courts have chosen to deal benignly with localities—not a single case has been decided against a local government on its merits.¹⁹ If, during the initial phase of the trial, the courts rule against the local government's claim that state action provides immunity, the cases typically go to settlement. In an atypical case where the settlement came prior to the Court's ruling on the state action immunity claim (*Richmond Hilton Associates v. City of Richmond*), a settlement was reached which cost the city \$2.5 million in cash, \$4.5 million in low interest loan guarantees, and nearly \$1 million in defense costs. Most observers believe the lower courts' failure to rule against a local government stems from the seeming impunity with which lower courts, showing sympathy for local governments, have bent the Supreme Court's holdings in *Boulder* and *Lafayette*. Despite the flexibility of lower court rulings, without further Supreme Court or Congressional action, vital questions will remain unsettled.

THE INTERGOVERNMENTAL RESPONSE

A variety of state and local organizations have adopted policy on local antitrust exposure. The National Association of Attorneys General notes the chilling effects of *Boulder* and supports federal legislation that would guide states in authorizing activities and in providing directions to their local governments that embody a "reasonable balancing of governmental and economic competitive interests." The National Conference of State Legislatures, also, supports a federal legislative solution. NCSL urges that Congress pass legislation to: (1) increase states' flexibility to delegate exemptions to counties and municipalities; (2) apply immunity only to "traditional" acts of governments; and, (3) provide an exemption less broad than the states themselves possess. The National Governors' Association and the Council of State Governments have thus far taken no official position on this issue.

The Conference of Mayors, National League of Cities, National Association of Counties, and National Institute of Municipal Law Officers have almost identical positions—they support federal legislation providing local governments with immunity equal to that of the states. Organizations representing local officials maintain that the problems they face under *Boulder* arise from federal judicial interpretations of Congressional enactments and that Congress is in the best position to rectify the situation. They fear that adopting lower and different immunity standards than those applied to the states would create new legal distinctions, potentially generating as much litigation as the current rulings.

The local groups argue that even if cities and counties were given the same protections as states,

¹⁶Letter from President Reagan to Mayor Charles Royer, May 27, 1983.

¹⁷Testimony of Assistant Attorney General William F. Baxter, *Local Government Antitrust Liability—The Boulder Decision*, Hearings Before the Senate Committee on the Judiciary.

¹⁸*Ibid.*

¹⁹In the case of the aforementioned \$6.3 million judgment against a former mayor and certain private defendants, *Affiliated Capital Corp. v. City of Houston*, 519 F. Supp. 991 (S.D. Tex. 1981), the City of Houston had earlier been dismissed as a defendant.

those protections could prove to be somewhat elusive. As discussed above, the *Jefferson County* case may well preview the demise of the state action doctrine, at least as it applies to price discrimination when states undertake proprietary activities. This case has been termed "the *Lafayette* of the states" because, as in that case, the Court limited immunity available to actions by government that appear to be competing unfairly with private businesses. The courts traditionally have been very reluctant to allow defendants to escape antitrust scrutiny on the basis of an immunity.

Finally, local officials maintain that even if full immunity were made available to them, numerous other mechanisms are still available to citizens who have been treated unfairly by local governments. State contract and tort remedies, federal civil rights remedies, state and federal criminal sanctions, sunshine laws, and, of course, the ballot box are all available to curtail overreaching by local officials.

UNRESOLVED QUESTIONS OF INTERGOVERNMENTAL DIMENSIONS

As noted, recent decisions leave a number of important questions unresolved. These include:

1. What constitutes active state supervision of local government actions?

In the case of *California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.*,²⁰ the Court deemed state policy to displace or restrain competition, even when forthrightly stated and clear in purpose, insufficient to confer state action immunity. Active state involvement and supervision had to be present as well. This issue was raised as it applies to local governments but was explicitly left open in *Boulder* and has not yet been settled.

At least two important cases on this point have been decided in 1983 (*Town of Hallie v. City of Eau Claire*, 7th Circuit, and *Gold Cross Ambulance v. Kansas City*, 8th Circuit). However, some observers see clarity in these cases—that the responsibility of states to actively supervise will not be great—while others see disarray. Even if the former interpretation proves correct, the Supreme Court can overrule lower courts, so local governments can find only partial comfort here.

Requiring active state supervision could place a great burden on state governments. Although states may want to share all or some of their immunity with local governments, they may not want to expend the resources necessary to "actively supervise" local activities so that the exemption can withstand legal challenges. If active supervision is necessary and proves too costly, local governments may be unable to wrest extensive immunities from the states.

2. Are the standards for judging alleged anti-competitive activities by local governments to be the same as those applied to private parties?

Alleged anticompetitive activities are traditionally evaluated under the *Sherman Act* by using either a *per se* rule or a rule of reason. The former rule refers to certain restraints of trade, such as price fixing, tying arrangements, and division of territories among competitors, that are presumed to be unreasonable and therefore illegal on their face. The latter rule requires the courts to determine whether the context, purpose, history, and effects of the challenged actions show them actually to be hindering or enhancing competition.

In *National Society of Professional Engineers v. United States*,²¹ the Court held that an anticompetitive restraint could not be defended on the basis that a private party (the National Society of Professional Engineers in this instance) had concluded that competition posed a potential threat to public safety and to the ethics of a particular profession. If applied to municipalities, this logic might mean that a municipal act could not be defended on the basis that public health, safety, or welfare considerations outweigh anticompetitive effects. Purely on this basis, a local government's ability to displace competition with regulation would be greatly limited, if not disabled.

However, if the precedent in *Professional Engineers* is not applied, a municipality could argue under a modification of the rule of reason that considerations of public health, safety, or welfare could be considered as well as an act's anticompetitive aspects. This approach, as noted in Justice Rehnquist's *Boulder* dissent, might place courts in the position of intrusively reviewing legislative wisdom. Such reviews of the reasonableness of local regulation are by definition "standardless" and, as such, are fraught with peril.

The Court, in both *Boulder* and *Lafayette*, considered this issue and allowed that it

may be that certain activities which might appear anticompetitive when engaged in by private parties take on a different complexion when adopted by a local government.²²

Obviously, though, to suggest the possibility of such a distinction is far easier than developing and applying a sensitive and workable mechanism.

3. What remedies may be appropriately applied to local governments generally and to public officials—both state and local—individually?

The antitrust laws provide for treble damages and attorney's fees. Both *Boulder* and *Lafayette* specifically avoided the issue of remedies, although in the latter case the Court intimated that remedies available for private antitrust violations may not be appropriate for governmental violations. At least one piece of legislation introduced thus far would limit remedies to simple damages. Limiting damages would tend to reduce some of the fears now being witnessed (even though the greatest fears probably concern costs, time

²¹435 U.S. 679 (1978).

²²*Boulder*, *op. cit.*

demands, and threats to public policies), but doing so might thwart the original deterrent purposes of treble damages.

4. What is the definitive difference between a governmental act and a proprietary one?

Although the *Boulder* ruling seems to drop the distinction concerning "governmental" and "proprietary" activities raised by the Chief Justice in *Lafayette*, the distinction continues to have some vitality in a number of areas. First, the Court used this distinction in its decision in *Jefferson County* as it applied the *Robinson-Patman Price Discrimination Act* to states and local governments. Second, the lower courts, notably in *Town of Hallie*, have used this distinction in determining whether there must be active state supervision of local government activities. Third, the distinction does help frame the issues. For example, if a local government opened its own furniture store and zoned all other furniture stores out of the city, it would seem that a stricter antitrust standard should be applied to that action than to a city severely restricting the right of private security guards to wear firearms in public.

The distinction, however, is blurry. No definitive legal standard has yet emerged. Attempts in other areas to distinguish between "governmental" and "proprietary" acts have produced what Justice Frankfurter once called a judicial "quagmire." Much of what governments do looks like what some businesses do, and vice versa. It is easy to decry this blurring, but separating the purely governmental from the purely commercial is no simple task. Is an act governmental because it is traditional, it is good, or it has never been done in the private sector? That none of these notions seems to suffice points up the problems inherent in this line of reasoning. Furthermore, the Supreme Court has made very narrow interpretations of what constitutes a "traditional governmental activity" in the series of cases that have flowed out of *NLC v. Usery*.²³

The Thurmond and Edwards bills, respectively, turn on this point, protecting regulatory powers but not the sale of goods or services by local governments. Many observers believe a bill dependent on drawing a clear line between these functions will generate at least as long a period of case-by-case judicial development as is now predicted for the general issue of municipal antitrust liability.

5. If additional immunity is conferred on local governments, should it differentiate among different types of governments?

The *Boulder* case specifically concerned a home rule city, finding that a general grant of home rule by the State of Colorado was not equivalent to action by the state itself when it came to regulating a cable television franchise. Ironically, as Justice Rehnquist raised in his dissent in *Boulder*:

[The] municipalities that stand most to lose by the decision today are those with the most autonomy. Where the state is totally disabled from enacting legislation dealing with matters of local concern [as in a strong home rule state], the municipality will be defenseless from challenges to its regulation of the local economy. In such a case, the state is disabled from articulating a policy to displace competition with regulation. Nothing short of altering the relationship between the municipality and the state will enable the local government to legislate on matters important to its inhabitants. In order to defend itself from *Sherman Act* attacks, the home rule municipality will have to cede its authority back to the state.

