

STATE RESIDENCY LAWS: THEIR CONSTITUTIONALITY UNDER THE
PRIVILEGES AND IMMUNITY CLAUSE

by

Werner Z. Hirsch

Department of Economics

University of California, Los Angeles

Los Angeles, CA 90024 - 1477

UCLA Department of Economics
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State, counties and municipalities tend to enact laws which generate jobs for their residents, particularly in times of declining economic activity. Public works which, amounted to up to 30% of all construction expenditures during the 1970s and 1980s, have been the major target of residency laws, although on the local level, police and firefighters have also been affected.¹

This paper will review state residency laws, then build an economic framework to analyze their constitutionality, before engaging in some empirical analysis.

Review of State Residency Laws

About half of the states have statutes, some simple and some complex, that require preference for resident labor in public work projects using public funds. Illinois Preference Act of 1984 is one of the more intricate and detailed acts. It declares --

§ 3. Whenever there is a period of excessive unemployment in Illinois, every person who is charged with the duty, either by law of contract, of constructing or building any public works project or improvement for the State of Illinois or any political sub-division, municipal corporation or other governmental unit thereof shall employ only Illinois laborers on such project or improvement, and every contract let by any such person shall contain a provision requiring that such labor be used: Provided, that other laborers may be used when Illinois laborers as defined in this Act are not available, or are incapable of performing the particular type of work involved, if so certified by the contractor and

¹U.S. Department of Commerce, Statistical Abstract of the United States, 1988, 108th., pp. 679.

In the Act, "a period of excessive unemployment" means any month immediately following 2 consecutive calendar months during which the level of unemployment in the State of Illinois has exceeded 5% as measured by the U.S. Bureau of Labor Statistics data.³ "Illinois laborers" means any person who has resided in Illinois for at least 30 days and intends to become or remain an Illinois resident.⁴

In general, residency laws differ as to the duration of residency required, conditions when out-of-state labor may be used, percentage of resident labor to be employed, exceptions to preference, and constitutional limits.

Until recently questions of the constitutionality of residency laws were examined under the Commerce Clause of the Constitution, the court usually holding such laws to be constitutional. However, in recent years the Privileges and Immunities Clause has been used for review of state hiring preference acts.

The primary purpose of the Privileges and Immunities Clause is to prevent states from enacting measures which discriminate against non-residents for reasons of economic protectionism. Modern analysis of the Clause by the Supreme Court began in Toomer v. Witsell⁵, where the Court examined whether the State had a valid justification for discriminating against non-residents. It developed a two-pronged "substantial reason" test. The first prong states that "a State may not discriminate against

³ Paragraph 2201 at 270.

⁴ Id.

⁵ Toomer v. Witsell, 334 U.S. 385 (1948). In Toomer the Court struck down as an unconstitutional violation of the Privileges and Immunities Clause a South Carolina statute under which nonresident shrimp fishermen were charged a license fee 100 times greater than that charged to residents.

noncitizens of other States where there is no substantial reason for the discrimination beyond the mere fact that they are citizens of other States."⁶ To prove a "substantial reason" there must be "something to indicate that the noncitizens constitute a peculiar source of the evil at which the statute us aimed."⁷ The second prong requires that there must be a "reasonable relationship between the danger represented by the noncitizens as a class, and the ... discrimination practiced upon them."⁸

The Supreme Court first applied this test to a State residency requirement statute in Hicklin v. Orbeck.⁹ It struck down as a violation of the Privileges and Immunities Clause the "Alaska Hire" statute which required that all Alaska oil and gas leases, easements, or right-of-way permits for oil and gas pipelines, and unitization agreements contain a requirement that qualified Alaska residents be hired in preference to nonresidents. It concluded that Alaska Hire had failed to satisfy the requirements of the Toomer substantial reason test.

