

RETHINKING FISCAL FEDERALISM

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Although interactions between federal and state taxes and spending programs are becoming increasingly controversial, this Article asserts that major theories of federalism built to divide regulatory authority between the two levels of government poorly account for the quite different problems of fiscal cooperation and competition. The Article therefore identifies and distinguishes three justifications for federal funding of states' operations: In some programs, funding seeks to insulate states from particular fiscal burdens, such as the side effects of federal policies or the abrupt termination of federal responsibility for particular problems. In other programs, funding provides an incentive for states to follow federal policy leadership. And in still others, the federal government assumes financial responsibility because of its superior fiscal capacity. The Article finds recent congressional action on unfunded mandates and the Court's new federalism jurisprudence lacking coherent justification under these three models.

The Article then turns to programs that aid low-income people, which present excellent examples of spending programs that suffer from design defects because of the current lack of a coherent theory of fiscal federalism. For example, the Article finds states' fiscal constitutions mired in pre-Keynesian economics. As a result, states consistently undercut federal macroeconomic policy, stimulating the economy during expansions and deflating it further during downturns. In addition, the Article identifies powerful but poorly understood features of state fiscal constitutions that systematically privilege low-income people. Accordingly, this Article criticizes recent moves to devolve fiscal responsibility for precisely the kinds of functions that states are least able to perform. The Article urges states to update their fiscal constitutions to eliminate chaotic responses to swings of the business cycle and to equip themselves to perform the tasks being assigned to them. It also recommends that the federal government adjust its fiscal relationship with states to account for these limitations.

INTRODUCTION

In recent years, all three branches of the federal government have acted to transfer greater regulatory and fiscal authority to the states. Congress enacted legislation that gave states control over funds once used to support welfare and related programs.¹ Even more broadly, it

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¹ See Personal Responsibility and Work Opportunity Reconciliation Act of 1996, tit. I, §§ 101-116, Pub. L. No. 104-193, 110 Stat. 2105, 2110-85 (codified as amended in scattered sections of 42 U.S.C.).

enacted the Unfunded Mandates Reform Act of 1995² (UMRA), which established new procedures for identifying and inhibiting legislation and regulations likely to impose burdens on states.

The executive branch has similarly advanced federalism measures. The first President Bush and President Clinton granted states a wide range of waivers from federal welfare statutes;³ the second President Bush has offered even more sweeping waivers from Medicaid requirements.⁴ President Clinton issued two executive orders on federalism that sought to limit federal agencies' actions that burden states.⁵ The second President Bush has proposed replacing Medicaid⁶ and parts of federal low-income housing assistance programs⁷ with block grants that states would largely control. He has given states greater authority over the enforcement of environmental and other federal regulatory statutes.⁸ And, in a move tantamount to block granting, he has proposed allowing states to rewrite federal rules in numerous other programs.⁹

The Supreme Court's "new federalism," in turn, has established a presumption against interpreting federal legislation so as to affect certain kinds of state policies.¹⁰ The Court has also expanded states' immunity from suit under federal statutes¹¹ and has toyed with establish-

² Pub. L. No. 104-4, 109 Stat. 48 (codified as amended in scattered sections of 2 U.S.C.).

³ See MICHAEL B. KATZ, *THE PRICE OF CITIZENSHIP: REDEFINING THE AMERICAN WELFARE STATE* 90-103 (2001).

⁴ CINDY MANN, *KAISER COMM'N ON MEDICAID AND THE UNINSURED, THE NEW MEDICAID AND CHIP WAIVER INITIATIVES* 19 (2002).

⁵ Exec. Order No. 13,132, 64 Fed. Reg. 43,255 (Aug. 10, 1999); Exec. Order No. 13,083, 63 Fed. Reg. 27,651 (May 19, 1998). President Reagan similarly issued an executive order to advance his conception of federalism. See Exec. Order No. 12,612, 52 Fed. Reg. 41,685 (Oct. 26, 1987).

⁶ See Robin Toner & Robert Pear, *Bush Proposes Major Changes in Health Plans: Critics See Less Security and Fewer Benefits*, N.Y. TIMES, Feb. 24, 2003, at A1.

⁷ See BARBARA SARD & WILL FISCHER, *CTR. ON BUDGET & POLICY PRIORITIES, HOUSING VOUCHER BLOCK GRANT BILLS WOULD JEOPARDIZE AN EFFECTIVE PROGRAM AND LIKELY LEAD TO CUTS IN ASSISTANCE FOR LOW-INCOME FAMILIES* 1 (2003), available at <http://www.cbpp.org/5-14-03hous.pdf>.

⁸ See President George W. Bush, Remarks at Sequoia National Park, California, 37 WEEKLY COMP. PRES. DOC. 830, 832 (May 30, 2001) (pledging to encourage state enforcement of environmental rules); see also Eric Pianin & Michael Grunwald, *Bush Plan Shifts Power over Polluters to States*, WASH. POST, Apr. 10, 2001, at A3 (reporting Bush proposal to scale back EPA budget by \$10 million and to provide \$25 million in grants to fund state enforcement efforts).

⁹ See SHAWN FREMSTAD & SHARON PARROTT, *CTR. ON BUDGET & POLICY PRIORITIES, "SUPERWAIVER" PROVISION IN HOUSE TANF REAUTHORIZATION BILL COULD SIGNIFICANTLY WEAKEN PUBLIC HOUSING, FOOD STAMPS, AND OTHER LOW-INCOME PROGRAMS* (2004) (describing the proposed "new authority [of] the Executive Branch to override, at the request of the state governor, almost any federal law or rule governing a long list of low-income programs").

¹⁰ See, e.g., *Gregory v. Ashcroft*, 501 U.S. 452, 470 (1991).

¹¹ See, e.g., *Bd. of Trs. of the Univ. of Ala. v. Garrett*, 531 U.S. 356, 363-74 (2001); *Kimel v. Fla. Bd. of Regents*, 528 U.S. 62, 78-80, 91 (2000); *Alden v. Maine*, 527 U.S. 706, 727-30, 758

ing a zone of state autonomy under the Tenth Amendment into which federal legislation cannot intrude.¹² It also has limited the authority of both Congress¹³ and the lower federal courts¹⁴ to direct state legislative, executive, and judicial operations. And the Court has expanded states' authority indirectly by narrowing Congress's ability to legislate under the Commerce Clause¹⁵ and Section 5 of the Fourteenth Amendment.¹⁶

Lacking in this flurry of activity is a coherent theory of just what this federalism seeks to accomplish,¹⁷ beyond the hazy concept of aiding states.¹⁸ Even if federalism's objective is simply to give states

(1999); *Fla. Prepaid Postsecondary Educ. Expense Bd. v. Coll. Sav. Bank*, 527 U.S. 627, 634–48 (1999); *Seminole Tribe v. Florida*, 517 U.S. 44, 72–73 (1996).

¹² See, e.g., *Nat'l League of Cities v. Usery*, 426 U.S. 833, 842–52 (1976), *overruled by* *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 537–57 (1985). Some states' rights proponents have continued to advocate restoring a version of state immunity from federal mandates, or at least unfunded mandates, to constitutional status. See, e.g., U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *FEDERAL REGULATION OF STATE & LOCAL GOVERNMENTS: THE MIXED RECORD OF THE 1980S*, at 4–5 (1993).

¹³ See *Alden*, 527 U.S. at 712; *Printz v. United States*, 521 U.S. 898, 925–33 (1997); *New York v. United States*, 505 U.S. 144 (1992); cf. *Gregory*, 501 U.S. at 464 (declining to apply a generally applicable law to preempt state regulation of its judiciary without clear instruction from Congress). *But see* *Reno v. Condon*, 528 U.S. 141, 148–51 (2000) (finding *Printz* inapplicable to a statute restricting states' release of confidential drivers' license information); Matthew D. Adler & Seth F. Kreimer, *The New Etiquette of Federalism*: New York, Printz, and Yeskey, 1998 SUP. CT. REV. 71 (criticizing the incoherence of this doctrine).

¹⁴ See *Missouri v. Jenkins*, 515 U.S. 70, 89–100 (1995) (prohibiting a federal district court from compelling state appropriations in order to implement desegregation order).

¹⁵ See *United States v. Morrison*, 529 U.S. 598, 607–19 (2000); *United States v. Lopez*, 514 U.S. 549, 565–68 (1995).

¹⁶ See *Garrett*, 531 U.S. at 365–68; *Morrison*, 529 U.S. at 619–27; *Kimel*, 528 U.S. at 80–91; *Fla. Prepaid*, 527 U.S. at 634–39; *City of Boerne v. Flores*, 521 U.S. 507, 516–29 (1997).

¹⁷ Indeed, Professor Chemerinsky has argued that, even in the regulatory context, the theoretical underpinnings of federalism are poorly articulated. See Erwin Chemerinsky, *Rehabilitating Federalism*, 92 MICH. L. REV. 1333, 1334–36 (1994) (reviewing SAMUEL H. BEER, *TO MAKE A NATION: THE REDISCOVERY OF AMERICAN FEDERALISM* (1993)).

¹⁸ To be sure, some proponents of federalism do not require more: for them, federalism is merely a code word for the uncritical expansion of states' authority at the expense of the federal government. See, e.g., ERIC N. WALTENBURG & BILL SWINFORD, *LITIGATING FEDERALISM: THE STATES BEFORE THE U.S. SUPREME COURT 25–38* (1999) (applying a simplistic approach to categorizing the results of cases and Justices' votes); WORKING GROUP ON FEDERALISM, DOMESTIC POLICY COUNCIL, *THE STATUS OF FEDERALISM IN AMERICA 1–7* (1986) (seeking across-the-board reduction in the role of federal government without identifying any principles to guide that reduction); see also TIMOTHY CONLAN, *NEW FEDERALISM: INTER-GOVERNMENTAL REFORM FROM NIXON TO REAGAN 99, 110–11* (1988) (suggesting that Reagan's federalism policy sought only to dismantle federal programs).

This incoherency is disconcerting because federalism also can be invoked to cover surreptitious objectives. See Martin B. Cohen, *Introduction to FEDERALISM: THE LEGACY OF GEORGE MASON 1, 21–22* (Martin B. Cohen ed., 1999) (discussing national speed limits, nationalized state guard services, and the silent rollback of welfare programs at the state level). Indeed, for some the priority is divesting the federal government of responsibility rather than investing it specifically in the states. See Jon D. Michaels, *Beyond Accountability: The Constitutional, Democratic, and Strategic Problems with Privatizing War*, 82 WASH. U. L.Q. 1001 (2004).

more power, knowing the purpose and limiting principles of this desire is necessary in order to know how much power to transfer and to select among the myriad possible ways of doing so. Particularly problematic has been policymakers' — and some scholars' — failure to distinguish between regulatory federalism and fiscal federalism. Although recent initiatives increasingly focus on federal-state fiscal relationships, traditional theories of federalism primarily address the distribution of regulatory power.¹⁹ Moreover, most scholarship focuses primarily on the role of federal court injunctions in upholding federalism. Yet while injunctions are pivotal to disputes over regulatory federalism, a broader array of actors and a more complex system of remedies are needed to implement a sustainable version of fiscal federalism.

This theoretical deficiency has had important practical consequences, especially for low-income assistance programs. One of the most important aspects of contemporary fiscal federalism is the transfer of responsibility for these programs from the federal government to the states.²⁰ A systematic examination of states' fiscal constitutions,²¹ however, reveals strong implicit biases against these programs.²² Thus, the actual level of financial support states provide for these programs is likely to fall significantly short of what a similar level of po-

¹⁹ To the extent that scholars have addressed fiscal federalism, it has been primarily in the context of taxation. See, e.g., Richard M. Bird, *Fiscal Federalism*, in THE ENCYCLOPEDIA OF TAXATION AND TAX POLICY 127, 127–29 (Joseph J. Cordes et al. eds., 1999).

²⁰ The most sweeping manifestations of this phenomenon are the replacement of the former federal-state cash assistance program for needy families with a fixed block grant to states and the proposals to make similar changes in housing, health care, food aid, and other federal programs. See *supra* p. 2547; see also Jon Michaels, *Deforming Welfare: How the Dominant Narratives of Devolution and Privatization Subverted Federal Welfare Reform*, 34 SETON HALL L. REV. 573, 598–99 (2004) (arguing that the structural component of the 1996 welfare law, which transferred programs to the states, undermined the legislation's substantive goal of promoting work).

²¹ The formulation of most states' fiscal policies is guided by a combination of state constitutions' fiscal rules (typically far more detailed than those in the federal constitution), state statutes, the state legislatures' procedural rules, and traditions that shape the expectations of the major players in budgetary affairs. When this Article speaks of states' "fiscal constitutions," it refers to the combined effect of all these restraints, even though many are not part of the states' formal constitutions.

²² Some have argued that a key purpose of the federal government's transfer of these programs to states was to reduce spending on social welfare programs while evading political responsibility for the resultant hardship. See, e.g., CHARLES NOBLE, WELFARE AS WE KNEW IT: A POLITICAL HISTORY OF THE AMERICAN WELFARE STATE 120–21 (1997). While some conservatives have candidly admitted that they manipulate fiscal policies as part of a larger agenda to shrink government, see Paul Krugman, *The Tax-Cut Con*, N.Y. TIMES, Sept. 14, 2003, § 6 (Magazine), at 54, 57–58 (criticizing conservatives that have admitted to employing tactics designed to make voters dislike the government), it seems unlikely that the widespread support for devolution of these programs can be explained solely in these cynical terms. Many policymakers sincerely believed that they were maintaining effective programs for people in need. To them, there is no need to decide between federalism and a robust safety net. Unfortunately, as this Article shows, devolution and protecting victims of economic misfortune are, indeed, inconsistent objectives — for reasons having nothing to do with ill will.

litical support might produce for programs not subject to these vulnerabilities. Moreover, the transfer of these countercyclical programs to states is likely to undermine the effectiveness both of those programs and of federal macroeconomic policy. Significant changes in states' fiscal constitutions will enable states to assume greater fiscal responsibility and to reduce structural biases that disfavor programs targeting low- and moderate-income people.

This Article seeks to develop a new conception of fiscal federalism shorn of inapposite assumptions borrowed from regulatory theory debates. This analysis proceeds in two distinct parts. First, it takes a global view of states' fiscal relationships with the federal government. In doing so, it develops more theoretically satisfactory models to explain cooperation and competition over spending programs, disentangles current debates about federal mandates, assesses the federal role in shaping states' taxing authority, and compares those areas in which the Court has buttressed states' fiscal positions with those in which it has brushed aside states' pleas. After developing this broad picture, it proceeds to explore the interaction between the business cycle and the fiscal provisions of state constitutions. It finds this interaction problematic, both for federal countercyclical fiscal policy and for programs aiding low- and moderate-income people. This finding suggests that federal initiatives that transfer responsibility for these programs to states are misguided. It also suggests that for these programs to have a fair chance to compete for resources on the state level, state fiscal constitutions and the structure of programs with joint federal-state fiscal responsibility must both significantly change.

Part I surveys the basic premises of regulatory federalism that have animated most of the theoretical work to date. It finds that many of these premises require significant adaptation before they can be applied successfully to fiscal federalism. It also finds that the practical problems fiscal federalism must confront are different, and often more complex, than those facing regulatory federalism.

Having identified the weaknesses of the traditional theoretical framework, the Article then explores the federal role in fiscal federalism. Part II analyzes the structure of the federal-state fiscal relationship as it has evolved since the New Deal. It finds the structure theoretically confused and the politics fundamentally unstable. It concludes that, while the common structures of federal-state programs are modestly more sensitive to the fiscal and political consequences of the business cycle than are states' own fiscal constitutions, they nonetheless fail both to shield programs for low- and moderate-income people from damage over the course of the business cycle and to prevent states from undermining federal macroeconomic policy.

