

## Who Should Authorize a Commuter Tax?

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*The decision to impose a commuter tax—a tax on income earned within the city by nonresidents—is typically made at the state level. There are both doctrinal and economic reasons for this allocation of authority. Cities are creatures of the states of which they are political subdivisions, and legal doctrine requires that they receive either state legislative or constitutional approval before exercising authority. States have jealously guarded their prerogatives over the taxing power. Perhaps there is nothing surprising about this state of affairs with respect to commuter taxes. After all, the natural stopping point for the exercise of unrestricted local authority is legislation that imposes significant externalities. Since, by definition, the commuter tax falls on nonresidents, the predicate of external effects appears to be satisfied. The underlying assumption is that the state legislature, which represents both city residents and commuters, is in a better position than the levying city to determine whether, in the absence of such a tax, commuters confer benefits on the city that sufficiently offset the costs they impose. In this Article, I accept the principle that the decision to tax should be allocated to that level of government that is best positioned to balance the social costs and benefits of the proposed exaction. I argue, however, that the workplace city, not the state, plausibly occupies that position. I contend that cities have incentives to take the external costs of commuter taxes into account, but that state representatives have fewer incentives to consider the benefits, as well as the costs of such a tax. I note that the decisionmaking structure of state legislatures creates a bias against a commuter tax, and contains few mechanisms that would induce the state to consider the net benefits that a city would enjoy from the tax. Finally, I suggest that a commuter tax could be a more appropriate means of defraying costs imposed by commuters than alternative fiscal instruments. Thus, I tentatively conclude that cities should be entitled to authorize the imposition of a commuter tax without prior state authorization.*

### INTRODUCTION

A few cities within the United States impose a commuter tax—a tax on income earned within the city by nonresidents.<sup>1</sup> Perhaps more

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Thanks for comments from participants in the Symposium, *Reassessing the State and Local Government Toolkit* at The University of Chicago Law School and a faculty workshop at New York University School of Law.

<sup>1</sup> See Paul Gessing, *Commuter Taxes: Milking Outsiders for All They're Worth* (NTUF Policy Paper, June 18, 2003), online at [http://www.ntu.org/main/press\\_papers.php?PressID=148&org\\_name=NTUF](http://www.ntu.org/main/press_papers.php?PressID=148&org_name=NTUF) (visited Oct 31, 2009) (noting that several cities have sought to implement commuter taxes, including New York City, Indianapolis, Pittsburgh, and Atlanta). New York City imposed a tax on all commuters until 1999, when the tax was repealed and replaced with one that imposed a tax only on non-New York State commuters. That tax was invalidated under the Commerce Clause in *City of New York v State*, 730 NE2d 920, 930–31 (NY 2000) (holding that the commuter tax was unconstitutionally discriminatory). For a discussion of commuter taxes in

cities would if they had the authority to do so, especially in light of the financial stress that localities face in the current economic climate.<sup>2</sup> A recent report from the Pew Foundation reveals a variety of measures that cities are taking to respond to a fiscal emergency that has resulted from significant decreases in tax revenues during the current recession.<sup>3</sup> Many of these measures involve service reductions.<sup>4</sup> But cities have also considered the possibility of increasing taxes and fees or exploring new revenue sources. There is little doubt that commuters remove a sizeable amount of potentially taxable income from cities, and thus serve as a plausible font of revenue. The Bureau of Economic Analysis has estimated that New York City experienced an outflow of commuter earnings in excess of \$183 billion in 2007.<sup>5</sup> New York City, of course, may be an extreme case, but outflow of earnings is pervasive. Cuyahoga County, where Cleveland is situated, experienced an outflow of \$12 billion, while Cook County saw \$43.6 billion of income enter commuters' pockets.<sup>6</sup>

Cities, however, face legal, as well as practical, obstacles to imposing commuter taxes. Cities are creatures of the states of which they are political subdivisions, and standard legal doctrine requires that cities receive either state legislative or constitutional approval before exercising powers.<sup>7</sup> As Gerald Frug and David Barron have illustrated in their recent critique of the limited scope of local revenue-raising authority, states have jealously guarded their prerogatives over the taxing power, especially when exercise of that power entails imposing obligations on nonresidents.<sup>8</sup> Those states that have adopted *imperio* home rule provisions typically constrain local authority to initiate leg-

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New York City, San Francisco, New Hampshire, and the District of Columbia, see generally Herbert Kaylor, *The Experience of Several Cities in Implementing a Commuter Tax*, 33 State Tax Notes 117 (2004).

<sup>2</sup> See Clayton P. Gillette, *Fiscal Home Rule*, 86 Denver U L Rev 1241, 1241 (2009) (suggesting that local revenue-raising initiatives could theoretically offset drastic budget cuts such as those recently imposed in New York City and California).

<sup>3</sup> See Pew Charitable Trusts, *Tough Decisions and Limited Options: How Philadelphia and Other Cities Are Balancing Budgets in a Time of Recession* 4–9 (May 2009), online at [http://www.pewtrusts.org/our\\_work\\_report\\_detail.aspx?id=52092](http://www.pewtrusts.org/our_work_report_detail.aspx?id=52092) (visited Oct 21, 2009).

<sup>4</sup> *Id.* at 1.

<sup>5</sup> See *Gross Commuters' Earnings Flows*, Table CA91 (Bureau of Economic Analysis 2009), online at <http://www.bea.gov/regional/reis/default.cfm?selTable=CA91&section=2> (visited Oct 31, 2009).

<sup>6</sup> *Id.*

<sup>7</sup> See Clayton P. Gillette, *In Partial Praise of Dillon's Rule, or, Can Public Choice Theory Justify Local Government Law?*, 67 Chi Kent L Rev 959, 963 (1992).

<sup>8</sup> Gerald E. Frug and David J. Barron, *City Bound: How States Stifle Urban Innovation* 61 (Cornell 2008) (“[N]owhere does home rule give cities local autonomy.”).

islation to “municipal affairs,” a category that might be thought to exclude revenue-raising from extraterritorial sources. Even many states that grant broader constitutional home rule to their cities remove the taxing power from those grants.<sup>9</sup> To my knowledge, no city has successfully claimed that the right to impose a commuter tax inheres in its home rule authority.<sup>10</sup>

Perhaps there is nothing surprising about this state of affairs. After all, the natural stopping point for the exercise of unrestricted local authority is legislation that imposes significant externalities. The conventional economic theory of federalism allocates governmental functions in accordance with the spatial properties of the public goods that each level of government might provide.<sup>11</sup> The underlying assumption is that the level of government that can best internalize externalities has the superior incentives to make socially optimal decisions. Similarly, the conventional story of Tieboutian sorting contains an assumption that public service provision (and presumably payments that support it) implicates no external effects.<sup>12</sup> The use of externalities to define the dividing point between those activities that should be available to the locality on its initiative alone and those that require approval from some more centralized entity is predicated on an assumption that, left to its own devices, the locality would ignore external effects and make decisions only after considering intramural, rather than social, costs and benefits. The implicit underlying supposition is that a more centralized jurisdiction, which will internalize all the costs and benefits of the proposed activity, is better situated than the locality to decide the socially desirable scope of the activity. Since, by definition, the commuter tax falls on nonresidents, the appropriate governmental deci-

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<sup>9</sup> See Gillette, 86 *Denver U L Rev* at 1245–46 (cited in note 2).