The Court returned to the question of the constitutionality of residency requirements under the Privileges and Immunities Clause in United Building and Construction Trades Council v. Mayor of Camden.¹⁰ Camden involved a challenge to a municipal ordinance of the City of Camden, New Jersey requiring that at least 40% of the labor force of contractors and subcontractors working on city construction projects be city residents. The

⁶Id at 396.

⁷Id at 396.

⁸Id at 399.

⁹437 U.S. 518 (1978).

¹⁰465 U.S. 208 (1984).

Court held that the interest of nonresidents in employment on public works projects was sufficiently "fundamental" as to "fall within the purview of the Privileges and Immunities Clause."¹¹ The Court's decision left open the possibility that major social afflictions could provide a "substantial reason" for a hiring preference act. Indeed, it cited language from Toomer which stated that inquiry under the Privileges and Immunities Clause "must ... be conducted with due regard for the principle that the States should have considerable leeway in analyzing local evils and in prescribing appropriate cures."¹²

A final element was added by the Supreme Court to Privileges and Immunities analysis in Supreme Court of New Hampshire v. Piper.¹³ Here the Court struck down a New Hampshire rule which limited admission to the State's bar to residents only. The Court alluded to the proper standard of review in Privileges and Immunities Clause cases when it said that "in deciding whether the discrimination bears a close and substantial relationship to the State's objective, the Court has considered the availability of less restrictive means."¹⁴

¹¹Id at 218. In reaching this determination the Court also noted that the market participant/market regulator distinction used to dispose of Commerce Clause challenges to hiring preference acts was not dispositive in the case of Privileges and Immunities Clause challenges.

¹²Id at 222-223, quoting from Toomer v. Witsell 334 U.S. at 396. The Camden remand seems to reject the suggestion made by the Court in Hicklin v. Orbeck that the assumption that a "State may validly attempt to alleviate its unemployment problem by requiring private employers within the State to discriminate against nonresidents" was "dubious" and presented "serious constitutional problems." Hicklin at 526, 527.

¹³470 U.S. 274 (1985).

¹⁴Id at 284. The Court cited Toomer v. Witsell saying that the Court in that case noted that the State could have eliminated the danger of excessive trawling (which could deplete the supply of shrimp) through means less restrictive than discriminating against nonresidents such as by:

The type of evidence needed to uphold a hiring preference statute was described in a Federal Circuit Court opinion written by Judge Posner in W.C.M. Window Co. v. Bernardi.¹⁵ He focused his analysis on economic efficiency; on whether the benefits which would accrue to the State from the Enactment of a hiring preference laws would exceed the corresponding social and economic costs. Citing both Hicklin and Camden, he wrote that:

there must be some evidence of the benefits of a residents-preference law in dealing with a problem created by nonresidents, and Illinois has presented none ... Illinois has presented no information ... concerning the benefits of the preference law. We are not told the unemployment rate in Illinois' construction industry, what such unemployment costs the state, whether it would be significantly increased by throwing open public construction projects to nonresidents (which might just cause a reshuffling of jobs between public and private projects) and whether the cost--if any--to Illinois of allowing nonresident labor on such projects, costs in higher unemployment or welfare benefits paid unemployed construction workers or their families, are likely to exceed any cost savings in public construction from hiring nonresident workers.¹⁶

"restricting the type of equipment used in its fisheries, graduating license fees according to the size of the boats or charging nonresidents a differential to compensate for the added enforcement burden they imposed." Piper at 224.

¹⁵730 F.2d 486 (7th Cir. 1984).

¹⁶Id at 497-498. Some state courts have also mentioned the presence of potential economic inefficiencies in invalidating state hiring preference acts. See Salla v. County of Monroe, 48 N.Y.2d 514: The statute was no geared "to focus efficiently on its goal"; "the disadvantages of additional expense, inconvenience and organizational disruption [involved in forcing employers to use resident labor may] deter contractors from bidding on New York public works projects altogether." Laborers Local Union No. 374 v. Felton Constr. Co., 98 Wash.2d 121, 654 p.2d 67 (1982): "The possible benefit accruing to the state from the retention of wages might be diverted out-of-state by nonresident workers may not equal the potential loss of foregoing the advantage of lower nonresident bids.