The Article then turns to an examination of states' strengths and limitations as fiscal partners for the federal government. Part III provides a broad survey of states' fiscal constitutions. It finds that they

rely upon economic assumptions largely discredited since the Great Depression and illustrates this point by surveying states' fiscal behavior over the last two business cycles.

Part IV then identifies the systematic biases against programs for low- and moderate-income people hidden in states' fiscal constitutions. Although many of these biases apply even in a static environment, some of the most serious — and least understood — biases disadvantage these programs over the fluctuations of the business cycle, causing funding to ratchet downward.

Finally, Part V charts a course toward a new fiscal federalism that rests on firmer theoretical, political, and economic foundations and that ameliorates the systematic biases the current system exhibits. This approach requires changing both states' fiscal constitutions and the terms of federal-state cooperation on taxes and spending programs.

I. THE INABILITY OF STANDARD THEORIES OF FEDERALISM TO EXPLAIN FEDERAL-STATE FISCAL RELATIONSHIPS

Although courts and scholars have developed a variety of normative and descriptive theories of federalism, the paradigm for most of these theories is the allocation of regulatory authority. Fiscal relationships between federal and state governments, however, operate in very different ways than do regulatory relationships. Most obviously, though regulatory federalism primarily seeks to define and protect separate zones of authority for the two levels of government, much of fiscal federalism addresses more subtle problems resulting when both levels are involved concurrently. Additionally, because money is fungible, superficially separate aspects of fiscal federalism are much more closely interconnected than are different types of social and economic regulation. Finally, although regulatory federalism is primarily a subset of constitutional law, theories of fiscal federalism must speak to the political branches as well as to the courts.

This Part explores the fundamental differences between regulatory and fiscal federalism. Section A seeks to categorize the major strains of federalism theory and the problems that arise as each theoretical structure is transplanted from the regulatory to the fiscal environment. Section B summarizes the differences between the practical problems that arise when implementing theories of fiscal federalism and those that arise when implementing the more familiar regulatory federalism.

A. Theoretical Differences Between Regulatory and Fiscal Federalism

Prominent theoretical justifications for federalism can be divided into four separate, if often related, models: dual sovereignty, compara-

tive process, pluralist, and comparative efficiency.²³ Each model offers insights into competition between federal and state governments. In subtle but important ways, the first three theories rely upon assumptions that fail to account for the differences between regulatory and fiscal federalism. These differences require modifications of each of these theories as they are translated to fiscal matters. To date, this adaptation has not happened. The fourth theory, comparative process, has greater applicability in the fiscal context, but has often been used improperly due to mistaken assumptions about the characteristics of states' fiscal constitutions.

1. *Dual Sovereignty Theories.* — The dual sovereignty theory of federalism seeks to protect the ability of federal and state governments to function as full sovereigns free from encroachment by the other.²⁴ Some formulations of this approach regard states' rights, like certain individual rights, as a first principle of constitutional law that requires no consequentialist justification.²⁵ They also commonly find civic virtue in the maintenance of viable, meaningful state governments that involve their citizens in public affairs.²⁶ Because the dual sovereignty theory focuses attention on actions by one level of government that implicitly insult the other or that impinge upon the other's ability to act,²⁷ it allows the federal government to act in areas of state interest if

²³ This division is based primarily on the likely consequences of each theory rather than on its normative rationale. For purposes of distinguishing between regulatory and fiscal federalism, nothing more is required. Accordingly, this Article provides only a superficial account of the diverse theoretical justifications for these visions of federalism, except as necessary to test their applicability to fiscal matters.

²⁴ See, e.g., Deborah Jones Merritt, *The Guarantee Clause and State Autonomy: Federalism for a Third Century*, 88 COLUM. L. REV. 1, 18 (1988) (arguing that state autonomy acts primarily "to check the power of the federal government" and that "the purpose of one governmental body is to check another"); Martin H. Redish, *Constitutionalizing Federalism: A Foundational Analysis*, 23 OHIO N.U. L. REV. 1237, 1240 (1997) (noting that "most fundamentally, [federalism] must see to it that both levels of government — the superior and subordinate sovereigns — are guaranteed sufficient power to assure their continued viability"). See generally RAOUL BERGER, *FEDERALISM: THE FOUNDERS' DESIGN* 48–76 (1987) (tracing the early development of the dual sovereignty concept); Akhil Reed Amar, *Of Sovereignty and Federalism*, 96 YALE L.J. 1425, 1429–51 (1987) (same).

²⁵ See, e.g., Michael C. Dorf, *Instrumental and Non-Instrumental Federalism*, 28 RUTGERS L.J. 825, 828–31 (1997).

²⁶ See, e.g., *Gregory v. Ashcroft*, 501 U.S. 452, 458 (1991); BEER, *supra* note 17, at 386; 1 ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* 243–44 (Phillips Bradley ed., Francis Bowen rev., Alfred A. Knopf 1987) (Henry Reeve trans., 1835) (1835) (finding civic virtue to be a bulwark against dictatorship when exercised at the local level); Adler & Kreimer, *supra* note 13, at 81–82; Richard B. Stewart, *Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy*, 86 YALE L.J. 1196, 1210–11 (1977).

²⁷ Although federalism is commonly deployed in favor of protecting the attributes of state sovereignty against federal encroachment, this model also supports limiting states to maintain the effectiveness of the federal union. See 1 LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 6-1, at 1021–29 (3d ed. 2000).

control of those areas does not seem essential to the states' ability to function as viable, sovereign entities. Accordingly, debates under this model typically revolve around determining which attributes of state power are essential to state sovereignty.²⁸ Some theorists, however, question whether states still merit treatment as full sovereigns.²⁹

On its face, the dual sovereignty approach could apply to fiscal as well as regulatory federalism: for states to fulfill their roles as sovereigns, they must have fiscal as well as regulatory power. Yet a closer examination of this theory of regulatory federalism shows that it has little application to fiscal federalism. Professor Erwin Chemerinsky summarizes the dual sovereignty view as holding that “[t]he central federalism issue in modern constitutional law is whether, and to what extent, state sovereignty limits federal powers. Is there a zone of activities assigned to the states for their exclusive control? Do some federal actions unduly interfere with state sovereignty?”³⁰ The possibility that federal and state regulations might offer conflicting instructions to private parties makes these questions urgent in the regulatory context. In the fiscal context, however, a larger federal role need not displace that of the states: the spending power is virtually always concurrent.³¹ According to the dual sovereignty approach, then, federalism concerns should not apply at all in fiscal matters.

2. *Comparative Process Theories.* — Comparative process theories seek to allocate responsibilities to the level of government most likely to produce the “best” results. This allocation, of course, requires two highly problematic enterprises: defining a “good” result and predicting which political system is most likely to produce one.³² The difficulty

²⁸ See, e.g., ROBERT F. NAGEL, *THE IMPLOSION OF AMERICAN FEDERALISM* 69–83 (2001) (arguing that the Supreme Court has tolerated severe affronts to state sovereignty, even in recent years).

²⁹ See *id.* at 49–57.

³⁰ Chemerinsky, *supra* note 17, at 1340 (footnote omitted).

³¹ Of course, states presumably could not make grants to foreign powers without federal approval. Cf. *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 373–74 (2000) (invalidating on preemption grounds a Massachusetts law that barred state entities from contracting with companies that do business with Burma, while declining to reach challenges based on the national foreign affairs power and the Foreign Commerce Clause). Nor could the federal government offer important state officials second salaries without the state's consent. Cf. *Spallone v. United States*, 493 U.S. 265, 273–80 (1990) (prohibiting a federal district court from imposing fines on individual city councilmembers that would coerce them into voting to bring city into compliance with a prior order). These exotic examples, and others that might plausibly be imagined, represent a trivial fraction of the areas in which federal and state spending power might be exercised.

³² See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* § 26.1, at 665 (6th ed. 2003) (arguing that the information costs of building a coalition at the federal level offer greater protection against ideological monopoly than states' more accessible political systems); NOBLE, *supra* note 22, at 32–34, 120–21 (reaching similar conclusions from a perspective sympathetic to such coalitions).

of this endeavor, however, has not discouraged numerous theorists.³³ Traditionally, for example, many have argued that the federal government is a more trustworthy guardian of civil rights and civil liberties.³⁴ Some scholars, however, have noted the more expansive positive rights in state constitutions and suggested that states' political processes may recognize rights that the federal system has not.³⁵ There is also disagreement as to whether local governments are more transparent and responsive to public concerns than are remote federal agencies.³⁶

The comparative process approach breaks down in the fiscal realm not on theoretical grounds, but rather on empirical ones. Specifically, comparative process arguments routinely fail to appreciate the gravity of the constraints in states' fiscal constitutions. Although state constitutions do indeed deviate from the federal model in offering more antimajoritarian positive rights for politically marginal groups, they also contain more antimajoritarian provisions limiting the states' fiscal capacity to aid many of those same groups.³⁷ These "supernegative" rights — limits on spending, taxation, and debt — are not founded on fears of majoritarian oppression of politically weak individuals and groups or of a current government's subversion of the means by which

³³ See, e.g., THE FEDERALIST NO. 10, at 83–84 (James Madison) (Clinton Rossiter ed., 1961) (arguing that the danger of avaricious factions at the state level makes centralization important); Chemerinsky, *supra* note 17, at 1342 (seeing federalism as a means of "encouraging responsive government"); Dorf, *supra* note 25, at 828 (discussing the Court's concern for "democratic accountability" when ruling on claims asserted by states).

³⁴ See, e.g., Akhil Reed Amar, *Five Views of Federalism: "Converse-1983" in Context*, 47 VAND. L. REV. 1229, 1231 (1994) (describing this argument as an aspect of the "nationalist" perspective); David A. Super, *Offering an Invisible Hand: The Rise of the Personal Choice Model for Rationing Public Benefits*, 113 YALE L.J. 815, 844–51 (2004) (arguing that devolution of control over who receives welfare benefits has opened the door to covert invidious agendas); cf. Sheryll D. Cashin, *Federalism, Welfare Reform, and the Minority Poor: Accounting for the Tyranny of State Majorities*, 99 COLUM. L. REV. 552, 554–55 (1999) (describing how local prejudice against welfare recipients can go unchecked when states exercise power over welfare programs).

³⁵ See, e.g., William J. Brennan, Jr., *State Constitutions and the Protection of Individual Rights*, 90 HARV. L. REV. 489, 491 (1977); Helen Hershkoff, *Positive Rights and State Constitutions: The Limits of Federal Rationality Review*, 112 HARV. L. REV. 1131, 1155–57 (1999). But see Amar, *supra* note 34, at 1243–46 (finding Brennan's celebration of federalism on the grounds of heightened state protections "weak"); A.E. Dick Howard, *Introduction to DEVELOPMENTS IN STATE CONSTITUTIONAL LAW*, at xi, xix–xx (Bradley D. McGraw ed., 1985) (noting that some scholars have expressed concern about a popular backlash against state judicial activism).

³⁶ Compare MICHAEL D. REAGAN & JOHN G. SANZONE, THE NEW FEDERALISM 121 (2d ed. 1981) ("Increased accountability at the subnational level is uneven, precarious, and difficult to measure."), with Rudolph G. Penner, *Reforming the Grants System*, in FISCAL FEDERALISM AND GRANTS-IN-AID 111, 120–21 (Peter Mieszkowski & William H. Oakland eds., 1979) ("If lower levels of government are given more discretionary power, the disposition of grants may therefore receive more public and governmental scrutiny than is possible in the Congress.").

³⁷ See generally G. ALAN TARR, UNDERSTANDING STATE CONSTITUTIONS 157–61 (1998) (describing provisions limiting states' discretion to spend).

it could be criticized and removed.³⁸ Instead, they allow groups to ensure adherence to their particular policy preferences that the majority may support in the abstract but not necessarily in a clear competition with alternative principles.³⁹ These supernegative rights predominately interfere with state and local governments' ability to aid politically weak groups⁴⁰ and thus skew the outcome of state and local political processes against those groups, probably ensuring that they will obtain less than their numbers and alliances otherwise suggest.⁴¹

Comparative process theorists also often fall victim to a static view of states' political processes. In fact, states' political processes operate in very different ways at different points in the business cycle. Although the business cycle generally has only a peripheral impact on regulatory decisions, its impact on fiscal affairs is profound. During booms, states with expanding revenues and falling obligations can indeed seem to be thoughtful and open political fora. During recessions, on the other hand, states can be hostile fora for spending programs because they are required to operate on balanced budgets.⁴² In particular, as developed below, spending on programs that focus on low- and moderate-income people are disproportionately vulnerable to cuts during recessions despite enjoying no particular advantages during booms.⁴³ Over several business cycles, therefore, funding for these programs is likely to ratchet down to levels well below what their political support might produce in a static environment. Until these

³⁸ See generally JOHN HART ELY, *DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW* 135–79 (1980) (arguing that countering these two types of majoritarian abuses is the primary justification for antidemocratic constitutional rules).

³⁹ See RANDALL G. HOLCOMBE, *PUBLIC FINANCE AND THE POLITICAL PROCESS* 30–40 (1983) (discussing the median voter model and voter behavior in referenda). Thus, for example, voters may like the idea of limiting taxes in the abstract but, when faced with a concrete tradeoff, prefer paying more taxes rather than allowing schools to deteriorate, reducing sentences to relieve pressure on corrections, and waiting in traffic for lack of investment in transportation infrastructure. If asked to vote on limiting taxes before the consequences are clear, the electorate may privilege opponents of taxes over groups advocating strong schools, tough penalties for crime, or the construction of highways or public transit.

⁴⁰ As discussed below, these provisions include a range of limitations on public spending, borrowing, and taxes. See *infra* section IV.C, pp. 2621–29. More recently, opponents of affirmative action, gay and lesbian civil rights, and leniency for criminal offenders have succeeded in inserting their policy preferences into state constitutions.

⁴¹ Put another way, these supernegative rights give a huge advantage to other groups competing in state politics. By assuring acceptance of much of the agenda supported by the advocates of these positions, they eliminate the need for those advocates to make policy concessions. These provisions also free those advocates to devote their full energies to winning enactment of their other preferences. Conversely, to the extent that the provisions explicitly or implicitly require supermajorities to adopt contrary positions or compel groups advocating other policies to compete against one another for scarce resources, they are likely to force those groups to make substantial compromises.

⁴² See *infra* Part III, pp. 2605–14.

⁴³ See *infra* section IV.D, pp. 2629–40.

practical realities are addressed, the comparative process approach cannot intelligently inform the theory of fiscal federalism.

3. *Pluralist Theories.* — Absent clear reasons to insist upon a single, uniform national policy, pluralists urge decentralization of authority.⁴⁴ First, pluralists argue that this decentralization allows the states to become laboratories of democracy⁴⁵ from which other states can learn about a variety of different responses to common problems.⁴⁶ This variety permits people that feel strongly about a particular matter to move to a state whose approach is more to their liking⁴⁷ or, looked at the other way, “makes government more responsive by putting the States in competition for a mobile citizenry.”⁴⁸ Further, pluralists argue that even if citizens are not mobile, preferences may differ geographically and states can better accommodate those preferences when free from federal restraint.⁴⁹ Conversely, voters can hold state officials more closely accountable than they can more remote federal officials. Second, pluralists see the diffusion of power among the fifty states as protection against a dangerous aggregation and abuse of power at the federal level.⁵⁰ Finally, allowing states to craft policies in response to

⁴⁴ See Amar, *supra* note 34, at 1233–40 (discussing the “laboratory” and “political market” models of federalism and noting the latter’s parallels to the separation of powers as a generic strategy for checking encroachments by centralized authorities); Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the “Race-to-the-Bottom” Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210 (1992).