<sup>10</sup> The New York Court of Appeals rejected the proposition that a commuter tax was a matter of home rule in *City of New York v State* on the grounds that taxation of commuters involved a matter of substantial state concern. 730 NE2d at 926. The court also invalidated state legislation that limited the commuter tax to non–New York State residents. *Id.* at 930. The court found that limitation invalid under the Privileges and Immunities Clause and the Commerce Clause of the Federal Constitution. *Id.* at 929–31 (stating that the Privileges and Immunities Clause “unmistakably secures and protects the right of the citizens of one State to be exempt from any higher taxes or excises than those imposed by another State upon its own citizens”).

The local government of the District of Columbia has been prohibited by Congress from enacting a commuter tax, notwithstanding the general grant of home rule. See DC Code § 1-206.02(a)(5) (West) (restricting the council’s ability to impose a tax on nonresidents).

<sup>11</sup> See Geoffrey Brennan and James M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* 174 (Cambridge 1980) (noting, however, that the conventional theory does not prove the case for federalism because larger governmental units could simply decentralize administration to the appropriate level).

<sup>12</sup> Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 *J Polit Econ* 416, 419 (1956).

sionmaker presumably lies at the state level because all payers (at least state-resident payers) as well as the city that seeks to impose the tax are represented in the state legislative process.

In what follows, I raise some objections to this view. As a general matter, the allocation of decisionmaking responsibilities in a manner that induces internalization of costs and benefits is perfectly befitting. But centralized jurisdictions that directly internalize all the costs and enjoy all the benefits of local action do not necessarily balance those factors in a manner that reflects social interests. Instead, political dynamics within the jurisdiction may cause distorted emphasis on either costs or benefits. Moreover, localities may have incentives to internalize the external effects of their activities so that external effects are considered in the local calculus of costs and benefits. Indeed, the concept of externalities necessarily implicates issues of degree and internal consideration of extraterritorial effects in order to avoid rendering home rule a nullity. All “local” action can be reclassified in ways that suggest extramural consequences: living wage ordinances that apply only to municipal employers allegedly distort state labor markets;<sup>13</sup> local ordinances that prohibit local discrimination on the basis of sexual orientation allegedly may conflict with state sensitivities about proper conduct;<sup>14</sup> and local rent control ordinances allegedly affect state housing markets.<sup>15</sup> Richard Briffault has recently catalogued the wide range of instances in which localities have been permitted to exercise extraterritorial authority, ranging from extensive use of extraterritorial zoning power to police power regulation and extraterritorial provision of municipal services.<sup>16</sup> Obviously, the mere invocation of external effects resolves little about the scope of municipal authority either to initiate legislation without prior legislative consent or to immunize municipal legislation from subsequent state preemption.

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<sup>13</sup> See *New Orleans Campaign for a Living Wage v City of New Orleans*, 825 So 2d 1098, 1107–08 (La 2002) (finding that a proposal to raise the minimum wage in New Orleans abridged the state’s regulatory power, as the state is entitled to set a uniform state-wide minimum wage in order to “preserve consistency in the wage market”).

<sup>14</sup> See *Romer v Evans*, 517 US 620, 646–48 (1996) (Scalia dissenting) (arguing that state-wide initiative denying protected status on basis of sexual orientation should prevail over conflicting local initiatives as representing an “effort by the majority of citizens to preserve its view of sexual morality statewide”). For a critique of this rationale, see Clayton P. Gillette, *The Exercise of Trumps by Decentralized Governments*, 83 Va L Rev 1347, 1402–05 (1997).

<sup>15</sup> See *Town of Telluride v Lot Thirty-four Venture*, 3 P3d 30, 38 (Colo 2000) (stating that local rent control ordinances can change the “dynamics of supply and demand” in the housing markets and that consistent prohibition of such ordinances encourages “high quality rental units”).

<sup>16</sup> Richard Briffault, *Town of Telluride v. San Miguel Valley Corp.: Extraterritoriality and Local Autonomy*, 86 Denver U L Rev 1311, 1313–17 (2009).

Instead, two factors appear to dominate the inquiry into external effects. The first is simply the extent of the intrusion. The fewer the effects, or the less intensively they are felt, the less reason to deny municipal authority. Given the size of the income outflows to commuters, however, there is little claim that a commuter tax worth its administrative costs falls into the *de minimis* category. The second factor, however, is more relevant. It involves the risk of exploitation. The concern about externalities is that localities will engage in activities from which they benefit, but the costs of which are imposed on nonresidents to whom local officials are not accountable. As a result, localities have incentives to engage in conduct that produces net local benefits, but that creates net costs from the social perspective. But if the risk of externalities involves exploitation of disenfranchised nonresidents, not simply the fact that external effects exist, then one could imagine situations in which local decisions that have extraterritorial effects are unobjectionable because local decisionmakers have sufficient incentives to consider external costs as well as net internal benefits.

In what follows, I argue that this rationale for understanding the scope of local autonomy, and hence the doctrine of home rule, plausibly permits the decision to impose a commuter tax to be left with the taxing city alone. In an ideal world, the decisions about who should pay for a set of local public goods and which fiscal instruments should be used to effect those payments would arguably be made by that level of government best able to balance the social costs and benefits of various funding alternatives. In short, the decision should be made in a manner consistent with principles of internalization. That might mean assigning the decision about a commuter tax to a unitary government that comprises both the central city that received the revenue and the suburbs that would bear the burden. But if an existing entity could reflect those same interests, then the creation of an additional bureaucratic structure seems superfluous. I argue, counterintuitively, that under realistic circumstances, it is the city that imposes the tax rather than the state that traditionally authorizes it that is best positioned to mimic the calculations of the ideal unified, metropolitan decisionmaker. Thus, I conclude that cities should be entitled to authorize the imposition of a commuter tax without prior state authorization.

### I. WHY A COMMUTER TAX?

The rationale for a commuter tax proceeds from the simple observation that nonresidents who work or shop in the city take advantage of public goods that are dedicated to public safety, street maintenance, sanitation, and so on, but make no direct contribution toward

defraying their cost. As a result, a commuter tax is allegedly necessary in order to match the benefits of city-financed services with the burdens that their provision requires. Early commentators supported some form of taxation on commuters who were perceived as necessarily imposing net costs on the central city.<sup>17</sup> Commuter taxes, on this view, reflect the same efficiency rationale as user fees. Failure to assess taxes not only allows commuters to free ride on the contributions of residents to local public goods. It also denies an opportunity for local officials to receive corrective signals concerning preferences for a set of local public goods, as evidenced by the willingness of consumers to pay for them.<sup>18</sup> Commuters who are able to utilize public goods without making commensurate payments have incentives to consume them to a degree that exceeds the marginal cost of providing them. Imposing offsetting taxes, on the other hand, is likely to improve the efficiency of government provision by mimicking competitive pricing models and delivering only those services that users value in amounts at least as great as their cost.

Wholly apart from the efficiency-enhancing elements of the commuter tax, a fairness element arises if both residents and nonresidents utilize the public good, but only the former contribute toward its provision. Commuters, moreover, are often assumed to earn higher wages in the city than the average city resident.<sup>19</sup> Thus, to the extent that the city is appropriately engaged in redistributive functions that depend on payments related to the ability to pay, commuters who benefit from the city's redistributive efforts (for instance, by attracting a better workforce as a result of redistributive educational payments within the city) should also contribute to that function. The upshot of these rationales, which at an early point in the debate assumed the somewhat tendentious heading of the "suburban exploitation" theory, is that commuter taxes are justified to compensate for the ability of commuters to avoid payments for municipal services generally, whether those payments would have defrayed the costs of providing specific ser-

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<sup>17</sup> See, for example, Amos H. Hawley, *Metropolitan Population and Municipal Government Expenditures in Central Cities*, 7 J Soc Issues 100, 100-01 (1951) (assuming commuters increase the need for service expenditures in a municipality and are thus a tax burden on residents).

