

The States' Struggle for Sovereignty: The Consequences of Federal Mandates

By Benjamin Barr¹

Today it is the norm, rather than the exception, for the federal government to issue massive transfer payments to states. Think highway funds and No Child Left Behind. But like your parents taught you, there is no such thing as a free lunch. Just the same, and as Justice Scalia has commented, the strings attached to these programs “make the states dance like marionettes on the fingers of the federal government.” It’s time to cut those strings.

Federalism is rooted in the concept of dual sovereignty. The Constitution created a federal government with limited and enumerated powers. In turn, the Tenth Amendment to the Constitution provides that powers not resting with the federal government “are reserved to the States respectively, or to the people.” As states become more reliant on federal mandates, the nation’s underlying system of federalism shifts from one of partnership to a master-servant relationship.

At first impression, it may seem hard to see the problem with federal transfer payments to the states. After all, state taxpayers finance a good portion of federal payments to state and local governments. Upon inspection, however, large-scale federal funding of state services is a two-edged sword. Federal funds distort legislative policy preferences and priorities, place

bureaucratic agencies beyond legislative control, and lock states into expensive funding commitments.

Once states become habitual users of federal funds, they become dependent on them. That will be true regardless of the institutional arrangements—including the scope of legislative appropriation authority—within the state.

Despite periodic efforts to rein in intergovernmental transfers (especially under the Reagan administration), payments have grown rapidly in absolute terms, in proportion to the federal budget, and most ominously as a percentage of state spending. Today, about 25 percent of states’ total revenue comes from the federal government.²

Because the federal government can borrow more easily than the states, and because states (unlike the federal government) must fear that tax hikes will induce an exodus of productive citizens and businesses, one would expect taxes and spending to grow faster at the federal than at the state or local level.

Strikingly, however, the opposite has happened. The federal tax receipts as a percentage of gross domestic product (GDP) have remained roughly what they were after World War II (about 17 percent). State and local



Continued on next page



tax revenues, in contrast, have almost doubled, from 5.5 percent of GDP in 1948 to 10.1 percent in 2005.³

Although this trend surely has more than a single cause, it appears that federal funding has permanently inflated the demand for government. Indeed, most federal grant programs have some substitution effect within the states, but their systemic, long-term effect is to *increase* state and local taxation and spending.

Large-scale federal funding inflates the size of state government far beyond the median voter's preference—or, put differently, the size of government for which citizens in each state would be willing to tax themselves. For example, Medicaid and similarly structured programs look like a bargain for the states. By accepting a one-for-one matching grant, wherein the federal government ends up funding half the total cost, a state can provide the service at up to twice the pre-grant level without raising taxes or shifting money from competing government programs.

The principal reason for Medicaid's stupendous growth is that its generous funding formula gives states a huge incentive to expand their programs.⁴ Some states now cover families with incomes of up to 275 percent of the poverty level. Almost all provide optional prescription drug benefits and long-term care for the poor and low-income elderly. In a few states, one-third of the population is now on Medicaid.

Where federal funds must be matched by state funds, the state's own policy and spending priorities will be distorted. Federally favored and funded programs will be overfunded by the state, while state functions that do not receive federal support will be shortchanged. When flagging revenues or other factors force the state to reduce expenses, however, the state can save only cents on the dollar by cutting the federally funded program.

Given the federal matching formulas, for example, a one-dollar reduction in a state's Medicaid spending would cause the state to lose more than \$2.00 in federal matching grants.⁵ Thus the state-level cut looks more expensive and requires more draconian steps than an equivalent cut in a wholly state-funded program. Even if the federally funded program is more generous than what the local citizens in the pre-grant world were willing to pay for, the state will prefer to cut competing state-funded programs or, failing that, raise taxes. Some valuable state programs may be crowded out altogether.

Take the State of Arizona, for example. Arizona passed propositions to expand eligibility for federal programs and limit legislative authority to tweak these programs, tying the hands of the state's legislators. After considering the general fund, other appropriated funds, non-appropriated funds, and federal transfer payments, the legislature is left to control but 25 percent of the state's spending. This erosion of state fiscal authority is troubling and is partially the consequence of expanding federal mandates.

Besides being expensive, uniform federal mandates are fundamentally flawed. Increased federal mandates offer homogeneous, national policy solutions for diverse, local problems. While uniform solutions might be fitting in limited instances, attention must be brought to the fact that unique communities require policy solutions fitted to their unique circumstances. Otherwise, one-size-fits-all solutions undercut the very foundation of federalism—that states should be on the forefront as laboratories of reform.

States and local communities know best when it comes to managing their resources and deciding how to use them. Carefully designed local programs specifically tailored to solve community problems should not be displaced in favor of one-size-fits-all federal formulas.

Continued on page 13

Imposing identical solutions nationwide removes incentives for states to compete and experiment in designing the most optimal policy solutions.