⁴⁵ See *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

⁴⁶ See POSNER, *supra* note 32, § 26.1, at 665 (noting the need for “experimentation with divergent approaches to problems of public policy”); Adler & Kreimer, *supra* note 13, at 78–79 (noting that it “makes sense to create a mechanism by which to test novel policies on a subnational scale”); Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentalism*, 98 COLUM. L. REV. 267, 322 (1998) (noting that “[a]bove all, an experimentalist regime gives locales substantial latitude in defining problems for themselves”); J. Harvie Wilkinson III, *Federalism for the Future*, 74 S. CAL. L. REV. 523, 524–27 (2001) (noting that “[f]ederalism offers not only the benefit of experimentation, but the promise of compromise”). But see Susan Rose-Ackerman, *Environmental Policy and Federal Structure: A Comparison of the United States and Germany*, 47 VAND. L. REV. 1587, 1591–97 (1994) (arguing that local innovation is unlikely to occur); Edward L. Rubin & Malcolm Feeley, *Federalism: Some Notes on a National Neurosis*, 41 UCLA L. REV. 903, 923–26 (1994) (arguing that centralized control of state laboratories would be more effective than a federalist system).

⁴⁷ See ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 309–31 (1974) (positing that movement among different polities, rather than voting in any one of them, is the best means of assuring individual liberty); Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956) (developing a model in which individuals satisfy their preferences for public goods by moving among communities that offer different tax and expenditure policies).

⁴⁸ *Gregory v. Ashcroft*, 501 U.S. 452, 458 (1991).

⁴⁹ See Adler & Kreimer, *supra* note 13, at 77–78 (describing the geographic diversity argument).

⁵⁰ See BEER, *supra* note 17, at 387–88 (noting that the Founders “considered the states to be institutions for correcting the deviations of the center”); Adler & Kreimer, *supra* note 13, at 79–81; Chemerinsky, *supra* note 17, at 1342 (noting that the values of federalism include “limiting federal tyranny”); Dorf, *supra* note 25, at 828 (emphasizing “dividing power to preserve liberty”); Herbert Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and*

local circumstances can reduce unnecessary intrusions upon the operation of the market.⁵¹ On the other hand, most pluralists acknowledge that power should be retained at the federal level when the nation needs to speak with one voice, when states are incapable of addressing a problem themselves, or when national uniformity would be more economically efficient.⁵²

Pluralist theories can operate along both political and economic dimensions,⁵³ but they nonetheless fit regulatory federalism more comfortably than they fit fiscal federalism. Recognizing the exclusive authority of state (or federal) government to regulate an aspect of social or economic activity generally is feasible. By contrast, federal and state fiscal policies are so pervasively interconnected that defining a zone of exclusive control for either level of government is virtually impossible. Numerous taxes and spending programs are explicitly coordinated between federal and state governments. Most states rely upon federal definitions of adjusted gross income or taxable income in their tax systems; many social welfare programs combine federal funding and standards with state administration (and additional funding).

Even when they are not explicitly coordinated, there is considerable overlap between the subjects each level of government wishes to reach with its fiscal policies. This interconnectedness undermines the accountability rationale for pluralism: if even careful social science research fails to determine conclusively which policies produced a given result, voters have little chance of reliably assigning credit or blame. Moreover, a common pluralist approach to fiscal federalism — having one level of government raise funds to be spent in accordance with policies selected by the other — tends to be unsustainable either constitutionally or politically.⁵⁴

Selection of the National Government, 54 COLUM. L. REV. 543, 558 (1954) (discussing the role of the states in “the containment of the national authority”). *But see* Amar, *supra* note 34, at 1240–43 (criticizing the unsupported assumptions of this model).

⁵¹ See HENRY J. RAIMONDO, *ECONOMICS OF STATE AND LOCAL GOVERNMENT* 64–67 (1992).

⁵² See Wilkinson, *supra* note 46, at 524 (“There are, of course, many issues that require national solutions. Almost no one advocates placing diplomatic and military responsibilities in the hands of the states. Such mega-weights as trade and immigration obviously need a national approach.”).

⁵³ See *Gregory*, 501 U.S. at 458 (finding that preserving broad state power “assures a decentralized government that will be more sensitive to the diverse needs of a heterogeneous society”); *Younger v. Harris*, 401 U.S. 37, 44 (1971) (maintaining “that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways”); POSNER, *supra* note 32, §26.1, at 665–66; Chemerinsky, *supra* note 17, at 1342; Merritt, *supra* note 24, at 10.

⁵⁴ When the federal government seeks to set policy and compel states to expend their own resources to administer that policy, it risks running afoul of the Court’s anticommandeering doctrine. See *Printz v. United States*, 521 U.S. 898 (1997); *New York v. United States*, 505 U.S. 144 (1992). No constitutional problems arise in the reverse situation, in which the federal government

Pluralism in fiscal federalism tends to be a matter of degree, and thus some of the theory's other, more ambitious claims also must be scaled back. The discretion states have in designing spending programs, although real, may be too technical and subtle for the electorate to act upon directly. "Laboratories of bureaucracy" can still provide valuable lessons concerning the consequences of particular policies, but they are unlikely to promote civic involvement. In addition, states' fiscal capacities vary far more than their regulatory capacities. An example of a successful policy in a wealthy state thus may be of little interest to a poorer one that has no realistic ability to emulate that success. Indeed, a poor state's program that is making the most of its resources may nonetheless be achieving less than an inefficiently run program in a wealthier state. The value of state laboratories declines as varying capacity causes them, in effect, to engage in quite different kinds of "research."⁵⁵

An excessive focus on regulatory federalism also tends to cause pluralists to miss an important national interest implicated in fiscal federalism. Because of its role in managing the national economy, the federal government has a much more specific interest in the aggregate level of federal and state taxing and spending than it does in the aggregate level of federal and state regulatory activity.⁵⁶ This suggests that pluralist arguments have much less force on fiscal matters.

4. *Comparative Efficiency Theories.* — Finally, the various economic models supporting and seeking to provide direction to federal-

gives states resources to expend according to state policy choices. This arrangement, however, requires considerable ongoing political generosity from federal policymakers: they must bear the political costs of raising the revenue and forgo the political rewards of spending that revenue on programs for which they would receive political credit, yet state officials receive credit from the public and favors from groups seeking to influence how those monies are spent. Thus, over time, funding for revenue sharing, block grants, and similar measures is likely to erode — as indeed it has. See *infra* section II.B.2.b, pp. 2589–91.

⁵⁵ This varying capacity tends to promote regionalism — for example, relatively poor southeastern states look primarily to one another for examples to follow. See, e.g., S. GOVERNORS' ASS'N ON STATE NATURAL RES. AGENCY BEST PRACTICES, FUNDING MECHANISMS, AND P'SHIPS, STATE LEADERSHIP AND BEST PRACTICES IN CONSERVATION 3 (2002) ("This white paper was developed specifically to respond to governors' requests for information on conservation success stories in the South and the factors that lead to those successes so that they could be replicated throughout the region."). Regionalism is generally considered to be unhealthy for the federal union. See *U.S. Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 467–72 (1978) (finding that the Compact Clause seeks to prohibit groups of states from securing political advantage over other states and thereby harming the balance of federalism).

⁵⁶ To be sure, some political groups advocate less regulation while others see this as less of a concern. In addition, an economic argument can be made that the aggregate level of business regulation in the United States affects its international competitiveness and the profitability of its industry. Even so, however, this concern applies only to regulation in particular substantive areas. The stringency of regulation imposed on prison inmates, for example, has virtually no impact on business; likewise, regulations on driving, alcohol consumption, and home decoration have modest sectoral effects at most. Even in the aggregate, these effects are likely inconsequential.

ism also betray the heavily regulatory orientation of their architects. These models typically suggest allocating responsibilities between federal and state governments based on economies and diseconomies of scale.⁵⁷ The comparative efficiency approach considers the externalities that might result from having a variety of state policies that would affect adjoining states or snarl interstate commerce nationally.⁵⁸ When it addresses fiscal issues at all, it is typically again in terms of market failures.⁵⁹

What is generally missing from these models, however, is serious macroeconomic analysis or an appreciation of the relationship between states' budgets and the business cycle.⁶⁰ The adverse consequences of states collectively undercutting federal macroeconomic policy⁶¹ — raising taxes and cutting spending when the federal government is trying to stimulate the economy out of a recession, or cutting taxes and boosting spending when the economy is in danger of overheating — are far greater than any sectoral distortions likely to result from inefficient regulation. Programs with significant diseconomies of scale that states might be well-positioned to operate in a static environment may prove highly inefficient if their funding is frequently rising and falling as states' budgetary fortunes change.⁶² And states facing the intense budgetary pressures that arise from an economic slowdown may be more likely to risk interstate animosity and litigation by imposing taxes that target out-of-state goods and services.

⁵⁷ See, e.g., POSNER, *supra* note 32, § 26.1, at 665–66 (seeing efficiency gains in having both federal and state governments directing activities); DAVID L. SHAPIRO, *FEDERALISM: A DIALOGUE* 36–37 (1995) (same); Dorf, *supra* note 25, at 828 (naming specialization as one of the virtues of federalism recognized by the Court).

⁵⁸ See, e.g., POSNER, *supra* note 32, § 26.1, at 666; Clayton P. Gillette, *Fiscal Federalism and the Use of Municipal Bond Proceeds*, 58 N.Y.U. L. REV. 1030, 1044–46 & n.60 (1983).

⁵⁹ See, e.g., EDGAR K. BROWNING & JACQUELENE M. BROWNING, *PUBLIC FINANCE AND THE PRICE SYSTEM* 412–14 (1979); Robert C. Ellickson, *Cities and Homeowners Associations*, 130 U. PA. L. REV. 1519, 1554–55 (1982) (noting that the presence of externalities may make local governments poor vehicles for income redistribution); Penner, *supra* note 36, at 119–20 (positing that local governments are unlikely to sponsor programs with high beneficial spillovers).

⁶⁰ This failure to consider the relationship between state political processes and the business cycle is not surprising. States historically have not been assigned to manage the macroeconomy and are ill-equipped to do so. Indeed, even the relationship between the federal election cycle and the business cycle was not appreciated until relatively recently. See EDWARD R. TUFTE, *POLITICAL CONTROL OF THE ECONOMY* 28–64 (1978).

⁶¹ It is widely believed that the federal government should be responsible for stabilizing the economy. See, e.g., RAIMONDO, *supra* note 51, at 64.

⁶² For example, state budgets absorbing substantial unanticipated budget cuts may be forced to abandon significant investments. Programs reaping a sudden budgetary bounty may rush to spend the funds (on a “use it or lose it” rationale), making dubious purchases and hires and expanding faster than their managerial structure can accommodate. Cf. Cheryl D. Block, *Congress and Accounting Scandals: Is the Pot Calling the Kettle Black?*, 82 NEB. L. REV. 365, 433 (2003) (discussing the mechanisms that prevent government corporations from falling into this trap).

B. *Practical Differences Between Regulatory and Fiscal Federalism*

Even if the goals of federalism were clearer, important questions would remain regarding the practical implementation of the model. Traditional scholarship is once again unhelpful, as analysis of regulatory federalism has focused upon the judiciary and the norms it may enforce.⁶³ Federal courts can expand states' regulatory authority in two basic ways: by expanding states' ability to act affirmatively and by narrowing the federal government's authority to encroach upon states' policy choices. The main question, therefore, is in what subject matter the expansion of state authority should take place. The courts can determine the respective scope of federal and state power on the basis of tradition, comparative institutional competence, the need for national uniformity, those functions essential to the effectiveness of one or the other level, or some other criterion. The stakes and consequences of change, at least on a gross level, are relatively apparent.

Enhancing states' fiscal capacities, on the other hand, is a far less straightforward process. Because "few internal limits exist to constrain" the Spending Clause⁶⁴ and because the Constitution's explicit provisions on fiscal federalism have relatively modest impacts on states' capacities, the courts' only role is through largely symbolic rulings under those provisions that do speak to states' finances⁶⁵ and through interpretations of other, broader provisions such as the Commerce Clause⁶⁶ and the Equal Protection Clause.⁶⁷ The locus of the most important decisions about fiscal federalism, therefore, is in the political branches, not the courts. This allocation raises a series of issues that lack a significant parallel in regulatory federalism.

First, federal policymakers wishing to enhance states' fiscal positions have a wider array of tools at their disposal than they (or the courts) do in enhancing states' regulatory authority. To expand states' purses directly, the federal government can give states money, assign to the states its rights to sums of money, expand states' revenue-raising powers, help states collect their taxes, or take steps to avoid preempting revenue sources states may wish to pursue. The federal govern-

⁶³ See, e.g., Redish, *supra* note 24, 1240-45 (considering four models of constitutional federalism).

⁶⁴ 1 TRIBE, *supra* note 27, § 5-6, at 833. The Court quickly abandoned the effort to constrain the spending power by imputing limits to what constitutes "the general welfare." *Id.* at 836-38.

⁶⁵ See *Edelman v. Jordan*, 415 U.S. 651, 663 (1974) ("[A] suit by private parties seeking to impose a liability which must be paid from public funds in the state treasury is barred by the Eleventh Amendment."); see also *Seminole Tribe v. Florida*, 517 U.S. 44, 58 (1996) (extending the general rule of sovereign immunity to private suits for prospective injunctive relief).

⁶⁶ See, e.g., *Quill Corp. v. North Dakota*, 504 U.S. 298, 318-19 (1992) (curtailing the ability of states to tax companies engaged in interstate commerce).

⁶⁷ See, e.g., *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 6 (1973) (declining to hold states responsible for the expensive redress of financial imbalances among public schools).

ment can also reduce the demands on state governments' purses by federalizing some functions previously performed by the states, by easing costly requirements for obtaining federal funds, or by immunizing states from liability to private parties. Some of these approaches are commonly discussed in terms of federalism; other equally effective means of strengthening states fiscally are either taken for granted or never considered in debates about federalism.

Second, because money is fungible, the amount of relief provided is far more important than the specific subject matter of the intervention. Thus, shielding the state welfare department from liability for improperly denied benefits may free up money for a reduction in the estate tax. Allowing the state to tax a particular kind of interstate commerce may provide the funds to build a new prison. Similarly, if the federal government gives a state \$100 million for law enforcement purposes, the state may expand its police budget or, alternatively, may seek to reduce its own spending on police and reallocate those funds to sanitation, highway construction, tax cuts, or other priorities. If the federal government seeks to constrain the state's ability to supplant in this manner — in other words, seeks to separate fiscal capacity from fiscal autonomy — the process becomes still more complicated, both practically and conceptually. By contrast, a basic threshold question in regulatory federalism is which sphere of state power we seek to enhance or constrain; regulatory power has little fungibility.

Third, because states have broad revenue-raising powers on their own and large, diversified budgets, a failure to provide fiscal assistance — a disinterest in federalism — does not necessarily prevent states from acting unilaterally. Because a state can raise another tax when one is struck down or can cut another program when federal mandates make one more expensive, federal policies do not directly constrain the broader scope of states' policymaking.⁶⁸ Here again, the practical consequences of enacting or eschewing a federalism agenda are far from clear. By contrast, a failure to act on an agenda of regulatory federalism generally has the obvious consequence of leaving states with little means for replicating the powers denied to them.