<sup>18</sup> See Clayton P. Gillette and Thomas D. Hopkins, *Federal User Fees: A Legal and Economic Analysis*, BU L Rev 795, 805 (1987).

<sup>19</sup> See David M. Herszenhorn, *The Mayor's Budget Plan: Commuters; Tax Plan for Non-residents Aims at Where the Money Is*, NY Times B4 (Nov 16, 2002) (describing it as "certain" that commuters who work in New York City earn "far more, on average" than city residents).

vices utilized by commuters or would have contributed to the redistributive objectives of the city that presumably also benefited commuters.<sup>20</sup>

But these rationales for commuter taxes ignore the benefits that nonresidents confer on central cities by virtue of working there. Commuters generate additional municipal revenues by increasing business activity in the city. Nonresident workers pay substantial sales and meal taxes to the extent that their daily routines include shopping and dining in the city, and frequently pay tolls to enter the city. Employers may pay payroll or other taxes related to employment. Even if commuters do not pay explicit fees or taxes that are used to defray expenditures on public goods that they consume, they allegedly support economic activity that increases employment and profits that generate tax revenues for the city, and that do not substitute for activities that would otherwise be generated by city residents. Finally, commuters pay state taxes, and state equalization programs funded with those taxes allegedly compensate for disparities that might remain as a consequence of commuter use of central city resources.<sup>21</sup> As a result, opponents of commuter taxes assert that commuters already pay their own way and the supposition that commuters impose excess costs on cities is misinformed.<sup>22</sup>

The arguments about the propriety of a commuter tax, therefore, are crucially contingent on the extent to which commuters directly or indirectly pay their “fair share” for city services. The evidence on the competing empirical claims, however, is highly contestable. Much of the evidence supports the proposition that commuters increase local public spending in central cities.<sup>23</sup> This seems logical, since most local public goods will be subject to congestion, so that the addition of commuters will impose additional costs on the city and its residents for providing those goods. Less clear, however, is the extent to which commuter activity offsets those additional costs. Even less clear is the proper response to any additional costs, benefits of commuter economic activity aside. The fixed costs of providing certain local public

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<sup>20</sup> For a discussion of the “suburban exploitation” theory, see Brett W. Hawkins and Douglas M. Ihrke, *Reexamining the Suburban Exploitation Thesis in American Metropolitan Areas*, 29 *Publius* 109, 110 (1999) (noting that the primary claim of the theory is that “suburbs impose costs on central cities without compensating them”).

<sup>21</sup> See *id.* at 110–11. Hawkins and Ihrke also suggest that city residents frequently take advantage of suburban services, creating an offset to the usual assumption that suburbanites exploit city services. They also suggest that the existence of suburbs creates jurisdictional competition in metropolitan areas that generates tax savings for city residents.

<sup>22</sup> See *id.* at 109.

<sup>23</sup> See text accompanying notes 24–45.

goods, such as potable water, may so dominate the cost of provision that using pricing models based on marginal costs results in individual payments that are too small to make their collection worthwhile.

Nevertheless, various researchers have attempted to assess the impact of commuters. Helen Ladd and John Yinger estimated the effects of various environmental factors,<sup>24</sup> including the city's share of the metropolitan population and the size of the employment sector in the city.<sup>25</sup> They concluded that a central city with a small percentage of the metropolitan population must spend more per resident on crime protection, traffic control, parking, parks, and other general services than cities with populations that constitute larger shares. A 10 percentage point difference in share of the metropolitan population translated into a 4.6 percent higher cost for general services and a 6.2 percent higher cost for police services in the city with the smaller share.<sup>26</sup> Ladd and Yinger also found that the costs of city services increased along with the size of employment in the city relative to city population. A 10 percent difference between two cities in private employment was associated with a 2.9 percent higher cost for general services and a 3.9 percent higher cost for police and fire services in the city with higher employment.<sup>27</sup>

Roy Bahl similarly finds a positive correlation between employment in the city and city operating expenditures.<sup>28</sup> But he is agnostic on whether the revenue effects of employment due to commuters offset the additional costs.<sup>29</sup> Howard Chernick and Olesya Tkacheva sought to estimate public expenditures in New York City as a function of private sector jobs in the city.<sup>30</sup> Based on a study of 24 big cities, they found that an increase of 10 jobs per 100 of population corresponds to a 2.5 percent increase in public expenditures and a 4.5 percent increase in expenditures for police and firefighters.<sup>31</sup> They calculated that commuter jobs increased New York City expenditures by \$1.2 to \$1.9 billion in 1997, of which about \$185 million consisted of

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<sup>24</sup> Helen F. Ladd and John Yinger, *America's Ailing Cities* 82 (Johns Hopkins 1989).

<sup>25</sup> *Id.* at 87.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> Roy W. Bahl, *Metropolitan City Expenditures: A Comparative Analysis* 22–23, 31 table 4 (Kentucky 1969).

<sup>29</sup> *Id.* at 23.

<sup>30</sup> See Howard Chernick and Olesya Tkacheva, *The Commuter Tax and the Fiscal Cost of Commuters to New York City*, 25 *State Tax Notes* 451, 455 (2002).

<sup>31</sup> *Id.* at 451.



additional police and fire expenditures.<sup>32</sup> They further calculated that these figures exceeded the additional tax revenues for the city generated by commuters' jobs.<sup>33</sup> Nevertheless, they conceded that their estimates "do not answer the question whether commuters to New York City pay their own way in fiscal terms, nor do they provide an assessment of the net benefits for commuters—that is, value of services minus taxes paid."<sup>34</sup>

Martin Shields and David Shidler provided some very cautious support for the exploitation thesis in a study of the effects of commuters on local government expenditures in Pennsylvania.<sup>35</sup> They examined the effects of commuting on congestion of public goods in the central city and resident communities. They concluded that commuters cause congestion of public goods and that, at least for some public goods such as police, libraries, and parks (though, oddly, not for roads), the marginal expenditure incurred by the workplace community as a result of an additional user exceeded the marginal expenditure incurred in the residence community as a result of an additional user.<sup>36</sup> They inferred that commuters could be failing to pay the costs related to their marginal congestion effect, and suggested that a commuter tax could alter the allocation of city and suburban populations to better reflect the optimal provision of public goods.<sup>37</sup> They admitted, however, that they did not account for the revenue side of commuter behavior, such as payment of occupational taxes to the workplace community or taxes paid by the employer that arguably compensate a municipality for the costs of public goods utilized by the employer's employees.<sup>38</sup> Given the small marginal effect they found, they concluded that a small amount of revenue from these sources could offset the congestion effect.<sup>39</sup>

Other studies take a different approach to the exploitation issue. William Neenan's study concluded that suburban commuters ex-

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<sup>32</sup> Id (explaining that over 25 percent of private sector jobs in New York City were held by commuters in 1996).

<sup>33</sup> Id at 455 (suggesting the revenue generated by commuters' jobs is close to \$1.55 billion, and therefore may be less than the extra expenditures associated with those jobs).

<sup>34</sup> Chernick and Tkacheva, 25 State Tax Notes at 455 (cited in note 30).

<sup>35</sup> See Martin Shields and David Shidler, *Do Commuters Free-Ride? Estimating the Impacts of Interjurisdictional Commuting on Local Public Goods Expenditures*, 33 J Regional Analysis & Pol 27, 40–41 (2003).