An Economic Framework for Analyzing Residency Acts

As argued above, the Supreme Court in recent Privileges and Immunities cases involving residency laws has streamlined the substantial reason test by omitting any mention of "the peculiar source of the evil" requirement it had previously cited in many cases. This refined formulation of the substantial reason test changes the focus from whether the nonresidents are the cause of the problem to the more practical analysis put forth by Judge Posner in W.C.M. Window which emphasizes costs and benefits.¹⁷ That is, the discrimination of the act is justified if it can be shown that the benefits accruing to the state outweigh the costs placed on nonresidents and neighboring states.

Thus, we will focus on the two major prongs of the substantial reason test--

- 1) The state's reason must be "substantial" and
- 2) There must be a close fit between the classification and the legitimate government interest, in other words, the classification is likely to be the most effective way to produce the desired legitimate results. Specifically, the discriminating classification must bear a "reasonable relationship to the danger" non-residents pose, be "narrowly tailored" to cover only those intended to benefit, and involve only legitimate proprietary state interests.

We are faced with the challenge of translating these two sets of criteria into operational terms that lend themselves to an implementation of the substantial reason test. Although, the Court did not provide clear

¹⁷W.C.M. Window Co. v. Bernardi, op. cit.

guidance as to what constitutes a "substantial" reason, the considerations that could justify the law are clearly economic and thus related to benefits and costs. The real question is what level of net benefits are required, and what sort of informational burdens are to be placed on the state in proving their existence of such benefits. The economic analysis in this paper seeks to provide assistance in answering these questions.

The condition that the reason bear a close relation to the degree of discrimination implies that an investigation will be made into the inclusiveness of the legislative category. In Hicklin, the Court found it important that the discrimination practiced in favor of the residents included a large number of persons who were not part of the problem addressed.¹⁸ The Court first sought to determine the magnitude and source of the problem and then evaluated the effectiveness of the state's method of addressing the problem. The focus was on the determination of benefits, however, and not on the construction of a typical judicial balancing. It would seem in many situations that excluding a large group of persons from sharing in the advantages of being a resident of a state would have economic benefits.¹⁹ The Court is doctrinally declaring as a condition of constitutionality that a characteristic of nonresidents must be identified other than residency itself, a characteristic which either leads specifically to the problems addressed by the law or leads to the benefits from the discrimination contemplated by the law. This investigation would be preliminary to an investigation of inclusiveness.

¹⁸Hicklin v. Orbeck op. cit.

¹⁹Any political benefits from hiring nonresidents would be achieved directly as a result of the discrimination against nonresidents, and thus should not be considered.

Recognizing these considerations, we would like to offer a framework of analysis (including standards and tests), which utilizes economic theory to provide a comprehensive view of the major dimensions and implications of a "substantial reason" requirement. These powerful tools could aid the Court in effectively implementing its "substantial reason" requirement. The framework has the following sequential components: (1) Whether the governmental interest involved in the classification is achieved by the mechanism or the scheme chosen; and (2) whether there is a close fit between the classification and the legitimate governmental interest, that is, whether the proposed classification is likely to be the most effective way to produce the desired legitimate results. Although both steps lend themselves to economic and econometric analysis, the focus of this paper will be on the former.

It will be argued that the method chosen to serve the governmental interest requires evaluating the extent to which the interest of the state is served. The existence and extent of benefits will determine whether there is justification to uphold the law. This would mean that the benefits that accrue to the state and its residents as a result of a residency law justify the discrimination practiced against out-of-state workers. Thus, the specific question is "do benefits that accrue to society as a result of the residency law outweigh the losses?"

The first component of an economic analysis of such a law ideally entails the estimation of major benefits and costs likely to result. An economic analysis that considers the effects of the law on the demand and supply functions of workers directly affected by the law has been carried

out in relation to municipal fire fighters and policemen.²⁰ The article estimated the effect of the law on the demand function due to --

- a. productivity increases resulting from availability of a force in the community and a "better feel" for the community's problems, and
- b. substitution of low for high-skill workers.