The question posed here is: Which local governments should be granted whatever immunity is afforded? The four Congressional bills introduced to date do not agree. Senator Thurmond's bill applies only to general-purpose units of local governments. Would special districts be fully foreclosed from any immunity in this instance? The other bills apply equally to general- and special-purpose governments. Presumably, the courts, Congress, or the states could choose to differentiate between general- and special-purpose governments in any general or specific grant of immunity that might be provided.

6. How would immunity apply to private parties that rely on local governments?

This issue has been raised, but not answered, in *Jefferson County* and other cases. For example, if a local government is sued for restraining or displacing competition by awarding a sole franchise for emergency ambulance service, is the selected franchise company liable as well? If accepting franchises from local or state governments or entering into development agreements makes private parties liable for antitrust litigation and antitrust costs, public bodies may be hard pressed to find companies with which to do business.

CONCLUSION AND OUTLOOK

The immediate problem facing local officials is a practical one: How do recent Supreme Court decisions affect their ability to provide public services? Many of the actions that local governments undertook routinely are now open to question. Threatened suits and litigation are costly and can delay, if not change, public policies. States can give their local governments immunities for particular activities but that course of action may not be smooth in all cases nor is there any guarantee that it will withstand judicial review.

A second problem is theoretical: has the status of local governments within the federal system changed? They receive no mention in the U.S. Constitution, yet between 1890 and 1978 they were implicitly, if not explicitly, considered to have standing equal to that of the

²³See *Intergovernmental Perspective*, Spring 1983, Vol. 9, No. 2, pp. 26-27, "*EEOC v. Wyoming*: Whither the *NLC* Defense?"

Federal Antitrust Laws

The SHERMAN ACT of 1890

The major piece of legislation governing federal antitrust policy is the *Sherman Act*. Enacted to impede the powerful industrial trusts which had sprung up during the latter part of the nineteenth century, *Sherman* makes illegal the "unreasonable" restraint of trade. The courts may judge an action illegal under *Sherman* by using one of two tests. An obvious action such as price fixing will, in all likelihood, be held illegal "per se"—that is, it is illegal on its face (intent is not considered). Other, more subtle or less manifest, actions may be deemed to be in restraint of trade because their effect—historically or otherwise—has been to harm competition. Such actions are judged under the "rule of reason" test.

The CLAYTON ACT of 1914

The *Clayton Act* governs trade practices to the extent that they produce monopolies or otherwise diminish competition. In relevant part, *Clayton* forbids price discrimination (the selling of a particular product to different purchasers at different prices); exclusive contracts (designed to keep buyers from dealing with the seller's competition); holding companies; and, interlocking corporate directorates.

The ROBINSON-PATMAN ACT of 1936

Finally, the *Robinson-Patman Act* expands on *Clayton* by restricting such discriminatory practices as unearned commissions, brokerage fees, or discounts.

The answers that Congress, the Court, and the states provide will not only clarify some of their own interrelationships, but will go a long way toward redefining the powers and the status of local governments in our evolving federal system.

It is incumbent on the federal courts to remember their intended role as arbiters—not legislators or administrators. They must recognize Congressional intent and the historical context in which legislation was passed. In so doing, the courts would be faithful to the principles of federalism under which government would be more effective and responsive.²⁴

The outlook for clarifying where local governments stand is by no means certain. Congressional hearings on this issue are not yet scheduled, but are expected to take place this fall. Lower federal courts will continue to hear related cases, and the Supreme Court is expected to take up cases this term that could resolve some of these issues. The answers that Congress, the Court, and the states provide will not only clarify some of their own interrelationships, but will go a long way toward redefining the powers and the status of local governments in our evolving federal system.

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states with respect to federal antitrust laws. The power of home rule, which local governments fought long and hard to establish, is said by some, including Justice Rehnquist, to be "dead" because of the Court's *Boulder* decision. The question is raised: to what extent should the Court intervene in state-local relations? Richard Williamson, former Assistant to President Reagan for Intergovernmental Affairs, has commented:

²⁴Richard S. Williamson, "Judicial Activism: Section 1983 and Antitrust Liability Chill Decision Making by State and Local Officials," *Harvard Journal of Law and Public Policy*, Vol. 6, Summer 1983, p. 164.

MASS TRANSIT AND THE TENTH AMENDMENT:

The *NLC* Doctrine Goes One More Inning

by Cynthia Cates Colella

In what has become a near heroic demonstration of tenacity, states and localities will again be asking the Supreme Court to decide that an activity, largely performed by governments, is protected from certain federal regulatory endeavors by virtue of the Tenth Amendment to the United States Constitution. In requesting such a ruling, state and local interests are hoping the Court will breathe new life into the now somewhat beleaguered doctrine of state sovereignty enunciated in *National League of Cities (NLC) v. Usery*.¹

¹426 U.S. 833 (1976).

Specifically in its 1983-84 Term, the Supreme Court will consider at least one case concerning a local mass transit system. That case will address the following question:

whether publicly-owned and operated mass transit systems are a "traditional governmental function."²

Moreover, in a separate case, the Court has been asked to consider:

whether an activity that now is predominantly conducted by local governments is precluded from being a protected "governmental function" because it formerly was conducted by private enterprise.³

Those questions, obviously, are not new ones. Indeed, they involve issues with which state and local governments, the U.S. Department of Labor, any number of lower federal courts, and the Supreme Court itself have been attempting to grapple for over a decade.

SAN ANTONIO AND CITY OF MACON: HISTORICAL AND LEGAL CONTEXTS

To understand either *Donovan v. San Antonio Metropolitan Transit Authority*⁴ or *City of Macon v. Joiner*, it is necessary to trace briefly the legal and historical contexts within which they have risen. Specifically, if *San Antonio* and *City of Macon* are seen simply as the latest of a particular series of intergovernmental legal struggles, the "battle lines" were drawn by the 1974 amendments to the *Fair Labor Standards Act* (FLSA). Those amendments extended federal minimum wage and maximum hour requirements to most state and local employees, an action alleged by states and localities to be unconstitutional. In 1976, the Supreme Court upheld their assertion.

Thus, in *National League of Cities v. Usery*, the Court ruled

Insofar as the 1974 amendments operate directly to displace the states' abilities to structure employer-employee relationships in areas of traditional governmental functions . . . they are not within the authority granted Congress by the Commerce Clause. . . . 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.⁵

In its opinion, moreover, the Court went on to note that the national government's commerce power as applied

²Joe G. Garcia v. San Antonio Metropolitan Transit Authority, Docket No. 82-1913, and Raymond J. Donovan v. San Antonio Metropolitan Transit Authority, Docket No. 82-1951.

³City of Macon v. C.D. Joiner, Docket No. 82-1974.

⁴Combined for appeal as Garcia v. San Antonio Metropolitan Transit Authority and Donovan v. San Antonio Metropolitan Transit Authority. The Court agreed to hear the San Antonio case on October 3, 1983.

⁵426 U.S. 833 (1976).

to the states and their political subdivisions encounters an affirmative barrier in another portion of the Constitution—namely, the Tenth Amendment.

Not surprisingly, the *NLC* decision was heralded by many state and local interests as a milestone in efforts to “rebalance” intergovernmental relations. It was, after all, the first major Tenth Amendment victory in the federal judicial arena in decades. However, succeeding attempts to employ the *NLC* precedent as a defense against other perceived congressional encroachments on state sovereignty have failed before the Supreme Court.⁶ What at first blush appeared to be a “settled” issue in the wage and hour field has resurfaced as anything but settled.

On December 29, 1979, the Department of Labor (DOL) published FLSA regulations affecting a broad range of state and local activities. Since codified under 29 C.F.R. Section 775.3, the regulations extended application of FLSA wage and hour requirements to what DOL described as “nontraditional” state and local functions. According to DOL, the fact that those activities are “nontraditional” means that they are not protected by the Tenth Amendment strictures set forth in *NLC v. Usery*. One function so designated was local mass transit systems, a fact that has led to much litigious activity as well as to calls for rescission of the regulations by a number of groups including the Advisory Commission on Intergovernmental Relations.⁷

The challenges to the mass transit regulations made in the lower courts illustrate the extent of legal confusion surrounding the concepts articulated in *NLC*. Hence, in the absence of any clear signals from the Supreme Court, district and appellate court rulings have been inconsistent—the mass transit regulations being ruled legitimate, for example, in Macon, Georgia;⁸ New Castle, Delaware;⁹ Chattanooga, Tennessee;¹⁰ and Augusta, Georgia;¹¹ but unconstitutional in San Antonio, Texas¹² and Puerto Rico.¹³

Legally, the confusion at the lower court level seems to stem from the emphasis a particular judge chooses to give one or both of two post-*NLC* Supreme Court opinions. For instance, in *Hodel v. Surface Mining and Reclamation Association*,¹⁴ the Court attempted to explain its position in *NLC* by constructing a “Tenth Amendment test:”

⁶See for example, *Hodel v. Virginia Surface Mining and Reclamation Association*, 452 U.S. 264 (1981), *United Transportation Union v. Long Island Rail Road*, 455 U.S. 678 (1982), and *EEOC v. Wyoming*, U.S. 103 S. Ct. 1054 (1983).