<sup>36</sup> Id at 38 (finding that for police, the marginal expenditure in the workplace community is \$54, compared to \$39 in the resident community; for parks and libraries, the marginal expenditure is \$23 in the workplace community and \$9 in the resident community).

<sup>37</sup> Id.

<sup>38</sup> Id at 40–41.

<sup>39</sup> Shields and Shidler, 33 J Regional Analysis & Pol at 40–41 (cited in note 35).

ploited central cities because they exhibited a greater “willingness to pay” for city services than city residents, and thus obtained more benefits from those services than did residents.<sup>40</sup> As David Bradford and Wallace Oates argue, however, this method of defining exploitation does not depend on what might be the more crucial question of whether commuters cover the costs of the services they consume.<sup>41</sup> Instead, by measuring personal benefit, Neenan determined only that commuters enjoy greater consumer surplus from city services than residents.<sup>42</sup> But it is less clear that cities should be able to capture that surplus, any more than a consumer of a private good should be required to pay the provider the full personal value of a good that he or she consumes. Even with a bias in favor of the exploitation thesis, Neenan found only modest central city subsidies of commuters.<sup>43</sup>

In a 1999 review of multiple studies of the effects of commuters on cities, Brett Hawkins and Douglas Ihrke reported that three studies (including Neenan’s) supported the exploitation thesis, while two studies concluded that commuters conferred benefits in excess of costs and two concluded that there was a rough offset between costs and benefits.<sup>44</sup> Two of the studies reanalyze Neenan’s data and reach a different conclusion. One of the studies, by R.S. Smith, concluded that, depending on underlying assumptions, commuters to San Francisco contributed (in 1972) between \$19.7 million and \$53.6 million more in tax revenues than it cost the city to attract and to provide services to them, and that these amounts indicated that commuters were sharing the city’s redistributive costs as well as reimbursing the costs related to commuter consumption of city services.<sup>45</sup>

In light of the difficulty of measuring what all seem to agree are the relevant factors that justify or refute the propriety of a commuter tax, perhaps the question of whether to impose such exactions must come down to one of politics. If there is a reasonable case to be made

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<sup>40</sup> See generally William B. Neenan, *Suburban-Central City Exploitation Thesis: One City’s Tale*, 23 Natl Tax J 119 (June 1970).

<sup>41</sup> See David F. Bradford and Wallace E. Oates, *Suburban Exploitation of Central Cities and Governmental Structure*, in Harold M. Hochman and George E. Peterson, eds, *Redistribution through Public Choice* 43, 46–48 (Columbia 1974).

<sup>42</sup> Neenan, 23 Natl Tax J at 139 (cited in note 40) (concluding that suburban tax contributions to the city can be “markedly increased” without offsetting the welfare gains the commuters enjoy from the city).

<sup>43</sup> *Id.* (“For a family of four this welfare gain is estimated to range from nearly \$7.00 to over \$50.00 a year.”).

<sup>44</sup> Hawkins and Ihrke, 29 *Publius* at 116 (cited in note 21).

<sup>45</sup> R.S. Smith, *Are Nonresidents Contributing Their Share to Core City Revenues?*, 48 *Land Econ* 240, 245 & table 3, 247 (1972).

that a commuter tax is necessary to induce commuters to internalize the costs that they impose on central cities, and also a reasonable case for the contrary position, then the political domain may serve as the proper forum for resolution of the debate. But that ostensibly neutral position requires that one address the less obvious question: whose politics? In the difficult world of allocating governmental responsibilities among multiple levels of government within a federal system, assignment of the decisionmaking role may ultimately determine the substance of the decision. As I indicated above,<sup>46</sup> different institutions and jurisdictions have different biases and incentives to emphasize different factors relevant to the imposition of a commuter tax. As a result, once we assign the function of selecting among multiple reasonable conclusions, we may well have predetermined the result that is reached on the underlying, but uncertain, empirics.

## II. THE SEARCH FOR AN IDEAL DECISIONMAKER

The desire to internalize all externalities suggests that the ideal decisionmaker on fiscal actions that affect cities and suburbs is a unified metropolitan government that comprises both the beneficiaries and the payers of the tax, that has an unlimited choice of fiscal tools for allocating the costs of services, and the officials of which are elected by all residents. In the case of a commuter tax, that entity would have incentives to consider the costs and benefits to both central city and suburbs, would presumably consider alternative revenue-raising devices that could compensate the central city for any net costs it suffered due to commuters, and would not suffer from distortions in decisions caused by logrolling among representatives from discrete districts. District-based representatives might base decisions on the interests of constituents, rather than on the metropolitan area as a whole. For instance, fees on activities that commuters use disproportionately (bridge tolls, parking taxes) could be used to compensate the city, but might have a very different incidence and different secondary effects than imposition of a commuter tax explicitly linked to income derived by payers from economic activity in the city. The internalization principle suggests that an entity with the above characteristics would be better positioned to consider the net effects of employing any of these alternatives on all those affected by the decision than representatives of either the city or the suburbs acting alone.

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<sup>46</sup> See text accompanying notes 9–15.

The existing allocation of decisionmaking responsibility among levels of government starts with the same assumption that self-interest alone will cause the city to favor commuter taxes and suburban communities to oppose them. Left to their own devices, officials of central cities might be thought systematically biased in favor of the tax because it provides them with revenues for which their constituents do not bear the burden. Moreover, cities with a choice of fiscal tools would have an incentive to favor commuter taxes over other exactions, such as parking taxes, that might better reflect a specific service being financed, such as traffic control, but that would also be imposed on some city residents. Allowing cities to impose a commuter tax without prior state approval, therefore, would offend the basic principle of internalizing externalities.

The state legislature might initially appear to fill the appropriate role, justifying the traditional allocation of authority over such taxes to that body. The state legislature, after all, comprises representatives of both the city and of the suburbs where commuters reside. But the bulk of state legislators likely represent neither group, so that most legislators' votes may depend on logrolling with respect to unrelated items or affinities to those more intensely interested in the issue rather than on a careful balancing of the net effects of commuting. The assignment of responsibility to state legislatures also carries its own bias, albeit one contrary to that of the municipality. Any pro-tax bias suffered by local officials will likely be offset by an anti-tax bias on the part of state legislators from suburban districts. Their constituents are likely to bear the full value of the tax, while the benefits are shared with city residents. There is at least some anecdotal evidence that a commuter tax is of high salience in suburban districts.<sup>47</sup> If that effect can be generalized, then it is highly likely that suburban representatives would logroll on this issue with otherwise disinterested legislators. The positive revenue effects of a commuter tax for any city recipient may be too minor for the tax to receive the same salience, so that city representatives may reserve their logrolling opportunities for issues that generate more intense benefits for the constituents of their district. The traditional assumption that suburban legislators control the legis-

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<sup>47</sup> In New York City's case, there was an allegation that the repeal of the state's commuter tax was motivated by a desire to influence an election in a state senate district. News reports indicated that legislative leaders supported the repeal to assist candidates from suburban districts. See Clifford J. Levy, *Legislature Acts Quickly to Repeal Commuter Tax*, NY Times A1 (May 18, 1999) (describing an evaporation of party lines as state legislators from suburban areas aligned against their urban counterparts).

lative agenda also suggests that removing the right to initiate a commuter tax from the home rule municipality will negate any effort to enact one. That assumption presumably was diluted by the shift to proportional representation in state legislators under one-person, one-vote principles. But there is at least some evidence that reapportionment has not caused the ideological realignments predicted for it, and may even have added to suburban strength in the legislature.<sup>48</sup>

But before endorsing a unified metropolitan legislature as the appropriate decisionmaker, one should consider the imperfections inherent in any such body. Given the history and stickiness of boundary drawing, unified metropolitan decisionmaking bodies will rarely reflect the interests of commuters and their workplace cities, but not other state residents. Even counties that subsume cities are unlikely to have boundaries that mesh well with the commuting population that would be affected by a tax. The figures that I cited at the outset indicate that counties frequently do not overlap with the employment base of their central cities, so that even county decisionmaking about a commuter tax would fail to capture the interests of non-county residents who commute into the city. The problem becomes more pronounced where a city draws a significant number of employees from across state boundaries, since sub-federal representative bodies rarely involve multiple states.