Likewise, it estimated the laws's effect on the supply function due to

- c. restriction of labor supply and
- d. changes in bargaining power.²¹

For example, local firemen and policemen residency laws can have positive productivity effects by first insuring availability of manpower in case of emergencies involving police and fire departments. A second advantage, closely related to this, is that requiring a firefighter or policeman to reside within a city promotes a "better feel" by the person for problems within the community; also, he or she will take more interest in the results of his work. These factors were found to result in productivity increases (and with it a decrease in the demand for firefighters and policemen).²² Altogether, municipal residency laws were found to have resulted in statistically significant increases in firefighters and policemen at a reduced level of compensation, ceteris paribus, thereby fostering the state's interest.²³ Resident and non-resident policemen and

²⁰Werner Z. Hirsch and Daniel Floyd, "The Substantial Reason Requirement Under the Privileges and Immunities Clause: The Case of Residency Laws", 15 (3) Southwestern University L. J. 431 (1985).

²¹Id.

²²Id at 465.

²³id at 466.

firemen are "different" for the purposes of residency laws in that they provide productivity increases that stem from intimate knowledge and care for a city.²⁴

Public works residency laws, however, are not likely to have such productivity effects, and a microeconomic analysis of demand and supply appears to be neither appropriate nor helpful. Therefore, this paper will offer a macroeconomic analysis of the potential effects of public works residency laws. Specifically, it will seek to ascertain whether in general benefits are likely to exceed costs, and if so under what conditions.

Economists can also make a contribution to the second component of the substantial reason requirement, that is, they can test whether the proposed legislation is likely to produce better results than conceivable alternatives. In other words, is the mechanism provided by the legislation likely to offer the most efficient way to produce the desired result-- maximum net benefits? Testing for the quality of the fit basically involves estimating the net benefits associated with alternative ways to deal with the given problem. This requires benefit-cost analyses of promising alternatives and a comparison of the empirical results.

Within the proposed macro-economic framework, we must determine whether the governmental interest is substantial, and if so, whether in a given classification the governmental interest is achieved by a residency requirement or preference law. Specifically, as a first step we will present an economic model which seeks to determine whether such laws are likely to produce net benefits to society; i.e., is the overall burden placed by the residency law on workers and their families directly, and on

²⁴Id at 467.

various private and public economic activities in the state indirectly substantial?

The economic model will draw on work by R. Haveman who has suggested that "the level and distribution of unemployed resources in the economy affect the evaluation of the social cost imposed on the economy by public expenditures."²⁵ Accordingly, the design, location and priorities of public investments should be influenced by the pattern of unemployment and excess capacity. Public expenditures that place heavier demand on regional sectors showing idle resource rates above the frictional minimum should have higher priority.

This argument is an extension of a better-known proposition that the lower the rate of unemployment in a region, the more likely public expenditures will result in crowding out and in wage inflation. Therefore, it follows that regions with higher initial unemployment suffer more from a lack of public expenditures to stimulate their economy and increase employment than do those with relatively lower unemployment. Consequently, the net benefit of public expenditures is greater for regions that have a larger pool of unemployed resources than for regions with smaller unemployment. The main reason is that in the first case there is less scope for crowding out than there is in the second case. Crowding out occurs in an economy where unemployment is already low, has its labor supply further reduced, and the new employment opportunities are filled mainly by workers leaving their old jobs attracted by higher wages. We will call the test based on the Haveman theory a crowding out test.

²⁵ Robert Haveman, "Evaluating Public Expenditure Under Conditions of Unemployment," Public Expenditure and Policy Analysis, 3rd ed., 1983, pp. 167-182.