⁷See *Recommendation B.3 of Regulatory Federalism: Policy, Process, Impact, and Reform*.

⁸*Joiner v. City of Macon*, 699 F.2d 1060 (11th Cir. 1983).

⁹*Kramer v. New Castle Area Transit Authority*, 677 F.2d 308 (3rd Cir. 1982), cert. de., U.S. 103 S. Ct. 786 (1983).

¹⁰*Dove v. Chattanooga Area Regional Transit Authority*, 701 F.2d 50 (6th Cir. 1983).

¹¹*Alewine v. City Council of Augusta*, 699 F.2d 1060 (11th Cir. 1983).

¹²*San Antonio Metropolitan Transit Authority v. Donovan*, 557 F. Supp. 445 (D.C.W.D. Tex., 1983).

¹³*Molina-Estrada v. Puerto Rico Highway Authority*, 680 F.2d 841 (1st Cir. 1982).

¹⁴452 U.S. 264 (1981).

First, there must be a showing that the challenged statute regulates the “States as States.” Second, the federal regulation must address matters that are indisputably “attributes of state sovereignty.” And third, it must be apparent that the States’ compliance with the federal law would directly impair their ability “to structure integral operations in areas of traditional functions.”¹⁵

Moreover, in *United Transportation Union v. Long Island Rail Road*,¹⁶ the Court held that the operation of interstate passenger and freight railroads “has traditionally been a function of private industry, not state or local governments.”¹⁷ At least three appellate-level courts—those ruling in the *Chattanooga*, *New Castle*, and *Augusta* cases—have taken the combined force of these decisions to mean that mass transit, like interstate passenger railroads, is not a traditional governmental function and therefore not protected by the Tenth Amendment.

However, at least one other court—the district court in *San Antonio*—has underscored the Supreme Court’s assertion in *Long Island* that the “emphasis on traditional governmental functions and traditional aspects of state sovereignty was not meant to impose a static historical view of state functions.”¹⁸ In addition, that court and the First Circuit have chosen to rely on the Sixth Circuit’s attempt to clarify what constitutes a protected government function, apparently finding that effort more useful and less “static” than the *Hodel* test. In *Amersbach v. Cleveland*¹⁹ the Sixth Circuit noted that

[b]y analyzing the services and activities which the [Supreme] Court characterized as typical of those performed by governments [in *NLC v. Usery*], we note certain elements common to each which serve to clarify and define a method by which a protected government function may be identified. Among these elements are: (1) the government service or activity benefits the community as a whole and is available to the public at little or no direct expense; (2) the service or activity is undertaken for the purpose of public service rather than for pecuniary gain; (3) government is the principal provider of the service or activity; and (4) government is particularly suited to provide the service or perform the activity because of a community-wide need for the service or activity.²⁰

If there exists great legal bewilderment, it stems in large part from the word “traditional,” implying, as it does, longterm continuity. Yet, it is doubtful that the Supreme Court meant to suggest that a function must have been conducted by government for some fixed

¹⁵*Ibid.*

¹⁶455 U.S. 678 (1982).

¹⁷*Ibid.*

¹⁸*Ibid.*

¹⁹598 F.2d 1033 (6th Cir. 1979).

²⁰*Ibid.*

period of time (say, 75 or 100 years) to be "protected," given its admonition against "static historical view[s]." Indeed, among others, the *Amersbach* court obviously attempted to diffuse the durational obstacle. Nonetheless, as exhibited in a recent statement by the Eleventh Circuit—"Expanding state involvement in mass transit does not alter the historic reality that mass transit is not a function traditionally performed by the state or its political subdivisions."²¹—the time factor continues to influence judicial determinations.

THE GOVERNMENTALIZATION OF MASS TRANSIT: CAUSES AND CURRENT STATUS

When the Supreme Court hears arguments in the *San Antonio* case it will be asked by *amici* representing state and local governments²² to decide that publicly-owned and operated mass transit systems are a "traditional governmental function."²³ If it chooses, in addition, to consider *City of Macon*, state-local *amici* will ask the Court to rule that an activity which now is predominantly conducted by local governments is not necessarily precluded from being a protected "governmental function" because it formerly was conducted by private enterprise.²⁴

Those opposing the state and local view, including the federal government, will argue that because, in the not too distant past, mass transit was primarily a private sector function, it cannot be considered traditionally governmental and thus immune, by reason of the Tenth Amendment, from federal wage and hour regulations. Additionally, opponents will assert that "because Congress provided some of the money used by local governments in acquiring and operating mass transit systems,"²⁵ the contention that mass transit is a traditional local function is even further diluted.

Although arguments on both sides will address the more strictly theoretical and legal issues stemming from *NLC* and its progeny, the Court has stated that its decisions also will be based on such practical considerations as the "degree of federal intrusion" and "effect[s] on state finances."²⁶ Hence, it is worthwhile to

“ Whatever its history, mass transit today is unequivocally a public function. By 1980, public transit systems carried 94 percent of all transit riders, owned or leased 90 percent of all transit vehicles, operated 93 percent of transit vehicle miles, and accounted for 55 percent of all transit systems. ”

trace briefly the historical causes of governmental involvement in mass transit as well as the extent of that involvement today.

Local Government and Mass Transit

Whatever its history, mass transit today is unequivocally a public function. By 1980, public transit systems carried 94 percent of all transit riders, owned or leased 90 percent of all transit vehicles, operated 93 percent of transit vehicle miles, and accounted for 55 percent of all transit systems²⁷ (see Table 1).

Moreover, within that public milieu, mass transit is primarily a local function. Because fares and other system-generated revenues covered only about 41 percent of total transit operating expenses. In 1980, local governments spent close to \$2 billion supporting those operations, by far the largest amount spent by any level of government (see Table 2). In addition, a number of local jurisdictions subsidize the capital expenses of transit systems.

Even before public ownership became the norm for transit systems, many cities were engaged in the business of regulating transit operations:

Because tracks were constructed in public streets, franchises were usually necessary so that the public thoroughfare could be used for private enterprise. Often cities required that an annual franchise tax be paid. In addition, there were often duties required by the street railway company as part of the franchise agreements. For example, it was common to demand that the street railway pave the area around its tracks, and the railway was responsible for clearing snow from the paved area in winter. . . . In the electric railway days, streetcar companies often had to maintain public bridges upon which their cars operated. . . .²⁸

²⁷American Public Transit Association, APTA Statistical Department, *Transit Fact Book, 1981* (Washington, DC: American Public Transit Association, 1981), pp. 27, 43.

²⁸George M. Smerk, "The Development of Public Transportation and the City," in *Public Transportation: Planning, Operations, and Management*, ed. George E. Gray and Lester A. Hoel (Englewood Cliffs, NJ: Prentice-Hall, Inc., 1979), p. 10.

²¹*Alewine v. City Council of Augusta*, 699 F.2d 1060 (11th Cir. 1983).

²²*Amici* represented by the State and Local Legal Center include the National League of Cities, the National Governors' Association, the National Association of Counties, the National Conference of State Legislatures, and the International City Management Association.

²³*Brief for the National League of Cities, The National Governors' Association, the National Association of Counties, the National Conference of State Legislatures, and the International City Management Association as Amici Curiae in Support of a Plenary Hearing and Affirmance of Joe G. Garcia v. San Antonio Metropolitan Transit Authority, et. al. and Raymond J. Donovan, Secretary of Labor v. San Antonio Metropolitan Transit Authority, et. al.*, Docket Nos. 82-1913 and 82-1951.

²⁴*Brief for the National League of Cities, the National Governors' Association, the National Association of Counties, the National Conference of State Legislatures, and the International City Management Association as Amici Curiae in Support of the Petition for Certiorari for City of Macon v. C.D. Joiner, et. al.*, Docket No. 82-1974.

²⁵*Brief for the National League of Cities, et. al. as Amici Curiae in Support of a Plenary Hearing and Affirmance of Garcia v. San Antonio Metropolitan Transit Authority and Donovan v. San Antonio Metropolitan Transit Authority, op. cit.*, p. 6.

²⁶*EEOC v. Wyoming*, U.S. 103 S. Ct. 1054 (1983).

Although there has long been some public ownership of mass transit,²⁹ the tremendous growth in local ownership in recent decades stems from a number of factors which made the industry unprofitable, causing private providers to leave in droves. For example, federal mortgage guarantee programs encouraged suburbanization and federal highway aid abetted mass automobile usage.³⁰ By the 1950s, then,

as no federal aid was available for public transportation, its relative position became worse. As the cities groaned under a rising tide of automobile traffic, despite the efforts to provide highways adequate to meet all transport needs, public transportation became shabbier, less attractive, and generally unable to generate revenues sufficient even to buy new buses.³¹

²⁹The first publicly owned transit system began operating in 1904. By World War II, 20 systems were publicly owned. APTA, *Transit Fact Book*, p. 27.