Even a unified metropolitan decisionmaker, moreover, would not necessarily be an ideal arbiter of all relevant factors in the decision to enact a commuter tax. To the extent that it represented regional—but only regional—interests, for example, it might not sufficiently consider the state's interests in optimizing vertical tax competition, a subject to which I turn momentarily. As a result, before proposing the creation of such a body, it might be useful to explore in greater depth than the summary views I have suggested above whether existing institutions for reaching a decision about a commuter tax might come sufficiently close to the ideal.

#### A. The City as Decisionmaker

The initial rejection of the proposition that a city should be permitted to impose a commuter tax is reminiscent of John Stuart Mill's argument for severely limiting the role of local representative bodies. Local officials should be permitted to "mismanage their own interests,

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<sup>48</sup> Stephen Ansolabehere and James M. Snyder, Jr, *The End of Inequality: One Person, One Vote and the Transformation of American Politics* 217–28, 233 (Norton 2008).

but not to prejudice those of others.”<sup>49</sup> Local residents will be able to redress mismanagement from which they suffer through the election process; but nonresidents who are unrepresented in local elections have little recourse when local mismanagement adversely affects them. Adverse effects need not, of course, be a function of mismanagement. Local officials have self-interested incentives to engage in policies that capture benefits for their constituents while imposing costs on others. Both incompetence and guile will lead local officials to engage in behavior that ignores the interests of the larger society. In the context of the commuter tax, these explanations suggest that local officials are likely to interpret evidence about the effects of commuting in favor of the exploitation thesis, so that city-originated commuter taxes will be overutilized from a social perspective.

But it is not clear that the assumption of local myopia is fully justified. The fortunes of cities whose economies require significant numbers of commuters are not easily isolated from the interests of nonresidents. To the extent that localities face interlocal competition for mobile capital and labor, local officials have incentives to consider the consequences of local tax policies on the ability to attract and retain both firms and workers who foster the city’s economic development. Higher taxes can translate into net revenue losses should they generate exit by mobile capital that must otherwise increase wages to compensate for higher taxes paid by commuting employees.<sup>50</sup> Employees who must pay the taxes have incentives to exit for employers in more hospitable jurisdictions. As a consequence, cities have incentives to be conservative in their estimates of the positive effects of commuter taxes. Commuters may recognize that taxes reflect the value of the services that they receive from the locality, but still object to paying that value because they believe that they can get similar resources “free” from jurisdictions that do not impose commuter taxes. That is, the locality may avoid imposing taxes that reflect the full capitalized value of the services they provide. The implications of local taxation are sufficient to lead some observers to suggest that interlocal competition will cause a race to the bottom in which localities impose taxes on mobile capital that are, from a social perspective, too

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<sup>49</sup> John Stuart Mill, *Considerations on Representative Government* 226 (Bobbs-Merrill 1958) (Currin V. Shields, ed).

<sup>50</sup> See Andrew Haughwout, et al, *Local Revenue Hills: Evidence from Four U.S. Cities*, 86 *Rev Econ & Stat* 570, 582 (2004).

low.<sup>51</sup> The effect is that the interests of commuters will be virtually represented in the city decisionmaking process notwithstanding their inability to vote directly on local policies that affect them.

The virtual representation of nonresidents may be enhanced if local residents serve as their surrogates in the local political process, such as by lobbying and bargaining in favor of policies that nonresidents would prefer, but are foreclosed from supporting directly. The imperfections of interlocal competition are likely to create just those possibilities. Interlocal competition has limited effects because some capital may be immobile, either because of location-specific investments that cannot easily be sold or replicated elsewhere, or because of agglomeration effects that make emigration by a single firm self-defeating. A firm that has located in a specific jurisdiction in order to be near its competitors, suppliers, and professional support (attorneys, bankers, financial advisors) might prefer to exit if it could induce the rest of the cluster to follow, but otherwise would find exit infeasible. As a consequence, we might find that exit of some firms is severely constrained. The same may be true of labor. Certainly, as I indicated above, commuters who face taxation in excess of the value they place on the central city's local public goods for which they pay have incentives to migrate to jobs elsewhere. But commuters who are tied to investments in homes, neighbors, and jobs suffer some constraints on mobility and thus some vulnerability to opportunistic taxation by the city. The result, one might conclude, is that immobile firms and commuters are susceptible to exploitation.

The inability to exit, however, does not necessarily translate into vulnerability. The obligation of immobile firms to compensate desired commuter-employees to offset commuter taxes, or the tax losses suffered by commuters who cannot command offsets does not necessarily permit the locality to impose taxes on immobile capital. Instead, it provides incentives for the relatively immobile to exercise political, or voice, options that they might otherwise forgo. The extent to which employers would select the voice option will likely depend on the ex-

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<sup>51</sup> See John Douglas Wilson, *Theories of Tax Competition*, 52 Natl Tax J 269, 288–89 (1999) (noting the possibility of a “race to the bottom” through inefficiently lax environmental policies but pointing out that this possibility may depend on assumptions about available tax instruments); Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 Harv L Rev 377, 380 (1996) (suggesting that interstate competition can cause states to act contrary to citizen interests); David E. Wildasin, *Interjurisdictional Capital Mobility: Fiscal Externality and a Corrective Subsidy*, 25 J Urban Econ 193, 196, 207 (1989) (concluding that the mobility of capital gives municipalities an incentive to “undertax” or to “underspend on local public goods”).

tent to which they must absorb the costs of any tax imposed on their employees in order to avoid their exit, or are able to pass on the costs of a payroll tax without risking employee exit. The more competition there is for employees from suburban employers, the more central-city employers will be required to absorb the costs of additional taxes on commuters, and the greater the incentive for employers to express their employees' concerns to local officials. The benefit of this option is that it provides a response to the allegation that a commuter tax imposed unilaterally by the city creates a form of taxation without representation. Representation may come in many forms. Resident employers who have to pay higher wages to offset the higher commuting costs of workers, or shop owners who have to reduce prices to attract commuting shoppers with less discretionary income have self-interested incentives to complain about the adverse impact of the commuter tax on their own situation. When they engage in political activity to represent their own self-interest, they simultaneously, if virtually, represent the interests of nonresident taxpayers. Assuming that these groups have sufficient political influence to induce local officials to consider the costs that a commuter tax will impose on them, local officials internalize the costs of the tax more than our initial consideration of the issue suggested.