In order to implement this test, unemployment rates in border counties must be estimated and compared. Channeling public expenditures into a state's economy, when unemployment is higher in its border counties compared to adjacent counties in other states, would enhance overall social efficiency. Given employment increases in a state's high employment counties would involve less crowding out than if these increases were to occur in counties of neighboring states with less unemployment. On balance, social efficiency would increase as a result of a residency or preference law. The higher the state's unemployment rate compared to that of bordering states, the more effective is a residency or preference law in reducing state unemployment without decreasing social efficiency. This result is most pronounced when the comparison of the unemployment rates focuses on the state's border counties and on neighbor states' counties which border on it.

The second issue relates to the question whether, indeed, a residency law is the best way of producing the desired results of lowering unemployment and increasing income in a given state, consistent with overall social efficiency. Major options are likely to fall into two classes of state actions--affirmative steps designed to improve the attractiveness of the state to firms who would manufacture and do other business in it, and affirmative steps to finance the creation of employment.

Empirical Analysis of the Illinois Preference Act as a Case Study

We will seek to present evidence on the size of the burden, and on whether disproportionate burdens are placed on the State when non-residents take employment away from residents.

Size of Burden

The income implications associated with non-residents working in Illinois' Public Works Project (other than streets and highways), have been estimated. Based on some plausible assumptions, Illinois employed in 1986 about 1273 non-resident workers in public works, financed by the Capital Development Board, working about 363,550 hours. In order to estimate the resulting income loss, the hour estimates must be multiplied by the average hourly wage of Illinois construction workers. The January 1986 average hourly wage paid in contract construction in Illinois was \$17.11 and had increased to \$17.47 in September 1987.²⁶ Thus, it appears appropriate to assume for 1986-87 an average hourly wage of \$17. Accordingly, the income loss is estimated to amount to about \$6.2 million a year.

While this is the direct income effect, there are additional indirect and income induced effects, since the reduced income of Illinois residents curtails their consumption spending and lower consumption reduces the production of the State's private sector. This effect can be measured with the aid of a regional income multiplier for construction and maintenance. Its general magnitude has been estimated with the aid of an interindustry analysis to be about 2.25 to 2.50.²⁷ Thus, the total income effect of nonresidents working on Capital Development Board projects is likely to be about \$14-16 million a year. Since Illinois' overall expenditure on public works projects was estimated to have amounted in 1986 to \$1,449 million (excluding all expenditures on streets and highways), while the Board's

²⁶ Illinois Department of Employment Security Illinois Labor Market Review, opt. cit.

²⁷ Werner Z. Hirsch, "Interindustry Relations of a Metropolitan Area," Review of Economics and Statistics, 41 (November 1959), at 365.

amounted to merely \$124 million, the \$14-16 million income loss associated with the Board's activities must be multiplied by 10.7. Thus, we would estimate that the overall 1986 income loss due to non-residents working in Illinois' public works projects (other than streets and highways) may have approximated \$150-172 million.

Evidence exists that unemployment among construction workers was high. For example, a special computation by the Illinois Department of Employment Security reveals that Illinois, during 1986 and the first ten months of 1987, paid in excess of \$155 million in unemployment compensation to construction workers.²⁸

There are other burdens on the state. Illinois pays unemployment compensation to non-residents who had worked even only for a few days in Illinois before becoming unemployed. These payments continue for up to 26 weeks. The unemployed non-resident who, when employed, commuted tends to spend unemployment benefit payments outside Illinois where he lives. This can reduce consumption spending and business activity in Illinois. Of the unemployment compensation of \$154 million paid between 1986 and October 1987 to construction workers, 14.2 million or 9.2% were paid to 9,388 non-residents who also constituted 9.2% of all claimants.²⁹

Other significant payments to non-residents were made by Illinois under the Aid to Families with Dependent Children and General Assistance programs.

Differential Unemployment Rates

Significant differential unemployment rates are likely to result in disproportionate burdens when non-residents take employment away from

²⁸ Files and printouts of the Illinois Department of Employment Security.