II. FEDERAL INVOLVEMENT IN STATES' FISCAL AFFAIRS

A considerable body of constitutional law has developed to deal with those situations in which federal and state agendas directly con-

⁶⁸ This assumes, of course, that the only purpose of a tax is to raise revenues. To the extent a state seeks to discourage or punish a particular type of activity through taxation, federal legislation or constitutional holdings striking down a tax may seriously constrain state power.

flict.⁶⁹ An entirely different, and largely neglected, set of problems arises when federal and state governments' agendas overlap. Most federal-state interactions are not characterized by pitched battles that end up before the Supreme Court or on the front pages of newspapers. Nonetheless, the interests of the two levels of government, and of the officials that staff them, diverge far more than the benign view of civics textbooks might suggest. This is particularly true with respect to fiscal matters: politicians at each level of government like to claim credit for addressing problems, yet none are eager to pay the bill. This tension gives rise to almost continuous wrangling that, though only occasionally newsworthy, has a profound influence on the nature and quality of public services provided.

Accordingly, any useful theory of fiscal federalism must explain both the patterns of federal-state cooperation and the tensions within that relationship. This Part attempts to provide such a theory by explaining the hidden undercurrents that drive fiscal federalism. Section A considers how the four models of regulatory federalism discussed above might apply to fiscal federalism. It then presents three additional models that seek to explain how federal and state governments collaborate with one another on fiscal matters. Despite the functional difference between this cooperative relationship and the competitive one underlying regulatory federalism, each of these new models bears the imprint of, and may be justified under, aspects of the regulation-based theories. Section B discusses some practical problems that arise in cooperative fiscal federalism under any of these new models. Section C then explores federal-state competition for politically appealing revenue sources and the federal government's increasing propensity to undermine states' revenue bases.

A. *The Development of a Cooperative Fiscal Federalism*

Relations between federal and state governments inevitably involve a mix of shared and contradictory priorities. Each area of governmental activity imposes demands on both federal and state officials. When goals are shared, officials must decide whether to cooperate, to try to induce the other level of government to expend its resources, or to seek to dominate the pursuit of that goal. When federal and state interests

⁶⁹ See, e.g., *Seminole Tribe*, 517 U.S. at 47 (holding that state sovereign immunity trumps congressional policy enacted under the Indian Commerce Clause); *New York v. United States*, 505 U.S. 144, 149 (1992) (limiting Congress's ability to compel states to participate in a federal nuclear waste disposal program). But see Stephen A. Gardbaum, *The Nature of Preemption*, 79 CORNELL L. REV. 767 (1994) (arguing that there is "profound confusion at the heart of preemption law"). See generally Deborah Jones Merritt, *Three Faces of Federalism: Finding a Formula for the Future*, 47 VAND. L. REV. 1563, 1564-73 (1994) (synthesizing constitutional law on the federal government's ability to impose its will upon states).

diverge, officials must find ways of advancing their preferred position without poisoning the working relationships needed for other purposes. This section explores the resolution of these problems in the context of fiscal federalism. Section 1 considers the circumstances under which federal and state governments will tend to divide up responsibilities, either deliberately or by default. Section 2 examines each level's incentives and opportunities to shift costs to the other. Finally, section 3 builds on this information to develop three conceptual models for understanding joint federal-state financial relationships on matters of common concern.

1. *Separatism in Fiscal Federalism.* — The default approach to federal-state relations in our system of government is the division of functions. The Constitution assigns a handful of functions to the federal government and leaves the unspecified remainder to the states. Therefore, when questions arise about which level of government should perform a particular function, our system first endeavors to determine into which sphere of responsibility that function falls. The four approaches to federalism discussed in Part I seek to guide and justify those decisions.

A perfect division of functions is, of course, impossible to implement. In several important areas, the Constitution's grant of power to the federal government is not exclusive. Moreover, many functions that fall indisputably within the enumerated powers of the federal government are practically inseparable from, or require coordination with, functions traditionally and most efficiently performed by states. This has become all the more true as advances in transportation and communications continue to shrink the sphere of the truly local. After 1937, the Court essentially abandoned attempts to enforce a constitutional division of functions that constrained Congress's ability to regulate in areas of traditional "local concern."⁷⁰ The recent renaissance in restrictive readings of the Commerce Clause⁷¹ only chips away at the edges of a vast zone of overlapping federal-state interests. Yet the Court has been even less aggressive in trying to constrain federal

⁷⁰ See, e.g., *United States v. Darby*, 312 U.S. 100, 113–15 (1941) (confirming the trend begun four years earlier with Justice Roberts's "switch in time" and holding that the enumerated power to regulate interstate commerce gave Congress the authority to regulate labor conditions where goods entering interstate commerce are produced).

⁷¹ See *United States v. Morrison*, 529 U.S. 598, 602, 617–18 (2000) (holding that Congress had no power under the Commerce Clause to enact certain sections of the Violence Against Women Act, as they regulated matters with too tenuous a connection to interstate commerce); *United States v. Lopez*, 514 U.S. 549, 552 (1995) (striking down the Gun-Free School Zone Act of 1990 on similar grounds).

spending programs, at least in part because it has restricted standing to challenge Congress's fiscal decisions.⁷²

The lack of a pristine, constitutionally enforceable line between federal and state zones of interests, however, has by no means doomed the division of functions as a preferred organizing principle for federal-state fiscal relations. Traditional divisions of responsibility tend to continue even without legal compulsion. The level of government that has been providing a service is likely to have developed networks of external and internal interest groups that support and guide the program. Unless the existing provider disappoints them mightily, these interest groups are unlikely to commit the resources necessary to persuade the other level of government to initiate a similar program. Similarly, these interest groups may go to the federal or state agency with which they are accustomed to working when seeking governmental expansion into an area related to the agency's existing activity. The static arrangements suit government officials as well: politicians from one level of government can deflect demands for action by arguing that it is their counterparts' responsibility.⁷³

Traditional lines also endure because major transfers of responsibilities can raise difficult financial and transitional problems. The initial costs of designing and assembling the program infrastructure, and the likely delay before the new provider can begin serving the public, may make the assumption of a responsibility traditionally lodged with the other level of government an unattractive political choice. Moreover, if either level wants to take over or supplement an activity being performed by the other, it must either find a way to prevent its counterpart from withdrawing funds or resign itself to spending a considerable amount of money "buying out" the base level of services the other is providing. A particular difficulty with the federal government assuming a new function is that existing levels of service vary considerably among the states: Members from states with strong programs may be unwilling to commit major resources to a takeover that will provide little tangible benefit to their constituents.⁷⁴

⁷² See, e.g., *Valley Forge Christian Coll. v. Ams. United for Separation of Church & State, Inc.*, 454 U.S. 464, 489–90 (1982) (denying taxpayer standing to challenge the below-market disposition of government property even when the challenge also lies under the Establishment Clause). *But see* *Flast v. Cohen*, 392 U.S. 83, 105–06 (1968) (creating what proved to be a narrow exception that allows taxpayers to challenge spending alleged to violate the Establishment Clause).

⁷³ The effectiveness of these arguments is likely to depend on how persuasive an analogy the politicians can make to existing functions assigned to the other level.

⁷⁴ On the other hand, once the federal and state governments have begun to share the financing of important public functions, efforts to clarify and rationalize these roles can prove difficult. States' varying levels of effort make it difficult to craft a financing scheme with broad enough appeal to pass Congress: even if federalizing the financing of one function would cost about the same as terminating federal involvement in another, some states likely would profit from that switch while others would face so many new costs that their congressional delegations would have

When traditional divisions of responsibility are ambiguous or unworkable, or when government is entering into a new field of activity, public officials still commonly seek a viable way of dividing responsibility. Dividing responsibility rather than sharing it reduces the potential for policy conflict or miscommunication. It also avoids the complicated problems that arise when the two levels of government share financial responsibility.⁷⁵

Even when neither level of government is prepared to take sole responsibility for a problem, the preference for divided rather than shared responsibility can still prove important. In some policy areas, the governmental response has been divided between two or more programs, in large part to create artificial federal and state purviews. The Medicare and Medicaid programs, for example, allocate health care costs into three categories: Responsibility for many hospital and physician costs for the elderly and disabled is assigned to the federal government.⁷⁶ The remainder of those costs, as well as other health care costs incurred by low-income elderly and disabled individuals and health care for low-income families with children, are assigned to a joint federal-state program.⁷⁷ Costs associated with care for childless adults and other low-income individuals not qualifying for a federal-state cash assistance program are left to the states. The federal government also assumes primary responsibility for providing cash assistance to low-income elderly and disabled individuals,⁷⁸ while leaving states with partial responsibility for low-income families with children⁷⁹ and full responsibility for other indigent childless adults. Similarly, the federal government takes primary financial responsibility for one set of roads — the designated interstate highway system — while leaving states to maintain many other highways that are, in fact, also important to interstate commerce.⁸⁰ In practice, the federal government, because of its greater financial resources and dominant position in our federal system, commonly takes the most politically appealing

difficulty supporting the transfer. A financing package sufficiently generous to avoid creating any losers would be costly and still might not win passage, with Members from states that barely break even likely preferring other, more rewarding applications of the funds required.

⁷⁵ See *infra* section II.B, pp. 2579–93.

⁷⁶ See 42 U.S.C. § 1395c (2000) (establishing Medicare hospitalization insurance program); *id.* § 1395j (establishing Medicare physicians' services insurance program).

⁷⁷ See 42 U.S.C.A. §§ 1396–1396v (West 2003 & Supp. 2004) (establishing Medicaid).

⁷⁸ See *id.* §§ 1381–1383f (establishing the supplemental security income (SSI) program).

⁷⁹ See *id.* §§ 601–619 (providing fixed federal block grant for Temporary Assistance to Needy Families (TANF), conditioned on states maintaining financial effort).

⁸⁰ See 23 U.S.C. § 103(a), (c).

functions for itself, leaving the less desirable ones to uncertain fates at the hands of the states.⁸¹

Locating a convincing, principled justification for these divisions of authority can be problematic. Constitutional formalism is of little avail: the federal government's spending authority, unlike its regulatory authority, is not structured in terms of specific enumerated powers.⁸² Even if some formalistic response could be crafted — allocating fiscal responsibility for some functions to the federal government and for others to the states — these decisions are unlikely to accomplish anything of much value. Money's fungibility makes the aggregate financial burden far more important than its distribution among governmental activities. For example, states would no doubt be happy to provide \$1 billion to purchase fighters for the Air Force if the federal government would contribute \$1.1 billion to their corrections budgets. A different set of tools is therefore required.

As discussed in Part I, the theories this country relies upon to divide regulatory authority translate poorly into the fiscal arena. Nonetheless, all four theories can be adapted to help divide responsibilities for spending programs, and to a lesser extent taxes, between federal and state governments.

The dual sovereignty model can explain why neither level of government is likely to take fiscal responsibility for basic functions incident to the other's sovereignty. Indeed, the Court sometimes has acted to prevent the federal government from increasing the costs to states of funding their core functions.⁸³ The compensatory model for shared fiscal responsibility proposed below⁸⁴ has its roots in dual federalism theory, but can also justify wholly federal responsibility as well as partial indemnifications of states.

⁸¹ Because the federal government, when it chooses to contribute financially, is in a position to dramatically lighten states' burdens, states have found it expedient to allow federal policymakers first choice among the components of an activity.

⁸² Federal taxing powers are, in theory, enumerated in a manner similar to federal regulatory authority. The categories are so broad and subject to such important variations in policy, however, that they function even more like the spending power than congressional regulatory authority under the Commerce Clause. The problem, then, is conceptually analogous to what regulatory federalism would confront if the federal government, like the states, held an open-ended police power. This open-endedness worried Madison and has troubled some commentators since. *See THE FEDERALIST NO. 41*, at 262–64 (James Madison) (Clinton Rossiter ed., 1961) (arguing that an expansive reading of the General Welfare Clause would be inconsistent with enumerated powers); BERGER, *supra* note 24, at 100–07.

⁸³ *See, e.g., Alden v. Maine*, 527 U.S. 706, 711–12 (1999) (holding that states' inherent sovereign immunity precludes the federal government from subjecting them to suit, even in their own courts, for many violations of federal labor laws).

⁸⁴ *See infra* section II.A.3.a, pp. 2571–74.

Some advocates for assigning fiscal responsibilities to states make comparative process arguments.⁸⁵ They assert, for example, that states are better equipped to modify policies in response to varying local conditions.⁸⁶ Yet the comparative process arguments underlying the superior capacity and leadership models for cooperative fiscal federalism discussed below⁸⁷ also may be invoked to show that the federal government can better address a problem and should be given full responsibility.

On the assumption that federal funds almost invariably come with strings, pluralists make essentially the same arguments for preserving state and local fiscal responsibility that they do for decentralizing regulatory power. Thus, for example, we continue to tolerate the gross inequities and inefficiencies that local financing of public education creates because of concerns that increased federal funding would mean increased uniformity and reduced local control.⁸⁸

Finally, responsibilities may be divided among the levels of government according to the comparative efficiency model.⁸⁹ The federal government, for example, often enjoys greater economies of scale, particularly when negotiating with private vendors. It also is impervious to interstate movement by people or businesses. At the same time, however, states' personnel costs are generally lower,⁹⁰ which gives them an advantage in operating labor-intensive programs. As noted

⁸⁵ See, e.g., REBECCA M. BLANK, *IT TAKES A NATION: A NEW AGENDA FOR FIGHTING POVERTY* 247–49 (1997) (arguing that antipoverty programs should “effectively use the comparative advantages of different governmental levels”).

⁸⁶ See, e.g., *id.* at 249.

⁸⁷ See *infra* sections II.A.3.b and II.A.3.c., pp. 2574–79.

⁸⁸ Cf. *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 49–50 (1973) (noting the value of experimentation at the school district level).

⁸⁹ Efficiency advantages by themselves are unlikely to determine the division of responsibility. Neither federal nor state policymakers are likely to assume financial burdens and political risks simply because they can do so more efficiently than their counterparts on the other level. To influence policy, comparative advantage generally requires some mechanism for compensating the more efficient producer of a good or service. To be sure, however, if both levels of government are under pressure to provide a particular service, the level that can do so more efficiently may succumb more quickly. Also, the federal government sometimes assumes responsibility for some functions in any state where the state government agrees to perform other, related functions; presumably, efficiency of delivery is one of the factors that helps guide federal policymakers' selection of which functions they will assume.

⁹⁰ In 2003, the average federal worker earned an estimated \$57,610, compared to \$40,600 and \$37,880 for state and local government employees, respectively. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, OCCUPATIONAL EMPLOYMENT STATISTICS: NOVEMBER 2003 NATIONAL INDUSTRY-SPECIFIC OCCUPATIONAL EMPLOYMENT AND WAGE ESTIMATES, http://www.bls.gov/oes/current/naics3_99000.htm (last modified Nov. 24, 2004, and Feb. 17, 2005). Although some differences may result from variation in the mix of tasks assigned to government workers at the three levels, this pattern also holds within particular classes of employment. For example, federal file clerks earned an average of \$37,360, although their state and local counterparts averaged \$25,770 and \$25,400, respectively. *Id.*

above, however, these analyses of relative efficiency tend to be static, neglecting the consequences of the business cycle.

2. *Cost-Shifting in Areas of Joint Federal-State Concern.* — Despite the well-honed instinct of federal and state governments to divide programmatic responsibilities, the most desirable division often is not obvious. None of the factors described above are self-executing. Sometimes custom or other factors fairly clearly suggest which level of government should take responsibility for a given function — and which is likely to be blamed if that function is not adequately performed. Otherwise, unless undertaking a particular function is likely to bring strong public approval, each level of government will have an incentive to try to shift the burden of that function to the other.