³⁰George M. Smerk, *Urban Mass Transportation: A Dozen Years of Federal Policy* (Bloomington, IN: Indiana University Press, 1974), pp. 11, 15.

³¹*Ibid.*, p. 16.

If the transit situation appeared grave in the early and mid-1950s, it had reached genuine crisis proportions by the latter part of that decade. Specifically, in 1958, Congress amended the *Interstate Commerce Act* to allow inter- and intrastate passenger carriers to discontinue service upon approval of the Interstate Commerce Commission—interstate carriers upon direct appeal and intrastate carriers after exhausting state procedural requirements.³² Prior to that action, such carriers had been required to gain the permission of state regulatory bodies:

From long experience the railroads had learned that gaining permission from state bodies was typically a very drawn-out and expensive affair. . . . All in all, after passage of the 1958 Act, the railroads were in a much better position than before to remove the passenger millstone from their necks.³³

³²Transportation Act of 1958, P.L. 85-626, 85th Congress.

³³Smerk, *Urban Mass Transportation*, pp. 27-28.

Table 1
PUBLIC OWNERSHIP* DOMINATES TRANSIT

Calendar	Total Number of Transit Systems	Public Percent of Industry Total	Total Transit Vehicles Owned and Leased	Public Percent of Industry Total	Total Vehicle Miles Operated (millions)	Public Percent of Industry Total
1940	20	2%	4,934	7%	—	—
1945	29	2%	14,609	16%	—	—
1950	36	3%	24,570	28%	—	—
1955	39	3%	22,011	30%	—	—
1960	58	5%	23,738	36%	—	—
1965	88	8%	29,592	48%	—	—
1970	159	15%	40,778	66%	1,280	68%
1971	177	17%	41,301	68%	1,292	70%
1972	203	19%	42,499	70%	1,282	73%
1973	246	24%	47,508	79%	1,468	80%
1974	308	33%	48,410	81%	1,621	85%
1075	333	35%	51,964	83%	1,706	86%
1976	375	39%	54,149	85%	1,770	87%
1977	455	45%	54,662	86%	1,790	89%
1978	463	48%	55,393	87%	1,825	90%
1979	523	51%	57,292	87%	1,840	91%
P 1980	576	55%	64,128	90%	1,939	93%

P - Preliminary

* Publicly owned transit systems include all transit systems owned by municipalities, counties, regional authorities, states, or other governmental agencies including transit systems operated or managed by private firms under contract to governmental agency owners. NOTE: Table excludes automated guideway transit commuter railroad and urban ferry boat.

— Data Not Available

SOURCE: American Public Transit Association, APTA Statistical Department, *Transit Fact Book, 1981* (Washington, DC: American Public Transit Association, 1981), p. 43.

Table 2
GOVERNMENT OPERATING SUBSIDIES
(\\$ in millions)

Year	Total Operating Expenses	Local Subsidies		State Subsidies		Federal Subsidies	
		Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
1970	\$1,995.6	\$ 231.0	11.5%				
1971	2,152.1	229.5	13.9	\$ 10.5	.5%		
1972	2,241.6	279.7	12.5	54.1	4.2		
1973	2,536.1	398.3	15.7	138.5	5.5		
1974	3,239.4	667.4	20.6	381.2	11.8		
1975	3,757.6	669.4	18.3	406.6	10.8	\$ 301.8	8%
1976	4,982.6	857.4	21.0	367.1	9.0	422.9	10.4
1977	4,336.6	841.1	19.3	478.4	11.0	584.5	13.4
1978	4,788.9	977.8	50.4	564.3	11.8	689.5	14.4
1979	5,611.4	1,416.9	25.2	637.7	11.4	855.8	15.3
1980	6,514.2	1,703.9	26.2	820.4	12.6	1,093.9	16.8

SOURCE: ACIR staff calculations based on the American Public Transit Association's **Fact Book, 1981** (Washington, DC: APTA, 1981) and the U.S. Bureau of the Census, **Census of Governments, 1971 through 1974**.

And remove that millstone—or threaten to remove it—they did with great alacrity. Urban commuter service was faced with a crisis and government was forced to respond if that service were to survive. The response is reflected in the massive local government involvement that exists today.

State Government and Mass Transit

As with local government, the state financial commitment to mass transit has been growing steadily over the years. Thus, by 1983, the states were "providing approximately \$2.4 billion in capital and operating assistance,"³⁴ up from \$1.9 billion in 1982.³⁵ Moreover, states routinely provide assistance in planning, research, and administration, in federal-local relations, in bond issuance, through legislation allowing localities to tax themselves for transit funds, and by forgiving some taxes.³⁶ Finally, in some "states—such as Connecticut, Rhode Island, Massachusetts, New Jersey, and Maryland—most key decisions on planning, financing and operating urban transportation systems are made at the state level."³⁷

³⁴Letter from Francis B. Francois, Executive Director, American Association of State Highway and Transportation Officials, September 12, 1983.

³⁵American Association of State Highway and Transportation Officials, **Survey of State Involvement in Public Transportation** (Washington, DC: AASHTO, June 1982), p. 7.

³⁶ACIR staff draft chapters, 1983.

³⁷Ecosometrics, Inc. and System Design Concepts, Inc., "Current Institutional Arrangements for Urban Transportation Decisions—and Potential Changes: Final Report," Research Report No. RR-152, prepared for U.S. Department of Transportation, Office of the Assistant Secretary for Policy and International Affairs (Bethesda, MD: Ecosometrics, Inc., 1981), p. 29.

The Federal Government and Mass Transit

The federal government responded to the crisis in mass transit with the *Urban Mass Transportation Act of 1964*, administered by the Urban Mass Transportation Administration (UMTA). That Act, as amended, provided funds both for capital and operating expenses:

- Section 3—Provides capital grants to assist State and local public bodies purchase or improve facilities and equipment. These grants, which cover up to 80% of project costs, were originally used to modernize bus fleets and for the acquisition of private bus companies by public agencies. The emphasis changed in the 1970's, and the largest share of the grant money has recently gone to the construction and rehabilitation of fixed-rail transit.

Amended in 1978 by the *Surface Transportation Assistance Act*, the current [capital] grant program authorized \$7.5 billion for the 5-year period 1979-83. In 1980, \$2.8 billion was allocated to local systems.

- Section 5—Provides grants to State and local public bodies by a formula based primarily on population size and density. These funds may be used for capital expenditures, but the vast majority have gone for operating assistance. The funds are subject to matching requirements—20% minimum for capital and 50% minimum for operating costs. Between 1975 and 1980, annual federal operating assistance increased from \$.3 to \$1.1 billion.³⁸

³⁸U.S. Department of Transportation, Office of the Secretary of Transportation, **Inflation-Responsive Transit Financing**, An Urban Consortium Information Bulletin (Washington, DC: U.S. Government Printing Office, 1982), p. 3.

However, particularly when viewed in real dollar terms, the federal role has been declining somewhat over the past couple of years (see Table 3).

Last year, federal transit policy was once more amended through the *Federal Public Transportation Act of 1982*.³⁹ Particularly significant is a new Section 9 block grant program designed to replace the Section 5 formula grant which expired at the end of fiscal year 1983.

The new block grant legislation authorizes increased funds to meet both capital and operating expenses. Although the appropriations process may not fully sustain these authorizations, it seems likely that some federal operating subsidy for mass transit "will survive for the foreseeable future."⁴⁰ Indeed, "indications are that the president will sign [an appropriations bill containing operating assistance] into law despite his opposition to operating assistance. At the same time, it has been reported likely that the administration will request recessions and deferrals to accomplish its objective to eliminate operating assistance."⁴¹ Other observers, however, believe that "the speculation that the Administration is likely to request recessions and deferrals is premature. . . ."⁴²

³⁹Title III of the *Surface Transportation Assistance Act of 1982*.

⁴⁰John W. Fischer, *The Federal Public Transportation Act of 1982: Provisions and Analysis*, Report No. 83-57 E (Washington, DC: The Library of Congress, Congressional Research Service, 1983), pp. 1, 17.

⁴¹Carol Kocheisen, "Conference OKs Transit Funds, Reagan Expected to Sign," *Nation's Cities Weekly*, 1 August 1983, p. 2.

⁴²Letter from Francis B. Francois, September 12, 1983.

FEDERAL ASSISTANCE: A CONTRAVENTION OF LOCAL TRADITIONS?

Obviously, federal assistance is an extremely important component of local mass transportation financing. However, whether the large sums of money that the federal government makes available to states and localities for mass transit purposes somehow nullify the "localness" of that activity is subject to debate.

First, it has been argued that in accepting sizable federal grants, states and localities relinquish some measure of control over the mass transit function. The congressional spending power, after all, is "conditional." Yet, the *Fair Labor Standards Act* is a direct order regulatory mechanism, unrelated to any grant. Moreover, and perhaps of greater significance, some of the functions explicitly cited by the Supreme Court in *NLC* as traditional local functions were themselves recipients of substantial federal assistance at the time of the 1976 decision. Notably, the nation's police departments had, for some time, been receiving federal money under the *Law Enforcement Assistance Act*; local schools and sanitation projects have and continue to receive major federal grants.