Some exactions may not fall within this category because they do not adversely affect those within the locality and thus leave open the possibility of exploitation. Consider, for instance, a toll on a road that is utilized primarily by nonresidents and that provides for no exit within the municipality that imposes the toll. The locality would have no incentive to restrict the toll to the marginal costs of road maintenance, since higher tolls do not deter any activity that the locality would otherwise enjoy. No one within the locality is likely to align with the interests of toll payers. But commuter taxes do not fall into that category. The identity of interests between commuters and local firms that rely on commuters for patronage or employment means that the latter are likely to empathize with the additional costs that commuter taxes impose on the former, and thus to raise arguments that reflect those that would have been made directly by commuters were they enfranchised to do so.

This is not to say that the interests of commuters will be perfectly reflected in the city's decisionmaking process or that virtual representation means that the interests of commuters will have the same influence that would exist if commuters enjoyed direct representation. Recall that even if some contribution from commuters is appropriate to defray additional marginal expenditures, the form of the contribution may vary. Different city groups will have different influence before the



city legislature, so that the presence of a particular resident group in local debates may affect the incidence of exactions from commuters, though not necessarily the enactment of *some* exaction. Assume, for instance, that the city decides that it is appropriate to impose some of the costs of providing city services on commuters. Assume further that the city is exploring three options: a tax on the income earned in the city by nonresidents; an occupational tax imposed on all individuals engaged in a profession or business in the city; or a parking tax. If resident parking-lot owners in the city are relatively few in number and can organize with relative ease, they may be able to create a more effective coalition to oppose the parking tax than the large, relatively diffuse group of resident employers who free ride on the efforts of each other to oppose the payroll tax. The result may be that the parking tax is less likely to be enacted than either the commuter tax or the payroll tax. That result may obtain, notwithstanding the possibility that commuters who drive into the city, and thus use parking facilities, impose greater burdens on city services (road congestion, road maintenance, traffic control) than non-driving commuters.

But the fact that there will be some divergence between the decision of a city council in which commuters' interests are virtually represented and the decision that would be made by an ideal unified metropolitan legislature does not mean that the former cannot be a better alternative than the latter. It may mean nothing more than that reasonable representatives of all those interested in the outcome of a debate could differ on which among numerous reasonable financing mechanisms should be used in any specific context. The fact that the incidence of a selected financing mechanism tax varies from alternatives does not imply that the chosen mechanism is inappropriate, especially if the interests of those adversely affected by the decision were effectively represented in the process. What virtual representation guarantees is an ability to influence the outcome—not ultimate victory.

#### B. The State as Decisionmaker

Whether it is worthwhile to accept even an imperfect local decisionmaking process about the propriety of a commuter tax similarly depends on whether the process within the state legislature is likely to cause fewer or greater distortions from the ideal. As I suggested above,<sup>52</sup> it is tempting to think of the state legislature as the entity closer to a unified metropolitan decisionmaker, because the legisla-

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<sup>52</sup> See text accompanying notes 46–48.

ture comprises representatives of both commuters and cities. One might therefore conclude that the state legislature will internalize the interests of all parties affected by a proposed commuter tax. But just as the initial position of the city as systematically biased in its analysis of a commuter tax gives way under a more careful analysis of the incentives of local officials, so does additional scrutiny belie the state legislature's ostensibly neutral posture.

As potential payers of the proposed tax, self-interested commuters have incentives to construe ambiguous data concerning the net effects of commuters on the city's fiscal position in their favor. Given the salience of taxation, self-interested commuters also have incentives to communicate to their state representatives a desire to deny the central city authority to impose the tax. Since state legislators represent districts, rather than the state as a whole, they have incentives to comply with the preferences of their constituents in order to maximize reelection possibilities or other objectives that are often posited for public officials, such as post-public service employment. They have more limited incentives to consider the interests of non-constituents, such as the city that seeks to impose the tax, or even the interests of the state as a whole. As a result, legislators are likely to vote in a manner that does not reflect careful balancing of metropolitan costs and benefits, unless their districts contain constituents who have competing interests. If district boundaries tend to align with city or suburban boundaries, rather than to cross those boundaries, then the outcome of the vote will depend on whether the cities or the suburbs have more representatives in the state legislature or have greater ability to logroll with disinterested representatives. With respect to the commuter tax, majorities may rule, but the majority will be composed of those who vote self-interestedly given the limited interests of their constituents. The result might be different if representatives were elected at large from the state or region as a whole, but that tends not to define the current design of state legislative districts.

This effect is exacerbated by the institutional structures that prevail in the legislatures of virtually all states. State legislatures (aside from Nebraska) are bicameral, with each chamber hosting its own set of committees. The need to enact a proposal in two chambers raises the costs of passage and reduces the costs of defeating a proposal.<sup>53</sup> Opposition groups can succeed by attaining success in either chamber. Indeed,

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<sup>53</sup> See Saul Levmore, *Bicameralism: When Are Two Decisions Better than One?*, 12 *Intl Rev L & Econ* 145, 151 (1992) (positing that a bicameral legislature promotes the status quo).

a majority in a committee can defeat a proposal favored by majorities in both chambers. As a consequence, a coalition that can command a majority in one forum can defeat a proposal favored by the majority of the consolidated chambers. Local governments typically host fewer committees or chambers, perhaps because the relative ease of exit compensates for some of the more intrusive governmental interventions that bicameralism may be intended to forestall.<sup>54</sup> But the fact that institutional design of state legislative processes favors opponents of the commuter tax, while institutional design at the local legislative level reflects less of a unidirectional bias belies the claim that the state legislature will be a more neutral arbiter of the claims for a commuter tax.

Moreover, while a commuter tax may be salient for representatives whose constituents are directly affected by the proposal, that group may be a minority of all legislators, especially where the proposal to authorize a commuter tax is limited to fewer than all municipalities in the state. One would imagine, for instance, that representatives from western New York would have little direct stake in proposals to permit New York City to tax commuters. But if that is the case, then what would motivate the voting behavior of those representatives? It is, of course, plausible that their lack of a stake in the outcome would induce them to consider the costs and benefits of the proposal from a neutral perspective. But it is also plausible that their indifference would cause them to cast their vote in accordance with principles irrelevant to the merits of the proposal. A substantial, though somewhat contested literature suggests that the driver of much state legislative action, at least in fiscal matters, involves efforts by the political party that dominates the legislature to confer benefits on its membership.<sup>55</sup> A related literature suggests that at least some state legislatures link party and policy, so that representatives will tend to vote for party-determined positions.<sup>56</sup> To the extent that party and policy are linked, state legislatures again look less like neutral arbiters of a commuter tax than their local analogues. Partisan politics are typi-

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<sup>54</sup> See id at 161–62.

<sup>55</sup> See, for example, Stephen Ansolabehere and James M. Snyder, Jr, *Party Control of State Government and the Distribution of Public Expenditures*, 108 *Scand J Econ* 547, 565 (2006). But see Michael C. Herron and Brett A. Theodos, *Government Redistribution in the Shadow of Legislative Elections: A Study of the Illinois Member Initiative Grants Program*, 29 *Leg Stud Q* 287, 306–07 (2004) (demonstrating tactical distribution of resources to districts with moderate voters in Illinois).

<sup>56</sup> See, for example, Thomas R. Dye, *Party and Policy in the States*, 46 *J Polit* 1097, 1097 (1984) (finding party-policy linkage in twenty states). For an brief overview of this literature, see Ansolabehere and Snyder, 108 *Scand J Econ* at 547 n 1 (cited in note 55).

cally seen as playing a lesser, sometimes nonexistent, role in local elections.<sup>57</sup> The absence of partisan politics is not necessarily desirable. Jessica Trounstine, for example, attributes the growth of political monopolies within cities at least in part to the absence of political competition.<sup>58</sup> But at least one benefit of the nonpartisan nature of local politics may entail less party-directed voting by legislators who otherwise have little incentive to consider the merits of a proposal.