Can one think of a federal reform that *would* make a difference in righting the imbalance of power between federal and state governments? One idea—with very limited chances of immediate enactment, but with considerable political potential—is to provide states with a genuine opt-out right from some or all federally funded programs. Currently, states can opt out of program participation *but not* out of the tax payments for those programs. This fiscal asymmetry helps to explain the universal state participation in virtually all federal programs.

To remedy that problem, Congress could and should provide that the citizens and businesses of nonparticipating states receive their proportionate share of payments as a credit against the next year's income tax.⁶ Doing so would lower the tax burden for individuals and businesses—whatever they paid in to support a federal program that the state government of their residence opted out of would be returned to their wallets. This provision need not operate across the board; it could be attached to individual federal funding programs.

A second reform option would be to amend the U.S. Constitution to prohibit federal mandates that require states to use non-federal funds to pay for them. As proposed, in part, by the late Congressman Paul Gillmor (R-OH) in the early 1990s, a suitable constitutional amendment would stop the federal government from forcing state governments to pay for federal programs. Specifically:

The Congress shall not enact any provision of law that has the effect of requiring any State or local government to expend non-Federal funds to comply with any Federal law unless the Congress reimburses the State or local government for the non-Federal funds expended to comply with that Federal law.



This proposal rests on a simple foundation: “When a local government is forced to pay for national policy, the local government becomes a servant of the national government, rather than a partner in federalism.”⁷ The underlying policy question is whether one government body should be able to propose an objective and demand that another government body pay for it. In a system of unchecked federal mandates, the federal government does exactly this.

By passing the buck for costly federal mandates onto local governments, Congress escapes fiscal accountability. Local government bodies are forced to raise taxes to comply with the requirements of the looming federal mandate. In turn, citizens turn to local authorities for assistance. Under this reform, Congress would be held directly accountable for the costs of the programs it creates.

Another reform option would be to expand the reach of the federal Unfunded Mandates Reform Act (UMRA) so that it is applied more frequently. Currently, “emergency” legislation and “constitutional rights” legislation are immune from the act’s provisions. Additionally, procedural gimmicks can be used in the U.S. House and Senate to get around UMRA requirements.

A final pathway of reform involves judicial redress. Each of three approaches presents some ray of light in challenging overbearing federal mandates in the courts.

Continued on next page

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The U.S. Constitution promises to the citizens a republican form of government in the states.⁸ Unless states can retain their own independence and autonomy, they cannot enjoy republican forms of government as promised under the Constitution. These promises are contained in the Guarantee Clause and the 10th Amendment.

Likewise, the Taxing and Spending Clause of the Constitution, under current precedent, permits Congress to condition the acceptance of federal grants on compliance with requirements, provided that the conditions are set forth unambiguously.⁹

Lastly, some federal statutes contain assurances that the law in question will not require states to spend or incur funds in administering the federal program.

It is difficult to counteract the destructive effects of federal funding programs. Procedural reforms, either at the federal or the state level, are difficult to achieve in the short term. The principal constraint is political

in nature. One way or the other, state legislators are called upon to deliver public services, build and maintain roads, provide police protection, and respond to emergencies. These crucial functions are often subsidized by the federal government, but transfer programs are being subsidized far more generously.

Increasingly, federal funds have driven legislators to expand payments for Medicaid and education, at considerable cost to other programs and constituencies. Legislators need and want a way out. In the long term, focusing attention on procedural and structural reforms, such as strengthening the Unfunded Mandates Reform Act, proposing a federal constitutional amendment to end mandates, or devoting funds to litigation challenges may just free states from the grip of their federal masters perpetually.

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- 1 The author wishes to thank Professor Robert G. Natelson, Davin Mason Scholar of Law at the University of Montana School of Law, and Tim Keller, the Executive Director of the Institute for Justice, Arizona Chapter, for their scholarly assistance with this project.
- 2 USASpending.gov, (FY 2007)
- 3 Office of Management and Budget, *FY 2007 Budget*, Historical Table 15.1.
- 4 See Michael S. Greve with Jinney Smith, "What Goes Up May Not Go Down: State Medicaid Decisions in Times of Plenty," American Enterprise Institute working paper, August 5, 2003, http://www.aei.org/publications/pubID.17115/pub_detail.asp.
- 5 Federal Register, Vol. 72, No. 228, November 28, 2007, <http://aspe.hhs.gov/health/fmap09.pdf>
- 6 The seemingly simpler option of remitting the funds to nonparticipating state governments would only exacerbate problems. To those governments, the rebate will look like the proceeds of an income tax they never had to levy, and they will rarely be prepared to pass them along. In fact, those governments will emerge as the strongest proponents of expanding a federal program in which they do not participate: the bigger the program, the bigger the windfall.
- 7 Paul Gillmor and Fred Eames, *Reconstruction of Federalism*.
- 8 U.S. Const. art. IV, § 4.
- 9 U.S. Const. art. I, § 8.

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Published by
American Legislative Exchange Council
1101 Vermont Avenue, NW, 11th Floor
Washington, D.C. 20005