Equally as important, in 1980, about 72 percent of federal transit funds were in the form of capital grants. Federal operating subsidies, while far from inconsequential, accounted for only about 13 percent of transit operating funds nationwide in 1982 and even less

Table 3
FEDERAL GRANT APPROVALS FOR MASS TRANSPORTATION

Year	Capital (millions)	Operating (millions)	Total	Percentage Change from Previous Year	Percentage Change in Real Dollars*
1965-69	\$ 547.8	—	\$ 547.8	—	—
1970	133.4	—	133.4	—	—
1971	284.8	—	284.8	+ 113%	—
1972	510.9	—	510.9	+ 79	—
1973	863.7	—	863.7	+ 69	—
1974	955.9	—	955.9	+ 11	—
1975	1,287.1	\$ 142.5	1,429.6	+ 50	—
1976	1,954.8	411.8	2,366.6	+ 65	+ 56%
1977	1,723.7	571.8	2,295.5	- 3	- 8
1978	2,036.9	685.3	2,722.2	+ 19	+ 10
1979	2,101.6	868.5	2,970.1	+ 9	0
1980	2,787.1	1,120.7	3,907.8	+ 30	+ 20
1981	3,020.2	1,178.1	4,198.3	+ 7	- 3
1982	2,586.6	1,108.8	3,695.4	- 12	- 17
Total	20,794.5	6,087.5	26,882.0		

* This column was calculated in using the GNP Implicit Price Deflator.

SOURCE: U.S. Department of Transportation, Urban Mass Transportation Administration cited in American Public Transit Association, *Fact Book, 1981*, Tables 19 and 20. 1981 and 1982 data derived from Urban Mass Transportation Administration, Office of Budget and Policy, *Memorandum* dated October 21, 1982; telephone conversation with Fred Williams, Urban Mass Transportation Administration; and ACIR staff calculations.

than that in large cities.⁴³ Yet, *FLSA* regulations, if applied to transit, clearly would affect operations.

LABOR, MASS TRANSIT, AND THE FAIR LABOR STANDARDS ACT

A labor-intensive industry, labor costs are estimated to comprise anywhere from 65 percent⁴⁴ to 73 percent⁴⁵ of the operating costs of mass transit. Therefore, any policy affecting labor costs could be expected, correspondingly, to have a profound effect on mass transit finances. Although,

within any given city, transit wages are not as out of line with other public wages as often appears . . . this does not change the fact that any significant attempt to control future transit costs will hinge on labor agreements, particularly on the wage rates and work rules included in new agreements.⁴⁶

The *Fair Labor Standards Act* requires covered employers to pay employees the federal minimum wage and to pay them one and one-half times their regular rate of pay for hours worked over 40 per week. Because neither DOL regulators nor transit experts currently know exactly how *FLSA* regulations would be applied to transit operations, no formal estimates have been made of their potential economic effects. Indeed, since transit workers tend already to be compensated above the federal minimum wage, that portion of the requirements would not be expected to have a great effect on transit budgets.

However, depending upon how they are eventually interpreted and administered, the actual overtime provisions of *FLSA* may have a substantial impact on some local transit agencies—particularly where spread premium pay is employed. A unique feature of transit labor is the peak hour work period. That is, a full contingent of drivers and operators will be required during the morning and late afternoon rush hour periods, with a much smaller number required during the remainder

⁴³U.S. Congress, Congressional Budget Office, **The Federal Government in a Federal System: Current Intergovernmental Programs and Options for Change** (Washington, DC: Congressional Budget Office, 1983), p. 125.

⁴⁴Richard U. Miller, Craig A. Olson, and James L. Stern, "Labor Costs and Collective Bargaining in Urban Mass Transit: Problems of Definition, Measurement, and Resolution," in **Urban Transportation Economics**, Proceedings of Five Workshops on Pricing Alternatives, Economic Regulation, Labor Issues, Marketing, and Government Financing Responsibilities, prepared for Department of Transportation, Office of the Secretary, Office of Transportation Economic Analysis (Springfield, VA: National Information Service, 1978), p. 141.

⁴⁵Telephone conversation with John Neff, American Public Transit Association, September 1, 1983.

⁴⁶Cynthia J. Burbank, "Transit Financing Trends and Outlook," in *Ibid.* It should be noted, however, that at least one analyst asserts that "the escalation of unit costs should not be confused with the escalation of deficits . . . Cost-of-living adjustments account for less than half of the escalation of deficits and should not be viewed exclusively as a debit on the ledger of community economics. To the extent that transit wages are spent for consumer goods and recycled through local economies, they represent a boon to the service sector and local economy." David Jones, "Conventional Transit Financing and Budgeting Constraints," University of California, Berkeley, n.d., pp. 3-4.

of the day and evening.

One response to this situation has been "dual-peak assignments" or "split shifts:"

[S]ome drivers work both a morning and evening shift, with a midday break. These drivers will face workdays (or *spreads*) of 12 to 13 hours. That workday may include only 5 or 6 hours of actual driving (*platform* time), but a driver faced with such an awkward and unappealing work schedule justifiably demands a full day's pay. There is also additional compensation (*spread premium*) for unusually long spreads. Thus the district may pay an operator nine hours' wages for six hours' work.⁴⁷

Under such an arrangement, the possibility of the *Fair Labor Standards Act* having an effect on transit finances is intensified by "spread premium pay":

This is a bonus, analogous to overtime, paid for all work performed beyond a *spread premium threshold*. For example, a typical contract might specify time and a half after a 10-hour threshold. Now suppose that a driver under that contract worked a run consisting of two 4-hour shifts separated by a 4-hour break. There are 6 hours driving before the threshold point, and 2 hours afterward. The driver therefore receives 6 hours of straight-time pay, and 2 hours of pay at time and a half, for a total of 9 (straight-time equivalent) pay hours.⁴⁸

Reiterating the caveat that no one is certain how *FLSA* overtime provisions would apply to the unique circumstances of mass transit operation, it is conceivable, under the law's 40-hour workweek maximum hour provision, that the "time and a half threshold" could be achieved after only 8 hours on a split shift. Although most labor agreements limit split shifts to 40 or 50 percent of total shifts,⁴⁹ rough estimates put the number of split shifts at between 20 and 50 percent.⁵⁰ Strict application of overtime provisions would still add considerably to transit agencies' operating budgets.

In addition to potential overtime costs, informal estimates put possible administrative costs to public transit agencies at between \$100 and \$200 million per year during the first few years of implementation—a substantial burden for an industry already reeling under enormous and increasing yearly deficits. Such costs would be likely to occur because *FLSA* requires special record keeping procedures which, in turn, would force many transit agencies to completely revamp their payroll systems.⁵¹

⁴⁷Kenneth M. Chomitz and Charles A. Lave, "Forecasting the Financial Effects of Work Rule Changes," **Transportation Quarterly** 37 (July 1983), p. 454.

⁴⁸*Ibid.*, pp. 456-457.

⁴⁹Jose A. Gomez-Ibanez and John R. Meyer, "Growth of Productivity and Labor Relations in Urban Mass Transit," in **Urban Transportation Economics**, p. 150.

⁵⁰Telephone conversation with Joe Jaquay, Research Division, Amalgamated Transit Union.

⁵¹Telephone conversation with Robert Batchelder, Chief Counsel, American Public Transit Association, August 18, 1983.

Protected Functions and ACIR Policy

The Advisory Commission on Intergovernmental Relations applauds the Supreme Court's recognition in *National League of Cities v. Usery* that

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

At the same time, however, the Commission finds that subsequent rulings have eroded the basic Tenth Amendment principles expressed in *NLC* and, like the governmental entities using *NLC*-type defenses, hopes that the federal judiciary will revive and expand upon the principles expressed in *NLC v. Usery*, particularly those addressing the "basic attributes of state sovereignty" and "integral functions" of state government.

Commission policy related to the *NLC* decision, first adopted in 1982 and reaffirmed in September 1983, speaks at least indirectly to the issues the Court will be facing in the case involving the application of federal wage and hour rules to mass transit workers. The Commission calls directly for the rescission of the Department of Labor's regulations (29 C.F.R.) that classifies ten government functions, including mass transit, as "non-traditional" and therefore subject to *Fair Labor Standards Act*.

One transit authority, long in the legal battle over *FLSA* and a recent loser at the appellate court level, is that of the Chattanooga, Tennessee area. While Chattanooga—like other metropolitan regions—is awaiting a Supreme Court statement before actually implementing the regulations, it has made some estimates of what its costs would be in the event of an unfavorable judgment. Authorities there have identified three types of costs:

1. **Retroactive Costs** dating back to the Labor Department's final regulations in 1979. Such retroactive overtime expenses will cost the transit authority between \$700,000 and \$800,000;
2. **Future Costs** of the *FLSA* regulations will, according to Chattanooga authorities, add 10 percent or \$120,000 to \$150,000 per year to the transit operating budget; and,
3. **Hidden Costs** in payroll and administrative changes necessitated by the *FLSA* regulations.⁵²

Transit authorities say that these additional costs would be extremely difficult for the Chattanooga system to bear.