²⁹ Ibid.

residents. Therefore, there is interest to know whether unemployment rates in areas of the state which would be primarily affected by non-resident workers, i.e. border counties, are significantly higher than those in areas of other states from which these workers are likely to come.³⁰ First, there is evidence that during this period, 33 of Illinois 39 border counties were classified by the U.S. Department of Labor as labor surplus areas.³¹ Secondly, an analysis of the unemployment rates of border counties of Illinois and five adjacent states for January-September, 1987, reveals significant differential unemployment rates in relation to 4 out of 5 states. (See Table 1). In relation to Kentucky counties, Illinois' unemployment was 62% higher, in relation to Missouri 54%, in relation to Iowa 34% and in relation to Indiana 4%. The exception was Wisconsin, whose counties had a 4% lower unemployment rate than had Illinois.

These unemployment data lead to the conclusion that the employment effects of the Illinois Preference Act are not only beneficial for Illinois, but also socially efficient. The act is likely to produce an increase in overall production in the U.S. economy by reducing crowding out of other production opportunities.

³⁰For example about 68% of all capital development contracts awarded by the Illinois Capital Development Board were with firms located in adjacent states. Most workers lived near the Illinois border. For example, 62% of the non-resident firms employing 67% of the workers against which the Illinois Department of Labor took action under the Preference Act between July 1984 and December 1987 were located in border counties.

³¹U.S. Department of Labor, Area Trends in Employment and Unemployment (January 1988), pp. 14-17.

TABLE 1

Unemployment Rates of Border Counties of Illinois
and Five Adjacent States, January-September 1987

		<u>Difference</u>	
		<u>Absolute</u>	<u>Percentage</u>
Illinois 9.5%	Indiana 9.13%	0.37	+4.1
Illinois 6.5%	Wisconsin 6.76%	-0.26	-4.0
Illinois 8.42%	Iowa 6.29%	+2.13	+33.9
Illinois 9.6%	Missouri 6.23%	+3.37	+54.1
Illinois 15.5%	Kentucky 9.57%	+5.93	+62.0

Source: Data provided by the Department of Labor of Illinois, Indiana, Wisconsin, Iowa, and Kentucky.

Is the Preference Act the Most Effective Method to Produce the Desired Legitimate Results?

As was mentioned earlier alternatives to residency laws fall into two classes -- steps that would make the state more attractive to manufacturing as well as other economic activities and steps to finance employment creation. Illinois' prevailing wage law, together with absence of a right-to-work law are claimed by some to be responsible for relatively high wages and difficult labor/management relations, which in turn negatively affect the locating of manufacturing activities in Illinois. Therefore, repealing the first and enacting the second could be considered alternatives. However, prevailing wage laws tested for 25 large U.S. cities for 1978-79 and 39 cities for 1970-73 were found to have low statistically significant effect on relative wages.³² Thus repeal of prevailing wage laws may turn out not to be an attractive alternative.

Enactment of right-to-work laws is highly controversial. Such laws increase management's bargaining power while reducing that of labor. Low wage industry maybe attracted by such laws in the short run, but not high wage, sophisticated industries.

Turning to the second alternative, i.e., state financing of employment creating activities, is a policy promising little success. State financed public works, for example, are unlikely to succeed under federalism unless accompanied by a preference law. Otherwise, a significant part of state moneys would end up attracting out-of-state workers.

³²Werner Z. Hirsch and Anthony M. Rufolo, "Effects of Prevailing Wage Laws on Municipal Wages", Journal of Urban Economics 13 (1983), at 124.

Conclusions

State residence laws can impose significant burdens on states, particularly when they are coping with unemployment. Under the Privileges and Immunities Clause of the Constitution, such acts can be held constitutional if in addition to constituting a heavy burden, they also can turn out to be socially efficient. This would be the case when the state enacting a preference law has significantly higher unemployment rates in its border counties compared to those of adjacent border counties of other states. This turns out to be the situation in Illinois where few if any attractive alternatives exist towards producing the desired legitimate results.