These same institutional characteristics of state legislatures suggest a response to the possibility that state legislators will simply employ legal doctrine to negate any attempted exercise of home rule to enact a commuter tax. Recall that my underlying claim is that proper definition of the scope of home rule permits local enactment of a commuter tax. Nevertheless, local authority to initiate legislation through the home rule power does not entail immunity from state intervention to reverse the local decision. As a general matter, a state may nullify the exercise of a home rule power by enacting a statute that conflicts with the local ordinance.<sup>59</sup> Indeed, even in states such as California or Colorado that permit ordinances to trump state statutes in areas of “municipal concern,”<sup>60</sup> it is likely that a commuter tax would fall outside that protected area for purposes of immunizing the locality from state intervention, even if the tax fell within the area for purposes of permitting the municipality to enact the ordinance in the first instance.<sup>61</sup> Thus, one might claim that, simply as a matter of state politics and state constitutional law, even biased decisions at the state level will ultimately render the local initiative superfluous as representatives of suburban districts sponsor legislation that prohibits a commuter tax (just as Congress has done with respect to the District of Columbia<sup>62</sup>). As a result, there is little reason to believe that defin-

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<sup>57</sup> See David Schleicher, *Why Is There No Partisan Competition in City Council Elections?: The Role of Election Law*, 23 J L & Pol 419, 421 (2007).

<sup>58</sup> Jessica Trounstine, *Political Monopolies in American Cities* 22 (Chicago 2008). See also Edward L. Glaeser and Andrei Shleifer, *The Curley Effect: The Economics of Shaping the Electorate*, 21 J L, Econ, & Org 1, 16 (2005) (demonstrating how a local politician might reduce competition by changing the electorate through differential taxes unfavorable to groups with opposing views).

<sup>59</sup> Paul Diller, *Intrastate Preemption*, 87 BU L Rev 1113, 1132–33 (2007).

<sup>60</sup> See Colo Const Art XX, § 6 (“[City] charter and the ordinances made pursuant thereto in [local and municipal] matters shall supersede . . . any law of the state in conflict therewith.”); Ca Const Art XI, § 5(a) (“City charters[,] . . . with respect to municipal affairs shall supersede all laws inconsistent therewith.”).

<sup>61</sup> For a discussion of the distinction between the right to initiate local legislation and the right to be immune from state intervention with respect to such provisions, see Lynn A. Baker and Clayton P. Gillette, *Local Government Law* 204–07 (Foundation 3d ed 2004).

<sup>62</sup> See note 10.

ing home rule to permit a commuter tax would create any but the most temporary change in the status quo.

But baselines matter. The same institutional considerations that make it easy for suburban interests to block state legislative authorization of a commuter tax also make it easier for a city that has authorized the tax to obstruct its nullification by the state legislature. The conflicting legislation must prevail through the committee and bicameral system that favors the status quo and permits even a minority interest to succeed. That does not necessarily mean that the city has the better of the argument. But to the extent one does believe that the city is in a better position to weigh the propriety of the tax, the fear that its actions will be undone by the state legislature should not serve as a barrier to implementing that determination.

1. Correlation between city and suburban welfare.

Of course, the story about the inevitable conflict between city and suburban interests is also oversimplified. One could imagine circumstances under which self-interested commuters should be willing to internalize the interests of the city, just as I predicted that the city would internalize the interests of commuters. Commuters should be willing to pay taxes imposed by the city to the extent that (1) their own welfare depends on the welfare of the central city, and (2) they perceive the commuter tax as essential to the latter. The first proposition is somewhat easy to establish. Numerous studies relate the financial health of suburbs to that of their central city.<sup>63</sup> A study of the Philadelphia metropolitan region suggested that an increase in city job growth of 1 percent translates into an increase of suburban house values of slightly more than \$1,000.<sup>64</sup> City growth in income, population, and housing values tends to correlate with suburban growth of the same variables.<sup>65</sup>

Those studies do not necessarily translate into suburban support for a commuter tax. Suburban resistance to a commuter tax to enhance suburban welfare may be a justifiable position, notwithstanding city conferral of benefit spillovers on suburbs. Most of the studies that correlate suburban and central city welfare conclude that the financial

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<sup>63</sup> See, for example, Andrew F. Haughwout and Robert P. Inman, *Should Suburbs Help Their Central City?* 45, 47–48 (Brookings-Wharton Papers on Urban Affairs, 2002).

<sup>64</sup> Richard Voith, *The Suburban Housing Market: The Effects of City and Suburban Job Growth*, Fed Res Bank Phila Bus Rev 1, 7 (Nov/Dec 1996) (finding that this effect is even more pronounced in cities with a commuter rail system).

<sup>65</sup> See Richard Voith, *Do Suburbs Need Cities?*, 38 J Regional Sci 445, 462 (1998).

health of the central city is reflected in suburban property values.<sup>66</sup> To the extent that the fiscal health of the central city positively affects property values, all suburban property owners have an interest in ensuring an optimal level of services of the central city. While commuters may constitute a disproportionate share of suburban consumption of those services, even noncommuting nonresidents whose property values reflect city conditions are beneficiaries of the city's capacity to attract mobile capital and labor. Thus, the internalization principle suggests that suburban contributions to the central city should come from all suburban property owners, not simply from commuters. Intergovernmental transfers from suburban tax revenues to the city treasury, therefore, may be a more appropriate fiscal tool for recognizing the spillovers than user fees or commuter taxes.

## 2. Vertical tax competition.

There is at least one respect in which state consideration of a commuter tax seems to have an advantage over city consideration. All taxes imposed by the city impose an externality insofar as they constrain the ability of the state to impose additional taxes on city taxpayers.<sup>67</sup> Moreover, if local taxation induces mobile capital to emigrate, firms may exit the state as well as the locality, so that local action denies the state revenues that it would otherwise capture. While interlocal tax competition is often thought to generate efficient delivery of public goods (notwithstanding the "race-to-the-bottom" claims mentioned above), vertical tax competition is more problematic, or at least "slippery,"<sup>68</sup> insofar as higher levels of government that presumably reflect a broader level of policy choices are constrained by the choices of lower levels of government. In theory, a publicly interested, but fiscally unconstrained, state official would tax all state residents at a level that maximizes the welfare of all state residents. That would include residents of localities that impose their own taxes. Publicly interested, but fiscally unconstrained, officials of the latter, however, would only seek to maximize the welfare of their constituents. Thus, it is plausible that local officials will not internalize the interests of nonresidents within the state, while state officials will internalize the interests of local

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<sup>66</sup> See, for example, Voith, *Fed Res Bank Phila Bus Rev* at 7 (cited in note 64).

<sup>67</sup> See Wilson, 52 *Natl Tax J* at 289–90 (cited in note 51) (explaining that when one layer of government increases its tax base, this action "diminishes the size of the tax base available to the other level of government").

<sup>68</sup> See *id.* at 291. See also Michael Keen, *Vertical Tax Externalities in the Theory of Fiscal Federalism*, 45 *IMF Staff Papers* 454, 470 (1998).

residents. As a result, if local officials are allowed to tax in a manner that preempts the fiscal capacities of state officials, it is likely that local officials will adversely affect the welfare of nonresidents.