CONCLUSION

There can be little argument that today mass transit is a governmental function—overwhelmingly owned, operated, and capitalized by governments at all levels. Moreover, in terms of operating expenditures and administration, it is a heavily local function.

When the Supreme Court hears the *San Antonio* case, it will be asked to decide whether mass transit systems are a "traditional" governmental function and therefore protected by the Tenth Amendment against federal direct orders such as those contained in the *Fair Labor Standards Act*. If the Court chooses to define "traditional" strictly in terms of longevity, it is likely to rule against local claims; if, however, the term "traditional" is refined or replaced as an operative legal adjective for protected governmental functions, the outcome is less certain.

Cynthia Cates Colella is a senior analyst in ACIR's Government Structure and Functions Section.

⁵²Telephone conversation with Thomas W. Dugan, General Manager, ATE Management and Service Company, Chattanooga, TN, September 19, 1983.

A Special Report

The Future of the States in the Federal System

The ACIR has extensively documented the pace and extent of state institutional and procedural reform in its forthcoming study, **The States Transformed: Expanded Roles, New Capabilities**. The Commission report should lay to rest many, if not most, concerns about the states' competence to perform their varied tasks. Although not all states have progressed equally, and room for further improvement exists in all 50, they have as a group streamlined, modernized and improved the machinery of governance to the point where the term "transformed" aptly applies.

Today's states are more activist, more representative, more responsive, and more professional in their operations than ever before. Improved capabilities, however, do not assure future effectiveness. By the beginning of the 1980s, states faced a variety of new challenges, including the proposed shifts of responsibilities from the national government under the New Federalism, cutbacks in federal domestic programs, recession and economic change, interstate competition, regulatory shifts, and administration of the new block grants. How states are equipped to face current challenges, what improvements are still needed in state operations, and what states are likely to face in the near future were the subjects of an ACIR hearing held on September 22, 1983 in conjunction with the Commission's review of existing recommendations on the states' role (See "ACIR News" in this issue of **Perspective**).

Expert witnesses with recent or current experiences in state or local government shared their views on the states' record and future role in the federal system. Participants included:

- The Honorable Patrick J. Lucey, Governor of Wisconsin from 1971 to 1977. Former Governor Lucey is currently an Institute of Politics Fellow at Harvard University. He was U.S. Ambassador to Mexico from 1977 to 1979.
- The Honorable Arch Moore, Governor of West Virginia from 1969 to 1977. Former Governor Moore is a practicing attorney in Moundsville and Charleston, West Virginia.
- The Honorable Charles Kurfess, former Speaker and Minority Leader, Ohio House of Representatives from 1973 to 1978, and Speaker from 1967 to 1972. He currently practices law in Bolling Green, Ohio.
- The Honorable Conrad Fowler, Probate Judge and Chairman of the Shelby County (Alabama) Governing Board from 1959 to 1977. He is currently public affairs director for West Point Pepperell in West Point, Georgia.
- The Honorable Tom Moody, Mayor of Columbus, Ohio since 1972.
- The Honorable James Gleason, County Executive of Montgomery County, Maryland from 1971 to 1978. He is currently a professor of government at Montgomery College.
- Neal Peirce, a journalist with the **National Journal**, and co-author of **The Book of America: Inside Fifty States Today**.

In essence, each panel member spoke to the point summed up by Mr. Kurfess: "Now that the states have tooled themselves up rather adequately, we must ask ourselves: for what purpose, for what role?" Although the answer to that question is likely to assume 50 different forms, several themes recurred throughout the discussion.

A Renewed Emphasis on Traditional Responsibilities. The fundamental mission of government, Governor Moore emphasized, is service delivery. Traditionally, the states have been major providers of services in such fields as education, transportation, hospitals and health care, and public welfare (see Table 1). In the years ahead, many of these traditional functions are likely to be increasingly important. Cutbacks in federal aid, combined with restrictions on local revenue raising capabilities, have put the spotlight on states to maintain and, in certain cases, upgrade services the public has come to expect.

A prime example is education. Given their important roles in education, it is not surprising that governors and state legislators are major participants in the current nationwide debate on education. At the ACIR hearing, the discussion revolved around the states' role in financing elementary and secondary education and in equalizing educational opportunities. States vary greatly in their share of state-local expenditures for local education—from over 97% in Hawaii to about 7% in New Hampshire. Over half the states provide at least 50% of state-local expenditures for elementary and secondary education.

Problems can arise when a function, such as education, is heavily financed by one level of government but administered by another. "What is the motivation," Governor Lucey asked, "to consolidate and bring about economic efficiency if you don't have to raise taxes to fund operations?" With proper controls to promote fiscal accountability, Governor Lucey generally supported a strong state role in financing education. Mayor Moody agreed, but for different reasons, pointing out that people in Ohio frequently vote down increased taxes for education because "it is the one area where the people

can strike back against perceived wrongs committed by government at every level." Mayor Moody therefore supported state financing of education costs because people in his state have been reluctant to tax themselves for this critical function. Judge Fowler felt that local funding of public schools to some degree is still important "to insure a substantial voice of the local citizen as to how education funds will be spent."

The National Governors' Association, Mr. Peirce noted, has recognized the states' important role in education when it adopted an eight-step educational reform plan at the governors' annual meeting last August. All those addressing the issue at the ACIR hearing agreed that it will fall to the states in many instances to take the lead in strengthening schools so that today's students can be equipped to participate in and lead tomorrow's economy. The states' role, Governor Lucey stressed, is particularly crucial in promoting equal educational opportunities so that "no child is penalized by accident of birth that puts that child in a district with low property values."

The States' Entrepreneurial Roles. States have traditionally served as "laboratories of federalism." They can try out new approaches before those approaches are adopted by other states or implemented nationally. Certainly, many states today are reinvigorating their entrepreneurial, innovator role. They are establishing "infrastructure" banks, creating state-wide redevelopment and retraining programs, and stimulating international trade and investment. Still ahead for the states, Mr. Peirce pointed out, are major environmental issues, land use control and farmland protection problems, and, of course, the threat of another energy crisis. All of these areas, Mr. Peirce said, lend themselves to unique state approaches or to interstate cooperation which may, or may not, bring in the national government.

The States' Role as "Middlemen" in the Federal System. State responsibilities in partially funding and administering large federal grant programs have become so pervasive that it is easy to forget the relative newness of this "intergovernmental manager" role. Un-

like earlier eras when federal grants were few in dollars and in number, today's \$90 billion in inter-governmental aid (of which three-fourths goes to the states) represents about one-fifth of state budgets.

The growth of the federal aid system has created a sometimes uneasy partnership among the levels of government. "It so often seems that the federal government decides rather unilaterally who is going to administer what and how," Mr. Kurfess stated. Further, he continued, "The federal government, in dealing with states, should deal with states as governmental entities, not just as branches of the national government. We should no longer assume that state governments are not responsible."

Judge Fowler agreed with the thrust of Mr. Kurfess' remarks: "The diversity of the states and of local units ensures that centralized policymaking affecting localities and their work will become cumbersome and inefficient."

Problems in federal-state-local relations arise not just in conjunction with federal grants and their attached rules and regulations but also because of the federal judiciary. "The judicial process is one which always tries to do justice in an individual case, but very seldom looks at the entire environment in which it works," Mayor Moody stated. He charged that the federal judiciary has intervened in basic city operations, often with few results beyond generating new responsibilities in recordkeeping and other administrative tasks.

Mr. Gleason saw the problem that plagues inter-governmental relations as a more basic, systemic one. "The fundamental conclusion I've come to is that Congress just cannot carry out its constitutional duties anymore. We need to find ways that Congress can do its job," Gleason said. In his view, the public interest, as opposed to vested interests, needs to be rediscovered and government made aware of its responsibilities.

Still Needed: Institutional and Procedural Reform. Governor Moore called attention to the need for state institutional reforms, but likened reorganization to "going through a mine field in any one of the more troubled parts of the world." According to ACIR re-

Table 1. Federal, State and Local Share of Finances, 1981-82

	State-Local General Expenditures From ALL Sources			State-Local General Expenditures From OWN Sources			
	Total (millions)	Percentage Financed by: Federal	State	Local	Total (millions)	Percentage: State	Local
U.S. TOTALS							
General	\$433,528.2	20.1%	46.2%	33.7%	\$346,582.9	57.8%	42.2%
Education	154,572.2	9.4	57.4	33.3	140,104.0	63.3	36.7
Public Welfare	56,256.9	56.5	37.9	5.6	24,465.8	87.2	12.8
Health & Hospitals	40,258.1	7.0	47.0	46.0	37,444.0	50.5	49.5
Highways	34,544.4	24.4	46.8	28.8	26,116.9	61.9	38.1

Source: ACIR staff computations based upon data tape provided by the Governments Division, U.S. Bureau of the Census, October 1983.