For a new program, this relationship can be expressed as a game between federal and state governments. Each side is plotting its actions based on calculations of what the other will do. If the federal government takes steps toward addressing the need, such as implementing a limited pilot program, states are more likely to wait than to assume the cost of the service themselves. State officials with a tepid commitment to the program will view the short-term harm of doing without the program for a few more years as less severe than the long-term consequences of having the program's cost become a permanent state responsibility. From the federal point of view, if some states move forward on their own to provide the service, initiating a new program becomes less politically appealing. The Members of Congress from the states that have moved ahead will have little to gain from establishing a federal program duplicating their states' efforts.⁹¹ Their lack of interest will require a supermajority of legislators from the remaining states to win enactment of the program. Government officials do, of course, create programs despite these incentives for each level to wait. This presumably reflects one level of government's conclusion that the other is unlikely to move or that addressing the problem quickly is more important than the long-term benefits of shifting the costs.

A slightly different set of considerations applies when one level of government is interested in expanding or improving an existing program funded by the other. The level of government that is funding the current program might, of course, welcome the augmentation. On the other hand, the fact that it did not fund the increment itself suggests that it preferred the resources be allocated to other programs. Unless the circumstances that motivated their counterparts on the other level

⁹¹ Of course, they might see the federal assumption of responsibility as a form of fiscal relief for their state. If a Member's political fortunes are closely tied to the governor's, he or she may be eager to free up more money for the governor to spend. Otherwise, however, these Members seem unlikely to receive much credit for such a subtle benefit to the state.

also affect policymakers responsible for the existing program,⁹² they will maintain that preference and therefore may seek to reduce their contribution to the cost of the program by an amount equal to the new contribution from the other level of government.⁹³ Thus, the new resources contributed to the activity would supplant, rather than supplement, the existing funds.

When the federal government wishes to fund an expansion of existing state activity, it can prevent cost-shifting by requiring states to “maintain effort” as a condition of receiving the new federal funding.⁹⁴ This requirement may have only limited effect if the existing program is difficult to describe precisely: the state may simply designate other funds it is already spending on related activities as its “maintenance of effort” and withdraw the funds for the program in question.⁹⁵

The federal government cannot directly replace its own expenditures with state funding in the same way because states’ increased contributions do not all appear simultaneously. Policymakers can, however, cite increased state contributions as a political justification for reducing federal commitments. Indeed, even if many states have not increased their contributions, federal policymakers may reduce their spending on a particular activity if they believe the states will be politically unable to allow services to decline to an unacceptable level. Any political repercussions from program cuts can be avoided by directing or coercing the states to bear the cost instead.⁹⁶

Constant financial maneuvering by federal and state policymakers would result in an instability that disrupts the ability of both levels of

⁹² For example, if the public becomes alarmed at a health or safety problem currently within the state’s purview, federal policymakers may feel pressure to become involved at the same time state officials feel compelled to increase funding.

⁹³ Consider, for example, a state program costing \$10 million per year. The state could have spent \$14 million, but preferred to devote the extra \$4 million to other projects or to keeping taxes down. If the federal government begins to contribute \$4 million to this activity, the state is very likely to reduce its contribution to \$6 million, freeing up \$4 million for other spending or tax cuts. Only if the program in question was next in line on the state’s list of funding priorities, or if events have suddenly elevated that program’s status, can the state be expected to maintain its current contribution.

⁹⁴ See, e.g., 42 U.S.C.A. § 609(a)(7) (West Supp. 2004) (requiring states to maintain seventy-five or eighty percent of their prior spending on Aid to Families with Dependent Children (AFDC) and related programs in order to claim their TANF block grants); 42 U.S.C. § 1382g(a)(3)–(4) (2000) (requiring continuation of state supplemental payments to elderly and disabled individuals receiving federal SSI payments).

⁹⁵ See GEN. ACCOUNTING OFFICE, GAO-01-828, WELFARE REFORM: CHALLENGES IN MAINTAINING A FEDERAL-STATE FISCAL PARTNERSHIP 18–20 (2001) (identifying state manipulation of TANF’s financial flexibility that shifted funds to activities far removed from TANF’s purposes).

⁹⁶ As discussed below, both Congress and the Court recently have moved against some types of these “unfunded mandates.” See *infra* section II.B.1, pp. 2579–86. One should remember, however, that these mandates are but one of several kinds of supplantation in federal-state fiscal relations, a process that works in both directions.

government to plan their budgets. Accordingly, several accommodations have been reached. First, the federal government has addressed some areas of joint interest with matching programs.⁹⁷ These arrangements allow states to increase their contributions without fearing federal supplantation; to the contrary, states can purchase services more inexpensively through a matching program because they can compel the federal government to pay a fraction of the cost. The federal government surrenders direct control of spending levels in matching programs, but it can strive to increase aggregate service levels by raising the federal matching rate.⁹⁸ It remains vulnerable to state supplantation to the extent that the program is so vaguely defined that a state may count existing expenditures in its other activities as its match⁹⁹ or divert program funds to reimburse itself for its match.¹⁰⁰

Second, the federal government has addressed other areas of joint interest by making symbolic payments to states with little attempt to prevent supplantation. For example, the Social Services Block Grant (SSBG) provides a broad, largely undifferentiated subsidy to states' human services budgets.¹⁰¹ Although states formally designate SSBG funds for particular programs, these designations are largely arbitrary: SSBG funds are practically interchangeable with state general funds going to those and similar programs. In effect, then, this is a different kind of matching program without a set matching rate: the federal government's contribution is capped, and the states are responsible for all costs exceeding that cap. Unlike programs in which the federal government pays a set percentage of total costs, however, this arrangement does nothing to improve the effective purchasing power of the state's own spending and hence offers no incentive for the state to increase or preserve that spending.

⁹⁷ See *infra* section II.B.2.a, pp. 2586–88 (discussing the functional limitations of these programs).

⁹⁸ Enhancing the match has two offsetting effects on state policymakers. On the one hand, it increases the efficiency of state contributions: each dollar the state spends buys more services with the enhanced match. On the other hand, it allows the state to remove some of its own contributions and still maintain or increase the level of services. Depending on the elasticity of the state's demand for the services, the result could be anything from full supplantation — withdrawing state contributions until the total federal-state funding equals the previous level — to a substantial increase in the state's contributions.

⁹⁹ See, e.g., LEIGHTON KU, CTR. ON BUDGET & POLICY PRIORITIES, LIMITING ABUSES OF MEDICAID FINANCING: HCFA'S PLAN TO REGULATE THE MEDICAID UPPER PAYMENT LIMIT 4–6 (2000) (describing how states count payments to public health care facilities as matching payments for Medicaid purposes), available at <http://www.cbpp.org/0-27-00health.pdf>.

¹⁰⁰ See, e.g., SUBCOMM. ON HEALTH & THE ENV'T, HOUSE COMM. ON ENERGY & COMMERCE, 103D CONG., MEDICAID SOURCE BOOK: BACKGROUND DATA AND ANALYSIS 335–42 (Comm. Print 1993) [hereinafter 1993 YELLOW BOOK] (describing how states taxed Medicaid payments to hospitals and applied the proceeds toward their match).

¹⁰¹ See 42 U.S.C. §§ 1397–1397f (2000).

Third, consistent with the traditional division of responsibility approach to fiscal federalism, federal and state governments have informally split many functions in which they both have interests into two or more programs with separate financing schemes. As discussed above, the federal government has proven quite adept at securing for itself the most politically attractive share of responsibility in these arrangements.

Finally, in three important situations, the federal government has recognized a duty to cooperate with states financially even when it might successfully have avoided the costs of a particular activity. These arrangements are described in the following section.

3. *Three Cooperative Models of Fiscal Federalism.* — This section seeks to explain the mechanisms of cooperation between federal and state governments, the ends to which they can sensibly cooperate, and the procedures for delineating responsibilities when cooperating. The federal government's cooperative fiscal relationships with state governments generally reflect one of three basic models: the compensatory model, the superior capacity model, or the leadership model. These models operate most explicitly and contentiously in the context of spending programs, but they also influence other realms, such as federal-state relationships in raising revenue. Views about the legitimate scope of these models have shifted throughout the country's history, particularly since the New Deal. In many respects, these changes appear to be more the product of historical accident than of any clear shift in fundamental values: had policymakers adopted plausible alternative approaches to the problems that confronted them, the theory of fiscal federalism might have evolved very differently. Whatever its etiology, however, this evolution has worked significant transformations in the structure of fiscal federalism.

(a) *The Compensatory Model.* — Many federal policies impose negative externalities upon the states. As an extreme example, when Congress declared war on Great Britain in the War of 1812, British armies invaded and sacked areas of several states. More prosaically, federal trade policies can affect the industries that provide the economic base for many states, federal installations can consume state and local services while remaining immune from taxes, and federal immigration policy can shape the population growth of states. All of these actions, and many others, can have dramatic fiscal impacts on state and local governments.¹⁰²

¹⁰² See generally U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, FEDERALLY INDUCED COSTS AFFECTING STATE AND LOCAL GOVERNMENTS (1994) [hereinafter ACIR, FEDERALLY INDUCED COSTS] (cataloguing federal fiscal impositions perceived by state and local officials).

The problem of federal activities creating negative externalities that fall on state and local governments came to the fore after World War II. The postwar boom vastly expanded the federal tax base while thrusting a host of new, demanding problems on state and local governments. As Walter Heller, a former Chairman of the Council of Economic Advisors, noted in the 1960s, “prosperity gives the national government the affluence and the local governments the effluents.”¹⁰³ Realization of this problem led to efforts to compensate state and local governments for some of these burdens.

Under the compensatory model, the federal government indemnifies state or local governments for costs it has inflicted upon them directly or costs that arise from areas of activity falling primarily within federal policy control. The question of what sorts of costs warrant compensation has been the subject of considerable controversy.¹⁰⁴ Sometimes states have prevailed in demands for compensation when the federal government has imposed costs on them, sometimes not. States have argued with particular fervor for compensation for those costs resulting from the federal government’s exercise of its exclusive powers; they have met with only mixed success. For example, the State Legalization Impact Assistance Grants (SLIAG), which the federal government provided in the Immigration Reform and Control Act of 1986¹⁰⁵ (IRCA), sought to help states with the costs of social services that newly legalized, undocumented immigrants would become eligible to use.¹⁰⁶ In this case, as in many others, tepid federal acceptance of claims for compensation resulted in the rapid erosion of grants in succeeding years.¹⁰⁷ More recently, states’ pleas for increased federal funding of public safety agencies in the wake of the September 11 attacks also had a compensatory element to them: waging war is a federal function, and yet many of the costs of the war on terrorism — as well as the cost of repairing the damage in lower Manhattan — devolved to states. Like the claims of states feeling IRCA’s impact, these pleas won only fleeting, partial compensation.

A few patterns emerge regarding the federal government’s willingness to compensate the states. The compensatory model of fiscal fed-

¹⁰³ WALTER W. HELLER, *NEW DIMENSIONS OF POLITICAL ECONOMY* 129 (1967).

¹⁰⁴ See ACIR, *FEDERALLY INDUCED COSTS*, *supra* note 102, at 33–38.

¹⁰⁵ Pub. L. No. 99-603, 100 Stat. 3359 (codified as amended primarily in scattered sections of 8 U.S.C.).

¹⁰⁶ See *id.* § 204, 100 Stat. at 3405–11 (repealed 1998). IRCA’s amnesty provisions legalized certain undocumented immigrants. See *id.* § 201, 100 Stat. at 3394–3401 (codified as amended at 8 U.S.C. § 1255a (2000)).

¹⁰⁷ See ACIR, *FEDERALLY INDUCED COSTS*, *supra* note 102, at 37–38; Swati Agrawal, *Trusts Betrayed: The Absent Federal Partner in Immigration Policy*, 33 *SAN DIEGO L. REV.* 755, 773–75 (1996) (detailing the decline of SLIAG funds that resulted from “raid[ing]” by “Senate and Administrative officials”).

eralism has been applied to offset the impacts of actions limiting states' revenues primarily when the federal government has explicitly invoked its immunity from taxation. Thus, for example, the federal government makes direct payments in lieu of taxes to communities with large federal installations or parks.¹⁰⁸ Changes in federal revenue policies affecting states' revenues, on the other hand, have rarely yielded commensurate compensation.

The federal government sometimes has compensated states for the elimination of substantial spending programs. Those grants, however, have been comparatively small and subject to cuts. For example, President Nixon established a program of "revenue sharing" to stem opposition to his elimination of many Great Society categorical grant programs.¹⁰⁹ President Reagan similarly created several block grants when he eliminated another large set of categorical programs.¹¹⁰ In both cases, the compensation provided to states only partially offset their losses from the elimination of the spending programs, and even these amounts eroded steadily in succeeding years. This pattern suggests that the compensation model is more likely to provide transitional relief than permanent relief for states disadvantaged by federal actions. In this respect, it resembles modern takings jurisprudence: the federal government need only provide transitional assistance for a few years to the injured party but need not compensate for the long-term loss.¹¹¹

The compensatory model honors the same values that animate dual sovereignty theories of federalism. The idea is that the federal government must be limited in the range of costs it can impose on the states to avoid impairing their ability to carry out their own chosen policies. And as a matter of respect, the federal government should not be cavalier about imposing any such costs. On the other hand, avoiding all impositions on states, or even all significant ones, is clearly impossible without hobbling the federal government, which increasingly and necessarily affects states as it pursues an expanding range of activities. Expanding the compensation model to cover all indirect impacts could dramatically raise the costs of federal regulatory and foreign policy activities. Lacking a logical limiting principle that

¹⁰⁸ See 31 U.S.C. § 6902 (2000).

¹⁰⁹ See State and Local Fiscal Assistance Act of 1972 (Revenue Sharing Act), Pub. L. No. 92-512, 86 Stat. 919 (repealed 1981); see also REAGAN & SANZONE, *supra* note 36, at 81-123 (describing the context for these changes and evaluating their impact).

¹¹⁰ TIMOTHY CONLAN, FROM NEW FEDERALISM TO DEVOLUTION: TWENTY-FIVE YEARS OF INTERGOVERNMENTAL REFORM 112-15 (1998).

¹¹¹ See, e.g., *Art Neon Co. v. City and County of Denver*, 488 F.2d 118, 121 (10th Cir. 1973) (holding that a zoning amortization provision unaccompanied by monetary compensation did not violate the Fifth and Fourteenth Amendments); *State v. Joyner*, 211 S.E.2d 320, 325 (N.C. 1975) (same).

would require compensation of some but not all indirect costs, the courts have never accepted the compensatory model as legally enforceable upon Congress.¹¹²

Even as a political concept, the compensatory model's indeterminacy raises significant difficulties. For this approach to shape permanent public policy in important ways requires more of a memory than the political process typically has. As the short lives of SLIAG and the underfunding of "first responder" programs enacted after September 11 demonstrate, the effectiveness of a claim for compensation for the impacts of federal actions generally depends on the claim's novelty. After a few years, federal policymakers begin to take the burdens on states for granted, the moral consensus in favor of compensation fades, and states not benefiting from the compensation resume the pursuit of their parochial agendas. The attacks on the World Trade Center highlighted New York's special vulnerability to terrorism, allowing the state to make a claim for federal help that was embarrassing for other states to oppose publicly. After a few months had passed, however, that peculiar vulnerability became less readily distinguishable from other states' peculiar vulnerabilities, such as Florida's susceptibility to hurricanes, and much of the funding for Manhattan's rebuilding quietly disappeared.

The dramatic, and often deleterious, effects of federal actions on states' finances seem certain to continue generating complaints about the paucity of federal compensation in debates about fiscal federalism. Claims of compensation for direct, high-profile federal actions seem more likely to prevail than those for indirect effects. This limit, however, can hardly be considered a coherent principle. Unfortunately, the diversity of states' claims to compensation, combined with the states' parochial tendencies to oppose recognition of any particular principle of compensation that does not benefit them,¹¹³ makes the development of such a principle unlikely. Without one, however, the model is impossible to implement except in the most ad hoc way: if taken to its logical extreme, it would shackle federal policymaking to an extent few could accept.