Whether this externality should be sufficient to deny local officials the capacity to impose a commuter tax may depend on the extent to which one believes that local and state officials act consistently with the theory. Assume, for instance, that state officials are unconcerned about optimal taxation, but seek only to maximize state revenues. Alternatively, assume that state officials distribute revenues in a manner that is less consistent with constituent preferences than local officials who distribute local revenues. After all, there are reasons to believe that, at least in some contexts, expenditure decisions made at state levels will be more vulnerable to nonrepresentative interest groups than are local expenditure decisions. The possibility of logrolling, the structure of state legislative committees and the bicameral legislature, and the higher transactions costs related to lobbying at the state level systemically increase transactions costs between constituents and legislators, and thus reduce the number of interest groups that have access to state legislators on any given issue. The result could be more distortion in state expenditure decisions, since those groups that can bear the higher transactions costs will face little or no opposition. I am not suggesting that dominant interest groups will always prevail at the state level. I am instead expressing skepticism on the question of whether state revenue will be spent in a manner more consistent with constituent welfare than local revenue. Under these circumstances, local taxation may generate an externality insofar as it constrains state taxation, but there is no reason to believe that the constraint on state revenue-raising diminishes state welfare.

### III. THE CHOICE OF FISCAL INSTRUMENTS

A final argument has ambiguous implications for unilateral city imposition of a commuter tax. There are, I have suggested, multiple fiscal instruments that a municipality could employ if it determines that commuters are not paying the full cost of the services they utilize. Bridge and tunnel tolls, parking taxes, or payroll taxes could all substitute for an explicit commuter tax to the extent that those exactions were paid disproportionately by commuters and by a relatively high percentage of commuters. One might conclude that those exactions reduce the need for an explicit commuter tax. Moreover, at least some of these exactions effectively constitute user fees and thus serve to reimburse the city for expenditures made on the payers' behalf, regardless of whether the beneficiary of the service is a resident or a commu-

ter. To the extent that an exaction links payments and services, it arguably promotes more efficient delivery of municipal services by signaling demand for certain services or levels of service. Thus, a highly targeted user fee that explicitly matches benefits with burdens would both require commuters, as well as residents, to pay for city services they consume, and would discourage both overprovision and underprovision of municipal services. As a result, one might infer that any effort by a locality to eschew these exactions in favor of a more general commuter tax that has a different incidence both varies from a Tieboutian ideal and falls farther from the objective of internalizing externalities.

There are, however, a variety of legitimate reasons why a locality would rationally select an income-based commuter tax over alternative revenue-raising mechanisms. Most obviously, the locality may not have free reign over alternatives. The state legislature often retains plenary power over the revenue-raising powers of localities generally, not simply with respect to commuter taxes. As a general rule, even home rule municipalities have limited fiscal autonomy; the fiscal instruments from which they can select without prior state authorization are typically limited to fees that demonstrably link individual benefit and cost rather than more broad-based taxes.<sup>69</sup> The same objections that are likely to emerge from nonresident employees with respect to explicit commuter taxes are similarly likely to emerge with respect to payroll taxes or fees. In addition, the fact that residents will be affected by these exactions may reduce their political plausibility. Thus, it is by no means clear that alternatives will be available.

Even where alternatives are available, the locality may have benign reasons to prefer a commuter tax. While user fees may be appropriate to defray the costs of many municipal services that have some of the characteristics of private goods, they are less plausible for other services that are consumed by commuters, but that have more of a public goods flavor. User fees for police or fire services, for example, would either be too difficult to measure or assess (imagine the traffic officer collecting a fee from each car it directed) or would cause too many perverse incentives (why call the fire department if it generates a fee for the caller and someone else could call?).

Even where user fees are feasible, they tend to be limited in amount to defraying the cost of the specific service funded with the revenue that they generate. For instance, bridge tolls may be imposed to reimburse the locality for the costs of constructing and maintaining

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<sup>69</sup> See Gillette, 86 *Denver U L Rev* at 1246–47 (cited in note 2).



the bridge. It is less clear that a proper user fee could include the costs of city services provided to those who use the bridge to enter the city (as opposed to police and fire services that are allocated to protection of the bridge itself).<sup>70</sup> Finally, to the extent that that a commuter tax properly reimburses the municipality for redistributive expenditures, it is even less likely that a user fee, which is intended to reflect the cost related to conferring a benefit on the payer and not to entail additional revenue raising, would be permissible.<sup>71</sup>

Other broad-based taxes, like payroll taxes, that indirectly compensate localities for expenditures will be paid on behalf of both residents and commuters, and thus are less likely to establish the linkage to additional expenditures required by the latter. Consider, for example, the Chicago Employers' Expense Tax. That tax applies to businesses that employ more than fifty full-time workers who perform more than 50 percent of their work service in the City of Chicago.<sup>72</sup> The underlying assumption ostensibly is that large employers put stress on city services by attracting large numbers of employees who gravitate to a central location. Presumably, however, resident employees already pay for at least a share of municipal services that congestion engenders through other taxes that commuters escape, such as property taxes. Resident Chicago employees whose wages reflect their employers' obligation to pay the Employers' Expense Tax will thus end up paying as much as commuter employees, notwithstanding the former's duplicative payments for the same services. Of course, it is plausible that Chicago could respond by reducing the alternative taxes. For instance, Chicago could reduce property taxes for residents to reflect the payments that residents make through the Employers' Expense Tax. But that would introduce a different set of distortions into the incidence of payments for local public goods. A resident property taxpayer who did not pay the Employers' Expense Tax would get the benefit of the lower property tax, but would not be required to incur the offsetting charges for local public goods that he or she enjoyed. Perhaps a series of credits or other calculations would be theoretically possible to generate a formula that imposed appropriate costs on

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<sup>70</sup> See, for example, *Northern Illinois Home Builders Association, Inc v County of Du Page*, 649 NE2d 384, 388-90 (Ill 1995) (finding a transportation impact fee on new development unconstitutional because the increased transportation costs borne by the county were not "specifically and uniquely attributable" to the new development); *Bloom v City of Fort Collins*, 784 P2d 304, 311 (Colo 1989).

<sup>71</sup> See *Silva v City of Attleboro*, 908 NE2d 722, 725 (Mass 2009).

<sup>72</sup> See Chicago Municipal Code § 3-20-030 (imposing a tax of \$4 per month per commission merchant or full-time employee).

commuters without distorting residents' payments. For instance, one could imagine a property tax credit for resident employees whose wages are subject to the Employers' Expense Tax. The administrative difficulties involved in determining how any given resident's wages were affected by the tax and calculating an appropriate offset to the property tax, however, suggests that the game may not be worth the candle. If the city's choice for recovering expenses rests between an imperfect payroll tax and an imperfect commuter tax, it is by no means clear that selection of the latter is inappropriate.

#### CONCLUSION

Both the economic theory of federalism and much doctrinal local government law proceed from the assumption that the scope of local autonomy should be related to the spatial consequences of local action. Localities should be allowed to provide services, and devise financial instruments for paying for those services, when their actions have intramural effects, but not otherwise. But the invocation of externalities is the beginning of the analysis, not the end. If the objective of law is to induce the internalization of externalities, then the allocation of functions among different levels of government should recognize that some relatively decentralized levels of government have incentives to act in accordance with the internalization principle even without the coercive intervention of law. Where that is the case, there is at least an argument that decentralized entities should have broad authority to act, notwithstanding extraterritorial effects. And that argument is all the stronger where it turns out that the decentralized actor is even better positioned to weigh all effects of its action than the more centralized actor. Perhaps counterintuitively, the imposition of a commuter tax may be a prime example of a situation where that state of affairs exists.