Mayor Tom Moody and former County Executive James Gleason at the ACIR hearing.

search, some 23 states have gone through the executive branch reorganization minefield since 1964 and virtually every other state has reorganized one or more departments.

At the Commission hearing, questions about the effectiveness of basic state institutional arrangements were raised. "States have never learned the lesson that states are organized on a vertical basis and every one of their organizations has a vertical hierarchy, but all of their problems are horizontal," Mayor Moody stated.

States still need to address the inherent institutional challenge of state-local relations. Cities are not mentioned in the U.S. Constitution, Mr. Gleason reminded the Commission. Their omission from the basic law of the land leaves localities in an ambiguous position. "One of the real problems in local government is to obtain from the legislature the authority to do the job," Judge Fowler noted.

Cities have spent the past 100 years struggling to gain home rule authority from their states, but even when successful, cities may be vulnerable. They are now, for example, potentially liable for antitrust violations. For the most part, states still enjoy protected constitutional status from federal antitrust law and, following a recent Court case, may share their immunity with localities for specified, state-supervised activities. But, as Mayor Moody said, "We have had local self-government since 1912, and we have a real dilemma asking the state to direct us to do something we are already doing."

Basic institutional and procedural relationships between states and their political subdivisions still need to be improved. "States always want to keep the reins on, and that becomes an increasingly serious problem as we move along. I think local governments should be

saying to their states: Give us the money or give us the power, but give us one or the other," Mr. Peirce commented.

Toward a Working Partnership. The Reagan Administration's New Federalism proposal has done more to focus attention on intergovernmental relations than perhaps any other single factor in recent memory. Although the major "swap" of functional responsibilities set forth in 1982 has not yet taken place, it remains a live issue in the minds of many, including some members of the ACIR panel. Mr. Kurfess observed, "Proposals for realignments of governmental functions have usually been based upon the cost of those functions and where the money should be coming from. . . . I would suggest that we look not just at what level is best equipped to raise the funds but also at what level is best equipped to effectively administer the function in question."

The debate over sorting out responsibilities still has not received the national attention it deserves, Mr. Peirce noted when he reiterated his call for a national convocation on federalism. Our local, state and national leaders need to begin setting a reform agenda because, in Mr. Gleason's words, "you have to raise the level of discussion of this problem; it has to be put upstairs."

Regardless of how the New Federalism evolves, a kind of de facto New Federalism is already taking place. People and their elected officials at the state and local levels are no longer looking to Washington as they once might have to solve their problems. Mayor Moody observed, "People are paying attention to solving their own problems, which was the President's initial thrust." No one, for example, really expects a new Marshall Plan from the federal government for education, Mr. Peirce said, and further, "States must be expected to take their expanded responsibilities. They have little choice; they will have to do that because eventually their citizenry will demand it."

In short, the history of intergovernmental relations for at least the past 20 years has been of centralization. In coming decades, if ACIR panel members are right, we may see a movement in the opposite direction.

Perhaps the primary factor causing the tide of centralization to crest and retreat is pressure on the federal fisc. With a \$200 billion deficit in the federal budget, Judge Fowler commented, we are seeing "a diminution of the federal role and the renewed emphasis on the states to solve problems." Mr. Peirce put the same trend another way: "If your senior partner is weak fiscally, you may find a lot more on your plate, however planned or not."

The bottom line, panel members appeared to agree, is an effective, efficient working partnership between and among the levels of government. "What we need now more than ever," Mr. Kurfess stated, "is a generation of public officials dedicated not just to making their governmental entity or institution more effective and more competitive, but to making the entire federal system more efficient and more effective in serving their constituents at every level of government."—**Stephanie Becker**

ACIR Finds States "Transformed," Reviews Reform Recommendations

At its fall meeting on September 22 and 23, the Advisory Commission on Intergovernmental Relations considered the findings and recommendations stemming from its forthcoming study, **The States Transformed: Expanded Roles, New Capabilities.** Today's states, the Commission concluded, are more representative, more responsive, more activist and more professional in their operations than ever before. Over the past two decades, states have implemented procedural and institutional reforms to the point where they can, as a group, be termed "transformed." They are now better equipped to assume and fulfill their expanded roles as "middlemen" in the federal system. "The states are," the Commission found, "pivotal actors in our federal system." Because of this critical role, the Commission called upon state leaders to "recognize the necessity for state leadership if future public policy challenges are to be successfully surmounted."

One area where the ACIR urged states to take a stronger lead is in building better state-local partnerships. State legislatures should direct their attention to matters requiring statewide uniformity and grant localities greater authority over matters requiring judgments of local preferences and needs. Specifically, the Commission said, states should provide adequate funding for the costs of local compliance with state mandates. In addition, the Commission reiterated its position that states should permit localities to diversify their revenue systems. The Commission also reaffirmed its longstanding belief that state-local tax systems should be equitable, diversified and productive so that they are capable of underwriting a major portion of state-local expenditure requirements. Further, the Commission urged that state personal and corporate income taxes be indexed to prevent unlegislated tax increases due to inflation "bracket creep."

The Commission also went on rec-

ord as affirming that education is primarily a state-local function and that it is the responsibility of these governments to structure their school systems. States have the responsibility, however, for ensuring equal educational opportunity. States additionally bear the responsibility, in the Commission's view, for financing state court costs and the costs incurred by local court systems that are adjudicating state laws.

As part of its review of prior Commission recommendations, the Commission also reaffirmed support for:

- Legislative oversight of federal funds;
- Codification, publication and review of state regulations;
- County modernization;
- Reassessing state regulatory and licensing boards and commissions;
- Reducing the use of state boards and commissions for "line agency" functions; and,
- Employing user charges when beneficiaries of government services are readily identifiable.

The Commission is expected to continue its review of recommendations regarding state reform and state-local relations at its December meeting.

ACIR Membership Expansion Passes Senate, Awaits House Action

Legislation has been introduced in both the House and the Senate to expand the membership of ACIR. Senator Roth's (DE) bill (S. 1052) would increase ACIR's membership by two, including an elected officer of a township and an elected school board member. Congressman McGrath's (NY) bill (H.R. 1617) would increase the membership by four, giving representation to school boards, towns and townships, and federal and state judges. Senator Andrews' (ND) bill (S. 1249) and Congressman McCain's (AZ) bill (H.R. 2536) would increase the membership by one to include a representative of Indian tribal governments.

On September 12, President Reagan spoke at the National Association

of Towns and Townships in support of having a town or township member placed on the Commission. On September 14, the bill introduced by Senator Roth to provide such representation passed the Senate by voice vote. Similar legislation is now pending in the House Government Operations Committee.

Last May, the Senate Select Committee on Indian Affairs held a hearing on tribal representation on ACIR. There has been no action on the counterpart House bill which is pending in the Intergovernmental Relations and Human Resources Subcommittee.

The Commission has opposed expanding its membership, and has recommended that any new representation, such as towns and townships, should be incorporated within the existing 26 member size of the ACIR. In judging individual proposals regarding membership composition, the Commission has consistently applied five criteria:

1. A balance should be maintained among the federal, state and local levels of government.
2. A balance should be maintained among political parties.
3. Governments represented on the Commission should be general purpose, rather than special purpose or single purpose.
4. The membership should be largely limited to elected officials of general governments.
5. Governments represented on the Commission should occur in all, or nearly all, states of the nation.

Next ACIR Meeting December 8, 9

ACIR's next meeting is scheduled for December 8 and 9 in Washington, DC. At that time, the Commission is expected to consider findings and recommendations from two major studies: problems in financing public physical infrastructure and state assistance to distressed communities. In addition to continuing their review of existing recommendations on state reform, Commission members are expected to review proposals for reducing municipal antitrust liabilities.

New Working Group on Unitary Tax Formed, Three ACIR Members Named to Serve

In a September 23 press release, Secretary of the Treasury Donald T. Regan announced the formation of a working group to study the unitary tax issue. The group's purpose, according to the release, is to develop a federal policy that is "conducive to harmonious international economic relations, while also respecting the fiscal rights and privileges of individual states." In *Container Corporation of America v. Franchise Tax Board*, the Supreme Court last June upheld California's use of the unitary tax. [For a more complete discussion of the *Container* case, see **Intergovernmental Perspective**, Vol. 9, No. 3, pp. 14, 15.] The Reagan Administration has rejected the suggestion that it file an *amicus* brief supporting a petition filed by Container Corporation asking the Court to rehear the case. Instead this working group has been appointed to study the issue and develop policy.

The working group will include private citizens and representatives of the federal government, state governments, and the American business community. Three ACIR members were named to the working group—Chairman Robert B. Hawkins, Utah Governor Scott Matheson, and North Dakota State Senate Majority Leader David Nething.