(b) *The Superior Capacity Model.* — The superior capacity model calls for the federal government to marshal its powerful fiscal resources and assist states with projects that they would have difficulty handling on their own. It is rooted in the same kinds of economic arguments that have helped define regulatory federalism. It also is an

¹¹² The closest courts have come is a line of recent cases preventing the federal government from pressing state officials into federal service. See sources cited *supra* notes 13 & 14.

¹¹³ For example, large, sparsely populated states will want to emphasize compensation for intrusions on state land. States with large immigrant populations will champion compensation for the effects of exercises of exclusive federal powers.

application of the comparative process theory of federalism, giving the federal government fiscal responsibility when it is better able to raise the necessary funds. Some examples of this principle can be found in the text of the Constitution, most obviously in the federal government's power to "provide for the common Defence."¹¹⁴

Prior to the 1930s, most of the areas where the federal government's capacity was recognized as superior to that of the states were those areas closely related to federal enumerated powers. By contrast, responsibility for social spending rested almost wholly on state and particularly local governments. This view changed dramatically with the Great Depression and the resulting election of Franklin Roosevelt and the New Deal Congress. The New Deal amended our implicit fiscal constitution¹¹⁵ by recognizing a new federal responsibility to provide countercyclical assistance. The collapse of state and local efforts to relieve the suffering of the unemployed made recognition of some version of the superior capacity model unavoidable,¹¹⁶ yet the philosophical consensus supporting the New Deal legislation was a relatively narrow one. Accepting a role for the federal government in addressing the greatest economic calamity in this country's recent memory did not require conceding a federal role in addressing milder or localized downturns. Thus, although federal tax and spending policy has "served as the primary vehicle through which income and wealth [are] redistributed in the United States" since World War II,¹¹⁷ that role has been under fire since the Reagan Administration. Indeed, it is precisely the redistributive programs that have been at the forefront of federal devolution of fiscal responsibility to states over the past decade.¹¹⁸

Ultimately, the lack of a clear consensus in favor of institutionalizing this amendment to the fiscal constitution in all but the most extreme circumstances left a very fragmented legacy. Many of the New Deal's social programs, particularly those offering work relief to two-parent families and childless adults, were allowed to lapse. The scope of assistance and the populations served by the remaining legislation (principally the Social Security Act) were both defined quite narrowly.

¹¹⁴ U.S. CONST. art. I, § 8, cl. 1.

¹¹⁵ Although the regulatory components of the New Deal rapidly became subject to pitched battles between the Court and the political branches, its fiscal components were accepted largely without question.

¹¹⁶ See REAGAN & SANZONE, *supra* note 36, at 45-49.

¹¹⁷ Kirk J. Stark, *Fiscal Federalism and Tax Progressivity: Should the Federal Income Tax Encourage State and Local Redistribution?*, 51 U.C.L.A. L. REV. 1389, 1390 (2004).

¹¹⁸ See *id.* at 1390-91; see also, e.g., Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, tit. I, § 103, 110 Stat. 2105, 2112-61 (codified as amended at 42 U.S.C.A. §§ 601-619 (West 2003 & Supp. 2004)) (converting the former AFDC program and several child care subsidy programs into block grants to states).

Even more importantly, federal funding for most programs was only partial: states were required to expend substantial funds of their own to obtain the federal aid. Thus, the federal government's support of countercyclical relief was supplemental to, and conditioned on, the states' continuing to spend their own money on countercyclical relief.

This shared fiscal responsibility made sense in practical political terms: it obscured the growth of the federal role, avoided a pitched battle over the transfer of longstanding state and local roles to the federal government,¹¹⁹ and allowed the federal government to extend its reach into more areas than might have been possible had the U.S. Treasury borne the full cost. Any economic rationale for this division, however, is elusive. In particular, the assumption that states have the resources to match federal payments is difficult to reconcile with the basic tenet of the superior capacity model.

This model's role remains unsettled. The federal government has responded to economic calamities and provides, for example, additional weeks of unemployment compensation during recessions and in states whose unemployment rates have recently surged.¹²⁰ The superior capacity model also justifies aid to states with serious mismatches between the need for a particular kind of governmental service and the means to provide it.¹²¹ Finally, this model — specifically the superior capacity of the IRS to explain and secure compliance with reporting requirements for the income and estate taxes — also helps explain the linkage of federal and state revenue systems.

Just as the compensation model, if applied to its full potential, would hobble the federal government, the superior capacity model, if pressed to its logical extreme, could marginalize states in a broad range of crucial policy areas. The federal government has a larger and more efficient revenue base. It also has effectively unlimited borrowing ca-

¹¹⁹ Compounding philosophical concerns about centralizing power is the fact that a complete federal takeover of these programs would have preempted states from making policy in areas where the New Dealers feared to intervene. See NOBLE, *supra* note 22, at 67, 71–72. In the South, these areas included preserving racial discrimination in the administration of public assistance programs. In many areas of the country, states manipulated assistance programs to ensure the availability of workers at low wages during harvests and other junctures important to the local economy.

¹²⁰ See DOROTHY K. NEWMAN ET AL., PROTEST, POLITICS, AND PROSPERITY: BLACK AMERICANS AND WHITE INSTITUTIONS, 1940–75, at 262–63 (1978).

¹²¹ See REAGAN & SANZONE, *supra* note 36, at 42–43. The concentration of low-income people in states with relatively modest tax bases led Medicaid, and later AFDC, to adopt matching rates that varied with state per capita income. See 42 U.S.C. §§ 1396b(a), 1396d(b) (2000) (Medicaid); *id.* § 1318 (1994) (repealed 1996) (AFDC). Similarly, states have demanded aid to meet increased security demands after the September 11 attacks, arguing that, especially where those demands are concentrated in a particular state, this is a problem that states lack the capacity to handle properly on their own. As noted, this argument, even paired with arguments that states were due compensation for assuming some of the costs of the federal government's war-related responsibilities, failed to win sustained sympathy from the Bush Administration or Congress.

capacity. And it has vastly superior economies of scale. These three factors arguably give it greater ability to design and fund a wide range of spending programs, displacing many longstanding state activities. Nonetheless, deference to states, concerns about excessive federal encroachment upon them, and the belief that federal funding could prevent them from exercising comparative advantages in administration have led to efforts to cabin the superior capacity model. In practice, the superior capacity model is largely confined to those areas in which federal capacity is markedly superior to that of states and those in which states' interests are relatively modest. Defining what it means for federal capacity to be markedly superior, and identifying which policy areas hold little interest to states, are both difficult and controversial tasks.

(c) *The Leadership Model.* — Under the leadership model, the federal government leverages its fiscal resources for particular types of activity that it believes are national priorities.¹²² When acting in this leadership role, the federal government has the choice whether, and how, to involve state and local governments. Thus, when the federal government determined in 1965 that access to health insurance was a problem of sufficient importance to require its intervention, it enlisted the states' help in financing and operating the program for low-income people, Medicaid,¹²³ but not the one for the elderly and persons with disabilities, Medicare. Thus, the leadership model represents an attempt to synthesize comparative process and pluralistic considerations in federalism: federal policymakers believe their national perspective allows them to recognize the importance of a problem states may have failed to appreciate, yet they often seek to enlist states' participation to secure the benefits of pluralism.

Like the superior capacity model, the leadership model evolved into its modern form as a result of the Great Depression. Previously, federal leadership had been largely confined to areas close to the federal government's constitutionally enumerated powers. Here again the New Deal amended the implicit fiscal constitution, this time as a side effect of its expansion of federal economic regulatory power. It vastly expanded the range of economic activities perceived as having sufficiently national scope to merit federal action. In some domains — such as banking, securities trading, and ultimately civil rights — this intervention was regulatory. In others — such as interstate highways, and later education and health care — it was financial. Taking on financial responsibility gave the federal government the opportunity to shape state regulatory schemes and budgetary priorities to an extent

¹²² The construction of the interstate highway system is one example of this.

¹²³ See 42 U.S.C. § 1396b (2000).

that politics and the Commerce Clause likely would not have allowed through direct fiat. Here, too, the federal intervention typically was only partial, leaving states to continue to spend significant amounts of their own funds on these projects. As in the case of countercyclical programs, this shared role helped to obscure and avoid debate over the expanding federal role. At the same time, it maximized the federal policymaking influence while restraining federal spending.

Ambivalence about the superior capacity model has fueled the growth of the leadership model as a less threatening alternative. As discussed above, New Deal initiatives launched because of the federal government's superior fiscal capacity evolved into exercises of federal leadership on behalf of particularly appealing and vulnerable populations. Yet the leadership principle, too, was fraught with potentially explosive tensions because many of its applications implicitly insulted the states. Sovereigns typically lead rather than being led. If a policy was generally deemed important, what basis did the federal government have for presuming that states needed coaxing to adopt it? And if a policy was not widely accepted, what legitimate authority did the federal government have for coercing states to adopt its preferences? The Supremacy Clause and the Reconstruction Amendments unambiguously codified states' subordinate position in our federal system, but expansion of the federal government's fiscal interactions with states multiplied the areas of potential friction.

These tensions might be submerged when a broad consensus existed in support of a particular initiative — such as the interstate highway system — and the federal government's leadership was primarily to resolve technical problems. In more controversial areas, however, such as social welfare policy, the federal government was almost continuously walking through a minefield: its benign requirements seemed to imply that states could not be trusted to take care of their own people, and its controversial measures were derided as products of detached federal arrogance. As discussed below, the inability to resolve this dilemma has destabilized large parts of federal-state relations founded on the leadership model.¹²⁴

Ensuring the stability of cooperative federal-state financing arrangements under the leadership model requires a limiting principle — a reason why the federal government should not take over full responsibility, a reason to expect sufficient benefits from a pluralist approach to justify the difficulties of federal-state coordination.¹²⁵ Typically, this

¹²⁴ See *infra* section V.B.1, pp. 2648–50.

¹²⁵ At the other extreme, the federal government may withdraw completely if it finds states declining to accept its leadership. This withdrawal may initially take the form of state-supported federal legislation to remove the conditions through which the federal government exercised its leadership. This stage would be followed a few years later by reductions in associated federal

reason comes in the form of an argument that states have a strong interest in contributing to the activity in question. For example, Professor Mark Pauly has suggested that people value income gains for their neighbors more than they do for people more remote.¹²⁶ More generally, states' ability to hire staff, locate offices, contract with suppliers, and make other administrative and subsidiary policy decisions has proven sufficiently alluring to induce states to continue to participate in a range of programs.¹²⁷ In addition, because the federal government commonly takes the initiative to establish programs addressing the most salient popular concerns, sharing financial responsibility may be the only means for states to obtain political credit in these areas.¹²⁸

B. *Practical Problems in Cooperative Fiscal Federalism*

Over time, any relationship is likely to have problems, real or imagined. Even when federal and state governments are cooperating under the models of fiscal federalism outlined above, difficulties are likely to arise. This section considers three such challenges, one whose importance is overstated in contemporary discourse and two that are largely ignored. Section 1 explores the popular but analytically deficient attacks on "unfunded mandates." Section 2 considers how various federal-state funding arrangements will weather changes in the business cycle. And section 3 addresses the consequences for states of major changes in federal priorities.

1. *The Puzzle of Substantive Mandates on States.* — Federal mandates are central to contemporary debates about fiscal federalism. Both Congress and the Supreme Court have taken action that purports to relieve states, yet neither has offered remedies that achieve its stated purpose. Similarly, both popular and academic writers have attacked mandates without fully accounting for their role in the broader scheme of fiscal federalism.¹²⁹ These debates generate considerably more heat

funding that is no longer needed to exercise federal leadership and that states may be spending in ways that fail to motivate the federal government to make the program a priority.

¹²⁶ See Mark V. Pauly, *Income Redistribution as a Local Public Good*, 2 J. PUB. ECON. 35, 36–37 (1973); see also Stark, *supra* note 117, at 1409–10.

¹²⁷ In essence, the federal government is selling the right to make these decisions to states. Because state governments' interests in securing the loyalty of local businesses and other constituencies are likely to be greater than those of the federal government, this transaction can prove beneficial to both.

¹²⁸ See *supra* pp. 2565–66.

¹²⁹ See, e.g., Paul Gillmor & Fred Eames, *Reconstruction of Federalism: A Constitutional Amendment To Prohibit Unfunded Mandates*, 31 HARV. J. ON LEGIS. 395 (1994); Jonathan Walters, *Modest Mandate Relief*, GOVERNING, July 2004, at 14; cf. Robert M.M. Shaffer, Comment, *Unfunded State Mandates and Local Governments*, 64 U. CIN. L. REV. 1057 (1996) (discussing similar issues, with a similarly narrow focus, at the state level).

than light.¹³⁰ Federal legislation can indeed distort state and local priority-setting,¹³¹ but, as discussed below, mandates are far from the only — or even necessarily the most significant — examples of this problem.

Among the most analytically bankrupt concepts is that of the unfunded mandate.¹³² Some of the programs that spark the strongest complaint are in fact those programs in which the federal government provides the most money to states. The concern, then, is not about the lack of total funding, but about the lack, or insufficiency, of marginal funding.¹³³ Yet an approach that measures the appropriateness of changes to mandates in terms of the availability of full incremental funding tied to a given activity is inherently arbitrary. First, it presumes that the federal government's current level of financial support is an irreducible minimum. Not only is this across-the-board presumption unsupported, it also creates perverse incentives: in effect, it tells the federal government not to increase support for the states in advance of deciding what conditions, if any, to impose on that support. It also treats as unfunded mandates the federal government's efforts to close loopholes through which some states may shift costs unilaterally to the federal government.¹³⁴ Second, this approach ignores the fungibility of money and the breadth of federal-state fiscal relations. Even if a mandate raises the net costs of one particular federal-state program, the state will suffer no loss of fiscal capacity — that is, it will not have to cut programs or raise taxes — if federal support increases a comparable amount in other areas. Third, this approach seriously impinges upon the sovereignty of the federal government. Put simply, the federal government cannot and should not be expected to continue grant programs indefinitely or to refrain from reformulating those programs in order to meet changing needs or preferences.

Most importantly, judging unfunded mandates by their incremental effects ignores the dramatic effects of the business cycle. Federal aid to states, both in absolute terms and as a fraction of states' budgets, increases substantially as the national economy declines. Taken to its

¹³⁰ In essence, states attack conditions on funding they receive from the federal government as either patronizing or misguided. Advocates of federal power, on the other hand, accuse states of seeking a free lunch — wanting to take the federal government's money without honoring its wishes for how that money is spent. Because both of these arguments are sufficiently abstract and extreme, they are unlikely to succeed in establishing a meaningful across-the-board rule.

¹³¹ See ACIR, *FEDERALLY INDUCED COSTS*, *supra* note 102, at 15–16.

¹³² See generally *id.* at 5–10 (exploring the functional issues of mandate funding).

¹³³ When Congress requires Medicaid to cover additional services or populations, it increases states' costs. As those costs increase, however, so does federal reimbursement of them. See, e.g., 42 U.S.C. § 1396b(c) (2000). Thus, Medicaid mandates typically receive about fifty-seven percent funding. See 1993 *YELLOW BOOK*, *supra* note 100, at 25.

¹³⁴ Given the difficulty of defining a loophole, this problem is all but inevitable with any definition of mandates that focuses on changes from a baseline.

logical conclusion, this approach would allow the federal government to burden states with a host of intrusive requirements as a condition of providing countercyclical aid during recessions, with states entitled to throw off these shackles each time the economy recovers. A cyclical reduction in state autonomy is difficult to justify under any coherent theory of federalism.

Presumably recognizing the untenability of the assumption that the federal government could avoid all unfunded mandates, UMRA is subject to both procedural and definitional limitations that render it largely symbolic. Procedurally, it allows simple majorities to waive its points of order.¹³⁵ Because any mandate without majority support could be removed by amendment, UMRA seems unlikely to change many legislative outcomes. Even if it could, however, its definition of unfunded mandates contains numerous exceptions — many based on historical divisions of funding — that make its application whimsical at best.¹³⁶ In particular, because it does not cover mandates in programs that give states discretion to reduce their expenditures in other ways,¹³⁷ it effectively exempts most large federal-state cooperative spending programs.¹³⁸

At the same time, the Supreme Court has effectively created its own version of an unfunded mandates reform act. It has prohibited Congress from imposing certain kinds of costs on states — particularly legal liability,¹³⁹ but also some personnel and other costs.¹⁴⁰ In contrast, when the federal government provides funding to states, the

¹³⁵ See FLOYD M. RIDDICK & ALAN S. FRUMIN, *RIDDICK'S SENATE PROCEDURE: PRECEDENTS AND PRACTICES* 1415 (Alan S. Frumin ed., rev. ed. 1992). UMRA does not contain a supermajority requirement for waiver of its provisions, such as those imposed on many budgetary procedures. See Congressional Budget Act of 1974, Pub. L. No. 93-344, tit. IX, § 904(c)(1), (d)(2), 88 Stat. 297, 331 (codified as amended at 2 U.S.C. § 621 note) (requiring a three-fifths vote to waive certain points of order under provisions of that Act).

¹³⁶ See, e.g., 2 U.S.C. §§ 658(5), 1503 (excluding several classes of legislation from the Act's coverage); *id.* §§ 658c(a)(1), 658d(a)(2) (permitting the Act to be enforced with a point of order only when the legislation in question would impose unfunded mandates totaling more than \$50 million); see also Elizabeth Garrett, *Enhancing the Political Safeguards of Federalism? The Unfunded Mandates Reform Act of 1995*, 45 U. KAN. L. REV. 1113, 1141 (1997) (estimating that "two-thirds of the mandates passed during the 1980s would have fallen under one of [UMRA's] exceptions").

¹³⁷ See 2 U.S.C. § 658(5)(B)(ii).

¹³⁸ In Medicaid, for example, most states cover a significant number of people and services not required by federal law. See, e.g., 42 U.S.C.A. § 1396a(a)(10)(A)(ii) (West Supp. 2004); *id.* § 1396d(a)(1) (West 2003) (delineating some optional coverage categories and services).

¹³⁹ See, e.g., *Bd. of Trs. of Univ. of the Ala. v. Garrett*, 531 U.S. 356, 374 (2001) (holding that Congress may not abrogate state sovereign immunity under the Commerce Clause); *Seminole Tribe v. Florida*, 517 U.S. 44, 47 (1996) (holding the same with regard to the Indian Commerce Clause).

¹⁴⁰ See, e.g., *Printz v. United States*, 521 U.S. 898, 933 (1997) (costs of conducting background checks); *New York v. United States*, 505 U.S. 144, 175-76 (1992) (costs of taking ownership of and regulating radioactive waste).

Court has granted it broad discretion to condition that funding.¹⁴¹ By focusing on the manner in which Congress imposes costs upon states, the Court superficially has escaped the irrationality of UMRA's efforts to preserve historical divisions of funding. This doctrine nonetheless contains myriad irrationalities of its own.

The Court's jurisprudence on funding conditions has developed as an offshoot of its decisions on direct federal regulation of states. This tie has led the Court to ask whether funding conditions are, in fact, tantamount to direct regulation. In *South Dakota v. Dole*,¹⁴² the Court held that they are not because states are free to decline the federal aid, freeing themselves from the conditions imposed.¹⁴³ The Court has thereby roughly mimicked UMRA's exemption for mandates with costs that the state can offset through other programmatic changes.

Yet excusing impositions if states have other means of achieving offsetting savings is much too formalistic: it ignores practical constraints on states, including, once again, the effects of the business cycle. On the one hand, some legally permissible savings are practically and politically unavailable.¹⁴⁴ Surely one cannot seriously suggest that during the Great Depression states could have declined federal aid, whatever the attached conditions. On the other hand, during the boom of the late 1990s, states' budgets were so flush that some did decline large federal grants because of relatively modest complaints with the conditions imposed.¹⁴⁵ Sharply increasing the conditionality of existing funds during economic upswings would not impair states' ability to carry out their own policy preferences by declining federal funds. If the question of voluntariness is to be the fulcrum of this debate, therefore, it must be answered in a context reaching well beyond a particular program.

¹⁴¹ See *South Dakota v. Dole*, 483 U.S. 203 (1987).

¹⁴² 483 U.S. 203.

¹⁴³ See *id.* at 211–12.

¹⁴⁴ The Court's assumption in *Dole* often is incorrect — that is, state and local governments frequently have little practical choice but to accept federal aid. See, e.g., Lynn A. Baker, *Conditional Federal Spending After Lopez*, 95 COLUM. L. REV. 1911, 1936–47 (1995) [hereinafter Baker, *Conditional Federal Spending*]; Lynn A. Baker, *The Prices of Rights: Toward a Positive Theory of Unconstitutional Conditions*, 75 CORNELL L. REV. 1185, 1240–42 (1990). Similarly, many theoretical opportunities to reduce state commitments are wholly unrealistic — and known to be so by the Congress that imposes the mandates. Thus, for example, a state could in theory reduce its Medicaid costs by cutting eligibility for nursing home residents, but in practice would face vehement opposition from nursing home operators and residents' families. More prosaically, many reductions in Medicaid coverage would result in increased uncompensated care that would indirectly raise costs and reduce efficiency in a state's healthcare system.

¹⁴⁵ For example, Ohio rejected its share of the federal welfare-to-work fund established in 1997 because it disliked the federal rules mandating which populations it should target. See Darrel Rowland, *State Boasts Extra \$500 Million in Welfare Money*, COLUMBUS DISPATCH, May 8, 1998, at 8D, LEXIS, News Library, Coldis File (describing the governor's decision to reject an \$88 million federal welfare-to-work grant in light of large surplus in TANF block grant).

Moreover, the Supreme Court's reliance on states' consent creates serious problems in itself. We do not allow individuals to sell themselves into slavery during times of economic desperation, after all, and one can reasonably argue that states similarly should not be extorted into giving away the essentials of their sovereignty. Perhaps in recognition of this problem, some commentators have suggested that certain conditions could be so inherently intrusive as to be constitutionally impermissible, even with the state's consent.¹⁴⁶ One can imagine, for example, that denying a state participation in Medicaid unless it moves its state capital might so offend the state's dignity and sovereignty as to be intolerable. Applying this principle, however, raises problems of its own — specifically, the delineation of the essential attributes of state sovereignty. The absence of a clear consensus identifying those attributes invites tendentious definitions and ad hoc decisionmaking of the kind the Court has repeatedly attempted with little success.¹⁴⁷

Concerns about possible federal extortion have led some scholars to suggest that federal conditions should be broadly disallowed as presumptively intrusive on state sovereignty.¹⁴⁸ This proposal is in some ways even more myopic than approaches relying on states' consent, and it risks savaging the states in the name of saving them. Although disallowance would shield states from unpleasant conditions, it likely would deprive them of considerable revenue.

The federal government is under no legal obligation to fund states and, when doing so, must share credit with state officials for any positive results. The ability to help shape the policies that it funds, therefore, is often the federal government's main incentive to provide aid to states. Without that inducement, it is less likely to deplete its political capital raising funds for another level of government to spend. In ef-

¹⁴⁶ See, e.g., Ilya Somin, *Closing the Pandora's Box of Federalism: The Case for Judicial Restriction of Federal Subsidies to State Governments*, 90 GEO. L.J. 461, 464–73 (2002) (arguing that “federal subsidization of the states undermines the key federalism values of responsiveness to diverse local preferences, horizontal competition, and vertical competition” and leaves states vulnerable to coercion). *But see* Jack M. Balkin & Sanford Levinson, *Understanding the Constitutional Revolution*, 87 VA. L. REV. 1045, 1100–01 (2001) (suggesting that some inherently intrusive conditions are justified by the importance of the rights Congress seeks to enforce).

¹⁴⁷ The Court has long had a constitutional avoidance canon. See *Gregory v. Ashcroft*, 501 U.S. 452, 470 (1991) (establishing presumption against interference with structures of state government when interpreting ambiguous legislation). *But see* *Chisom v. Roemer*, 501 U.S. 380, 411–12 (1991) (Scalia, J., dissenting) (noting the majority's failure to apply the *Gregory* presumption to ambiguous legislation also purportedly affecting qualifications of state judges). It has also experimented with definitions of core state functions that would provide grounds for striking down federal laws impinging upon those functions. See, e.g., *Nat'l League of Cities v. Usery*, 426 U.S. 833, 855 (1976), *overruled by* *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 531 (1985).

¹⁴⁸ See, e.g., Baker, *Conditional Federal Spending*, *supra* note 144, at 1988–89.

fect, then, disallowing federal conditions on grants to states would be tantamount to denying states the ability to contract to perform services for the federal government.¹⁴⁹ Whatever problems may attend the current approach, which mimics unconscionability doctrine, treating states as legal incompetents without capacity to enter into binding contracts seems extreme and, indeed, quite insulting.

Interest in extreme remedies is natural given both the naïveté of the consent formulation and the problems inherent in defining the essential elements of sovereignty doctrine. States' success in eliminating mandates over the past few decades, however, raises serious questions about whether any judicial override of the political process is needed. Thus, although *Dole* might not withstand analytical scrutiny, it largely reaches a sensible result.

This conclusion reflects the fact that a mandate's political viability depends significantly upon which model of cooperative federalism drove the federal government to enact the program to which the mandate applies. Funding provided to compensate states for burdens imposed by federal activities is rarely saddled with harsh conditions.¹⁵⁰ Built as it is on an analogy to tort, the compensatory model holds that attaching any mandates to funding — other than those necessary for the funding to reach those actually bearing the burden in question — would be inappropriate.¹⁵¹ The compensatory model's incompatibility with broad mandates, however, is relatively unimportant: large, long-term compensatory payments are rare. After a few years, the imposition that led to the payments is taken for granted and other uses for the funds in question offer greater rewards for federal budgeteers.

The continued political viability of mandates disbursed under the leadership model is correlated with sustained agreement with federal policy. When the public trusts the states to uphold important values and doubts the direction of federal leadership, support for federal funding conditions can collapse. Thus, for example, the 1996 welfare law eliminated numerous mandates that bound states when it replaced the Aid to Families with Dependent Children (AFDC) program with

¹⁴⁹ See *id.* at 1966–67 (arguing for a doctrine that would allow the federal government effectively to contract with states to perform specific functions for it, but establish a presumption against the constitutionality of most others).

¹⁵⁰ But see ACIR, *FEDERALLY INDUCED COSTS*, *supra* note 102, at 37–38 (citing examples).

¹⁵¹ Oddly, it appears that this “reimbursement spending” is one of the few kinds of funding that Professor Baker would allow the federal government to condition: she defines constitutional “[r]eimbursement spending” legislation as any appropriation that “specifies the *purpose* for which the states are to spend the offered federal funds and simply reimburses the states, in whole or in part, for their expenditures for that purpose.” See Baker, *Conditional Federal Spending*, *supra* note 144, at 1963.

the Temporary Assistance to Needy Families (TANF) block grant.¹⁵² Of course, the elimination of mandates may not be the great victory for states that it appears to be. The rationale for continuing federal funding disappears once federal policy leadership is rejected.¹⁵³ The fate of TANF is therefore no surprise: Congress froze the funding¹⁵⁴ and then began to cut it in nominal terms.¹⁵⁵

Perhaps the most interesting questions regarding political viability arise under the superior capacity model of cooperative federalism. Because programs justified under this model address problems that states would be hard-pressed to handle on their own, an argument can be made that states have less ability to resist federal conditions on these programs than conditions on programs justified under another model. It is unclear, however, whether states would want to resist: these are areas where states most need to induce the federal government to intervene. Just as the elimination of federal restrictions tends to lead to the reduction of the federal role in programs justified under the leadership model, it also can undermine federal policymakers' motivation to continue supporting programs when the federal government has superior fiscal capacity.

States receiving funding under the superior capacity model have an incentive to submit to federal mandates. Without conditions targeting the aid, the nature of the activity being funded may become less clear. Should some states divert funds to activities that federal policymakers do not value — or to activities for which their own fiscal capacity seems sufficient — the program's opponents likely will cite that as evidence that current federal funding is excessive.¹⁵⁶ And any reductions opponents achieve are likely to injure all states. Absent some grounds for imposing a duty on the federal government to fund states without

¹⁵² See Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, tit. I, § 103, 110 Stat. 2105, 2112–61 (codified as amended at 42 U.S.C.A. §§ 601–619 (West 2003 & Supp. 2004)).

¹⁵³ See, e.g., *Block Grants: Lessons Learned: Testimony Before the Subcomm. on Oversight and Investigations, House Comm. on Econ. and Educ. Opportunities*, 104th Cong. 3 (1995) (statement of Linda G. Morra, Director of Educ. and Employment Issues, Health, Educ. and Human Servs. Div.) (stating that block grants consolidated by President Reagan, which primarily funded human services programs, received an average of twelve percent less in federal funds in 1982 than they had as individual programs the previous year).

¹⁵⁴ See 42 U.S.C.A. § 603(a)(1)(A) (providing identical block grant amounts for six years).

¹⁵⁵ See *id.* § 603(a)(3) (supplementing the amounts that otherwise would be provided as TANF block grants modestly for certain states with population increases or low historic spending); Act of Sept. 30, 2002, Pub. L. No. 107-229, § 114, 116 Stat. 1465, 1467 (continuing TANF block grant without these amounts, which resulted in a net reduction in funding for states).

¹⁵⁶ Even programs with few ideological opponents are not secure: opportunists seeking funds for other activities are constantly on the alert for programs whose rationale has eroded. Cf. David A. Super, *The Quiet "Welfare" Revolution: Resurrecting the Food Stamp Program in the Wake of the 1996 Welfare Law*, 79 N.Y.U. L. REV. 1271, 1297 n.91 (2004) (discussing the relative primacy of fiscal concerns over policy objectives in states' responses to new federal programs).

regard to its policy preferences — that is, unless the compensatory model also applies to a program — no obvious basis exists for criticizing the bargain that the two levels of government strike, even though the federal government holds significant advantages in this process.¹⁵⁷

2. *Cyclical Stresses on Federal-State Spending Programs.* — The centrality of federal mandates in the discourse about threats to states' capacity to carry out their policies is yet another example of the conventional wisdom on fiscal federalism falling victim to static analysis. Ultimately, far more important than quarrels over substantive conditions on federal funds is the effect of the business cycle on the cooperative structures under which those funds are provided. This section first examines the problems that cyclical fluctuations impose on programs that require states to match some proportion of federal contributions. It then considers whether the elimination of matching requirements ameliorates those problems.