Last Spring, the Commission issued its report, **State Taxation of Multinational Corporations (A-92)**, setting forth ACIR's research findings and recommendations on the unitary tax. In the Commission's judgment, states should be allowed to continue using the unitary or worldwide combination method in taxing multinational corporations. In arriving at this recommendation, the Commission weighed, among other factors, whether or not state use of the unitary tax methodology had caused "serious national harm." ACIR's investigation produced no evidence that harm to the nation had been done; there has been no cut-back in foreign investment, no retaliatory taxation on U.S. corporations operating abroad, and no refusal by foreign govern-

ments to conclude tax treaties with the U.S. government. Without proof that serious national harm had been done, the Commission felt that Congress should not enact legislation limiting state tax practices affecting multinational corporations.

ACIR Testifies on Entitlement Programs

On October 4, 1983, ACIR Executive Director S. Kenneth Howard testified before the Congressional Task Force on Entitlements and Human Assistance Programs. Speaking on behalf of the Commission and as a former state budget office director, Howard told the Task Force:

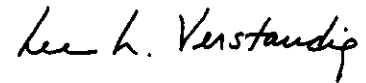
Although heavily supported by the national government, they (i.e., entitlement and human assistance programs) typically require matching financial support from state and local units; both the national and state levels practice the golden rule that he who has the gold makes the rules.

Difficulties in implementing these programs arise, Howard pointed out, not simply because of the rules attached by the national and state levels, but also because the programs themselves are volatile. Projecting Medicaid costs, for example, with an aging population and rapidly rising health-care costs, takes "monumental luck," Howard stated. Congress can help, he urged, by providing states with adequate notice before making major program changes. Howard also encouraged clarifying national rules and providing adequate consultation with state and local officials before new regulations are promulgated.

(continued from page 2)

onstrating anew the rewards of a federal system—the ability to adapt, innovate, and allow multiple units of government to address the needs which can best be handled at their level.

Over the coming months, the task of ACIR will be to recognize that this new season is here in earnest; that, indeed, we are not a unitary system of government, and that states and localities have inherent powers distinct from those granted to Washington. It is the story of the reaffirmation of the sound principles underlying a federal system of government, which the Commission looks forward to continuing to report to you in **Intergovernmental Perspective** and other publications. We'll all be watching these pages.



Lee L. Verstandig
Assistant to the President for
Intergovernmental Affairs

THE PROPERTY TAX PARADOX

by John Shannon

A wonderful Pennsylvania Dutch expression best describes the paradoxical behavior of the property tax—"The faster it runs the behinder it gets." For example, property tax collections more than quadrupled between 1962 and 1982,* rising from approximately \$18 billion to \$78 billion. Despite this impressive growth, the share of *total own source* local revenue contributed by the property tax dropped from 69% in 1962 to 48% by 1982.

What has toppled the once mighty property tax from its position of absolute dominance in the local revenue field? The quick answer is local revenue diversification. To be more specific, local property tax collections have not grown as rapidly as have the receipts from an assorted collection of local non-property-tax revenue producers—local option income and sales taxes, selected excises, user charges and interest on idle cash.

These powerful forces have propelled the local revenue diversification movement:

- (1) local governments' persistent need for more revenue;
- (2) public hostility toward the local property tax; and,
- (3) local officials' ceaseless search for less painful ways to raise revenue.

As clearly illustrated by the accompanying figure, cities have advanced much farther along the local revenue diversification route than have the counties and the school districts. The relatively modest municipal dependence on the property tax is due partly to the fact that many cities enjoy wide latitude in choosing their revenue instruments—thanks to their home rule charters. Also, many state municipal leagues have successfully lobbied state legislatures in support of greater revenue powers for their constituent members.

As a result, the typical American city now has a revenue system resembling a three-legged stool. One leg is the property tax; the second leg, local non-property taxes; and, the third, other local revenues—mostly user fees and interest on investments.

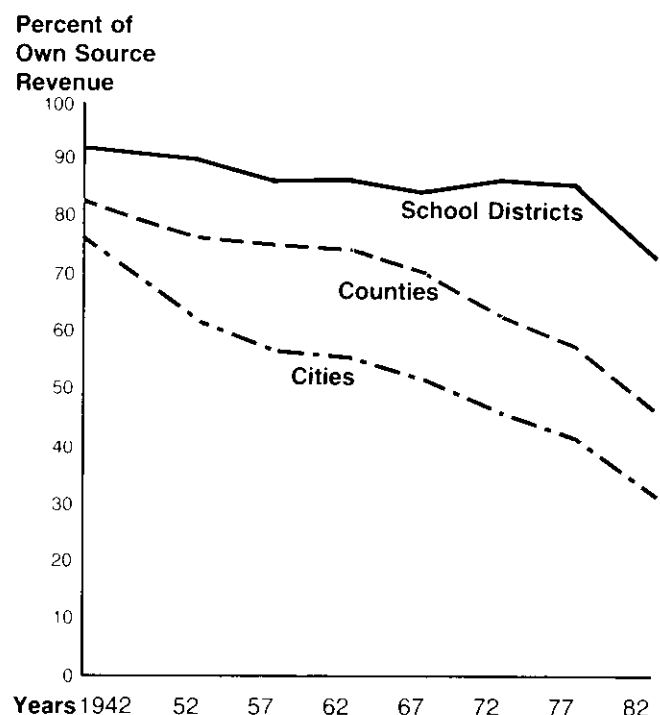
In examining these aggregate data, two caveats must be kept in mind. First, national averages always conceal tremendous variations within our diverse system of fiscal federalism. Cities in New Hampshire are still extremely dependent on the local property tax—in 1982, that tax accounted for 75% of all their own-source revenue. By comparison, Alabama cities have virtually shed their property tax skin—their property tax produced only 7% of their own-source revenue in 1982.

The second caveat is even more important; it would be very risky to make a straight line extrapolation from past trends and predict that most cities and counties will so be able to throw away their property tax hair shirts.

There are several factors that suggest that the property tax will continue to play a fairly important revenue role for most municipalities and counties. A sharp upswing in property tax collections since 1982 suggests that when 1983 Census data become available it may reveal that for the first time in many years property tax receipts rose at a faster clip than did receipts from other local revenue producers. The reduction in federal aid and the recession have apparently forced many local governments to bear down somewhat harder on their old standby, the property tax. It should also be noted that one of the fastest growing items on the non-property tax side of the local revenue ledger—interest on earnings—may not be able to maintain its startling growth rate. Between 1977 and 1982, local governments' interest earnings soared from \$5 billion to \$13 billion as localities quickly took advantage of rapidly rising interest rates.

It is probably safe to assume that the venerable local property tax will neither disappear rapidly from sight nor will it stage a sustained comeback. Rather, its relative importance will decline very slowly as the revenue systems of cities and counties become more diversified.

Chart 1
Property Taxes As a Percentage
of Own Source Revenue



*All references to years continued in this "Fiscal Note" are to fiscal years.



The Chairman's View

Dear Reader:

A federalism conflict is brewing between state and national rules for taxing multinational corporations. The issue stems from the fact that several states use the worldwide combination approach for determining the taxable income of multinational firms. The Treasury Department and numerous businesses have taken the position that these state practices do not conform to internationally accepted standards that account for the income of corporations located in each country. It followed, then, that these state tax practices worked against a national interest—international tax harmonization—to promote the free flow of foreign commerce.

THREE FEDERAL INTERVENTION TESTS

Conflicts between the foreign commerce concerns of the national government and the tax autonomy of the states cannot be resolved without specific criteria or tests to evaluate the merits of the competing claims.

The first test is the **pre-dominant national interest test**. Here, restrictive federal action against the states is appropriate if a state activity falls

clearly within the domain of the national interest that reasonable doubts must be resolved in favor of action by the national government. It is not necessary under this test to show that the nation has been seriously harmed or even that it might be harmed in the future by the failure of the national government to act. It is only necessary to assert that the national government must be free to pursue the national interest (i.e., international tax harmonization) without hindrance or obstruction by the states. Where the foreign commerce concerns can be identified as predominant, state interests must give way "beyond the water's edge."

The second test is the **potential national harm test**. In this case, restrictive congressional action could be justified on the grounds that failure to act might cause a substantial drop in foreign investment in the United States or widespread retaliation by several foreign countries against American business firms operating abroad. Examples of potential harm are to be found in the recent statements of British officials warning of possible retaliation against American firms.

The third and the most stringent alternative test to justify federal restrictive action against the states is the **demonstrated serious national harm test**. Here, restrictive national action could be taken only after clear and convincing evidence shows serious economic or political harm being done to the nation by the failure of states to harmonize

their tax practices with those of the federal government and foreign countries. Such national harm could be incurred, for example, if many foreign corporations failed to invest in the U.S., or if foreign governments imposed retaliatory taxation on U.S. corporations operating abroad.

The demonstrated national harm test is clearly superior to the other two tests because it forces national policymakers to balance two equally important constitutional concerns—promoting the free flow of foreign and domestic commerce and insuring states wide latitude in charting their own tax policies. To put the issue more sharply, only a persuasive demonstration of serious national harm should trigger the prohibitions of the foreign commerce clause upon the states. As noted in the ACIR report, **State Taxation of Multinational Corporations**, the staff investigation produced no evidence that state use of worldwide combination had caused serious harm to the nation.

Robert B. Hawkins
Chairman

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(November 1983)

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