(a) *Matching Programs.* — The largest federal-state cooperative funding program, Medicaid, in theory requires states to supply about forty-three percent of total program funding.¹⁵⁸ Other important programs, from cash welfare and child care subsidies to transportation, require state or local matches as well.¹⁵⁹ These matching requirements have many appealing features. They allow the federal government to stimulate creation of a program significantly larger than it is prepared to fund. In this sense, matching systems best fit the leadership model of cooperative fiscal federalism. Consistent with that model's assumptions, they memorialize the sentiment that fiscal responsibility for a particular set of problems is traditionally a state concern and that the federal government is not agreeing to a transfer of those responsibilities. From the state's point of view, although providing the match consumes resources, having state money involved strengthens its moral

¹⁵⁷ There is an argument, however, that mandates act as a kind of compact among states. In this light, funding decisions involve clashes of interests not just between federal and state governments, but also among states: thus, when states — through their congressional delegations — approve a mandate, they each agree to surrender some control over received federal funds in exchange for maximizing the attractiveness of the program to federal budgeteers. Such a compact is rational and socially beneficial, but the only way to make such a compact under the Constitution is through Congress. See Somin, *supra* note 146, at 470–71. Congress therefore has two very different roles in cooperative funding programs: it acts both as a representative of the states in crafting a compact in which they surrender a degree of autonomy in pursuit of federal funding, and as the principal judge of the adequacy of that compact. Its ability to regulate political monopoly is clearly compromised.

¹⁵⁸ 1993 YELLOW BOOK, *supra* note 100, at 25.

¹⁵⁹ Technically, the TANF block grant does not have a matching requirement. It does, however, require states to spend seventy-five or eighty percent of the amounts they spent under the federal-state matching programs that the 1996 welfare law replaced. See 42 U.S.C.A. § 609(a)(7)(B)(ii) (West Supp. 2004). The penalty for failing to make these “maintenance of effort” expenditures is a reduction in federal funding. See *id.* § 609(a)(7)(A). The provision's effect, therefore, is similar to that of a matching system subject to a cap.

claim to control the program's direction. Federal matching also allows state policymakers to create an exaggerated sense of their own effectiveness by producing more than twice as many services as voters are funding through state taxes.

The reliance of this country's means-tested programs on matching structures in large part reflects a historical accident or compromise. President Franklin Roosevelt recognized that state and local governments lacked the fiscal capacity to cope with the Great Depression, but he feared the political consequences of fully federalizing responsibility for relieving economic distress.¹⁶⁰ Part of his response to this dilemma was sectoral — largely federalizing relief of particularly appealing populations such as the elderly — and part was in the form of shared fiscal responsibility.¹⁶¹ In effect, although the New Dealers recognized the need for the federal government to intervene because of its superior capacity, they constructed a program on the leadership model instead. That approach has been with us since.

Matching arrangements, however, fit poorly within the compensatory and superior capacity models of fiscal federalism. When the federal government owes states a moral duty of compensation, the states' willingness to spend their own funds seems irrelevant to the discharge of that responsibility.¹⁶² A deeper problem arises with respect to the superior capacity model. Because it is based on an acknowledgment of a state's fiscal difficulties, it is counterproductive to base the amount a state receives to meet its fiscal shortfall on the amount it can produce despite its problems: the states most in need of help will be those least able to claim it.

Economic downturns magnify matching programs' difficulty responding to states' insufficient fiscal capacities. Although matching rates for means-tested programs commonly vary based on states' individual median incomes, the national average matching rate does not. Thus, a state whose median income falls substantially during a recession will not see the matching rate it receives from the federal government rise unless its losses exceeded the national average. Even

¹⁶⁰ See WALTER I. TRATTNER, *FROM POOR LAW TO WELFARE STATE: A HISTORY OF SOCIAL WELFARE IN AMERICA* 287–90 (6th ed. 1999); see also MICHAEL B. KATZ, *IN THE SHADOW OF THE POORHOUSE: A SOCIAL HISTORY OF WELFARE IN AMERICA* 227, 239–40 (1986).

¹⁶¹ See KATZ, *supra* note 160, at 238. Social Security benefits for senior citizens were entirely federally funded. Means-tested programs for low-income children and elderly people not qualifying for Social Security, although far less costly, were financed by various matching arrangements with states.

¹⁶² Even if the federal government is deemed to owe states compensation for only some part of a set of costs, it can handle that debt more appropriately by providing only partial funding and allowing states to decide for themselves whether they prefer to fill the gap with spending, with cost-cutting, or with a combination of both.

states suffering disproportionately, or caught in a regional or sectoral recession, will receive no relief for their first years of distress due to delays in reflecting changed circumstances in matching rates. Moreover, the reliance on median income can falsely equate two states whose income distributions are similar in the middle but diverge enormously at the top and bottom.¹⁶³

In part because of these stresses, states have endeavored to evade their matching responsibilities. One simple approach is to count monies the state is already spending on other activities toward its match or, much to the same effect, to expand the matched program to cover items in the state's budget for which the federal government never meant to assume responsibility.¹⁶⁴ States have also developed a wide array of more sophisticated schemes, by which they seek to extract funds from service providers paid with Medicaid funds in order to meet their matching requirements.¹⁶⁵ States' zeal in constructing these "creative financing" or "maximization" schemes, along with the federal government's efforts to shut them down, have led to considerable tension between the two levels of government.

¹⁶³ If a regional recession causes huge income losses largely confined to the bottom third of the income distribution, for example, a state's median income may seem identical to that of a state experiencing no dislocations at all, even though the first state's demand for Medicaid and other services may be far higher. Similarly, states with relatively modest median incomes could have very high incomes at the upper end of the income distribution that could be taxed to pay for services, or they could have relatively flat income distributions at the top end of the scale.

¹⁶⁴ For example, although federal matching funds for foster care and adoption assistance are available only for children coming from very low income families, *see* 42 U.S.C. § 672(a) (2000), New York in the early 1990s transferred much of the remainder of the cost of its foster care system to the federal government by treating it as "emergency assistance." Such tactics spurred proposals for legislative reform. *See* H.R. DOC. NO. 103-273, at 181 (1994); CONG. BUDGET OFFICE, *THE ADMINISTRATION'S WELFARE REFORM PROPOSALS: A PRELIMINARY COST ESTIMATE* 25-31 (1994). Nonetheless, the strategy paid handsome rewards, as it resulted in a permanent augmentation of New York's eventual TANF block grant.

¹⁶⁵ For example, the state will increase reimbursements to county nursing homes by \$100, drawing down at least \$50 in federal matching funds. Separately, the state will require the county to contribute \$75 to the state (or reduce its aid to the county sponsoring the home by \$75). At the end of the day, the state and the county will each have gained at least \$25, entirely paid by the federal government, without providing any additional care. Reproducing similar schemes on a large scale can effectively eliminate the state's net cost of its match. To choke off this sort of scheme, the federal government must either prevent the state from increasing reimbursements to friendly providers or prevent it from receiving a share of those increases back from the providers. Neither task has proven easy. Indeed, in the mid-1990s, the Congressional Budget Office adopted a presumption that states would evade twenty-five percent of their matching requirements for any Medicaid expansion even if the legislation offered no obvious opportunities for gaming. *See* CONG. BUDGET OFFICE, *REDUCING THE DEFICIT: SPENDING AND REVENUE OPTIONS* 323 (1994). *See generally* TERESA A. COUGHLIN & STEPHEN ZUCKERMAN, *STATES' USE OF MEDICAID MAXIMIZATION STRATEGIES TO TAP FEDERAL REVENUES: PROGRAM IMPLICATIONS AND CONSEQUENCES* 10-13 (Urban Inst., Discussion Paper No. 02-09, 2002) (describing many of the states' inventive matching schemes), *available at* http://www.urban.org/UploadedPDF/310525_DP0209.pdf.

(b) *Unmatched Programs.* — To avoid this tension, the federal government has established a broad subset of grants-in-aid to state and local governments that require no match. Some of these programs are highly conditional, often referred to as categorical aid programs; others are loosely defined, commonly called block grants. Federal expenditures for these programs have grown considerably since World War II, both as a share of states' budgets and as a share of total federal grants-in-aid.¹⁶⁶ These unmatched programs bring structural problems of their own.

Because states do not bear any costs when expanding these programs, their fiscal prudence cannot be relied upon to limit federal financial exposure. Some other means is required. When the program is designed to serve a very specific function, it can be expressed as an uncapped entitlement.¹⁶⁷ A prominent and successful example of this approach is the Food Stamp Program, through which the federal government bears the full cost of benefits provided under a federally specified formula to households meeting a federally designed definition of need.¹⁶⁸ In many cases, however, a uniform national structure is either infeasible or difficult to agree upon.

This dilemma leaves the federal government with only one practical means of containing costs absent a matching requirement: a cap on expenditures. The size of the overall cap is likely to be arbitrary and, unless the activity is extremely popular, may erode over time.¹⁶⁹ Moreover, the federal cap must be disaggregated into caps on the grants to each state or to each locality. Setting these funding formulas is inherently arbitrary, and the result is at least as likely to reflect states' relative political power as it is to reflect the goals and needs of the program. The invisibility of the relevant decisions exacerbates this problem: the media, and certainly the electorate, can hardly be expected to stay on top of each of the myriad formulas governing federal grants-in-aid, much less to understand how subtle variations in the factors can significantly change the results. If a funding formula does indeed contain highly arbitrary elements, then the net fiscal effect is a taxation and redistribution program based on states' relative political power. Although in theory this redistribution could be designed to shift resources from rich states to poorer ones, affluent states' congressional delegations will resist too great a shift. Unless increasing aggre-

¹⁶⁶ Penner, *supra* note 36, at 112–14.

¹⁶⁷ The uncapped entitlement is the most efficient and politically transparent mechanism for delivering many kinds of government benefits. See David A. Super, *The Political Economy of Entitlement*, 104 COLUM. L. REV. 633, 672–86, 695–709 (2004).

¹⁶⁸ See 7 U.S.C.A. §§ 2011–2036 (West 1999 & Supp. 2004). Because of the difficulty of specifying what is required to operate the program, the Food Stamp Act relies on a fifty percent matching requirement for administrative costs to encourage state frugality. See *id.* § 2025(a).

¹⁶⁹ See Super, *supra* note 167, at 714.

gate resources for the activity being funded is of great importance, redistribution based on political power rather than on fiscal need has little to commend it in a federal system.

Furthermore, capped programs offer little help in alleviating the cyclical tensions in states' budgets. To be sure, to the extent they provide a largely noncyclical revenue stream,¹⁷⁰ these funds are superior to most sources of state tax revenue.¹⁷¹ But when demands for state funding rise during economic downturns, these programs remain static. The difficulty of crafting a funding formula that targets resources accurately from recession to recession has largely prevented the creation of countercyclical block grant programs for public works jobs or similar forms of relief.¹⁷² As a result, public works grants, like most other federal grants-in-aid, do not respond to the business cycle; these programs do not provide much relief to those that are hard hit by cycles, including young workers and the chronically unemployed.¹⁷³

Most importantly, capped programs are the most vulnerable to the conflicts inherent in the leadership model of federal-state relations. The federal political process has difficulty evaluating the costs of compliance with funding conditions, leading to a tendency to overspecify how categorical funds should be expended.¹⁷⁴ The accumulation of these strings on funding leads periodically to a backlash in which programs are consolidated into unconstrained block grants, often with reduced funding. The difficulty of determining how states are spending block grant funds, and dissatisfaction with some of their known choices, politically weaken federal programs to aid states and lead to their shrinkage or disappearance over time.

Even more so than matched programs, therefore, block grants are likely to deceive voters regarding the true costs and effectiveness of various levels of government. Recipient governments appear efficient because they can provide more services than their taxes can finance. By contrast, the federal government appears inefficient because it receives little credit for expenditures it finances. In the short term, this illusion can distort voters' decisions about the consumption of public

¹⁷⁰ Many of these programs, however, tend to erode over time, particularly relative to inflation. *See id.* Lacking any functional definition of the appropriate level, policymakers typically judge these programs' funding relative to the baseline of the prior year's appropriation. Those legislators seeking funds for other priorities may choose to ignore the effects of inflation and contend that freezing the program's nominal funding level is not a "cut."

¹⁷¹ *See infra* section IV.D.1, pp. 2630–32.

¹⁷² *See* Roger J. Vaughan, *The Use of Federal Grants for Countercyclical Job Creation*, in *FISCAL FEDERALISM AND GRANTS-IN-AID*, *supra* note 36, at 143, 160.

¹⁷³ *See id.*

¹⁷⁴ *See* Penner, *supra* note 36, at 136–37.

goods.¹⁷⁵ In the long term, the lack of political rewards for federal policymakers is likely further to destabilize grants to states and to accelerate their shrinkage over time.

3. *Impacts of Federal Deficit Reduction Efforts.* — Because of the share of states' budgets that the federal government provides, the periodic efforts to reduce the federal budget deficit have profound impacts upon states.¹⁷⁶ Although federal budget-cutters often describe their efforts in terms of shared sacrifice, in practice, aid to state and local governments inevitably takes a disproportionate share of the reductions.¹⁷⁷ Most obviously, those parts of the federal budget that are legally immune from cuts — payments on the national debt, long-term leases, military procurement contracts, and the like — lie almost entirely outside the realm of aid to state and local governments. In addition, federal policymakers can expect to be held accountable for cuts in wholly federal programs — Social Security, Medicare, farm price supports, defense, foreign aid, and the like — far more rigorously than for those mediated through the states.¹⁷⁸ Also, much aid to state and local governments is defined in terms of fixed amounts rather than in terms of functions it is intended to serve,¹⁷⁹ making it vulnerable to nominal dollar freezes and to arbitrary percentage reductions. Absent a specific functional, rather than historical, justification for a given funding level, the program's champions will have difficulty making a compelling case for why it cannot be cut.¹⁸⁰ Thus, a five percent reduction in

¹⁷⁵ See Wallace E. Oates, *Lump-Sum Intergovernmental Grants Have Price Effects*, in *FISCAL FEDERALISM AND GRANTS-IN-AID*, *supra* note 36, at 23, 29.

¹⁷⁶ See Donald Haider, *Balancing the Federal Budget: The Intergovernmental Casualty and Opportunity*, in *FINANCING STATE AND LOCAL GOVERNMENTS IN THE 1980S: ISSUES AND TRENDS* 205, 212–15 (Norman Walzer & David L. Chicoine eds., 1981).

¹⁷⁷ These policies have contributed considerably to the depth and persistence of the current state fiscal crisis, costing state and local governments more than \$175 billion over the four-year course of the current fiscal crisis. See IRIS J. LAV & ANDREW BRECHER, *CTR. ON BUDGET & POLICY PRIORITIES, PASSING DOWN THE DEFICIT: FEDERAL POLICIES CONTRIBUTE TO THE SEVERITY OF THE STATE FISCAL CRISIS 1* (rev. 2004), *available at* <http://www.cbpp.org/5-12-04sfp.pdf>.

¹⁷⁸ For example, the headlines will proclaim that the *state* is cutting child care subsidies; state officials' assertions that reductions in federal aid are responsible likely will appear down in the body of the article. See, e.g., Susan E. Kinsman, *Weicker Refuses To Add Money for Heating Aid*, *HARTFORD COURANT*, Oct. 5, 1994, at A3. Such assertions may not be believed by even those that read them.

¹⁷⁹ Thus, for example, if the Pentagon needs to buy a certain number of bullets each year, it will necessarily have to receive annual increases to account for inflation: the failure to receive those increases will be evident in shrunken armories. By contrast, aid to state and local governments will be defined solely in terms of an arbitrary amount in an appropriations act.

¹⁸⁰ See Super, *supra* note 167, at 695–96 (describing the political weakness of programs that are not “functional entitlements”).

total federal spending may result in cuts of twenty percent or more in aid to state and local governments.¹⁸¹

Because nearly all state (and local) governments are required to balance their budgets annually, they generally lack much ability to phase in their accommodation of these cuts. Indeed, because their fiscal years generally begin on July 1, states may be several months into the year before they learn about changes in federal aid.¹⁸² Unless these changes come during periods of unforeseen growth in states' revenues, states must compensate for large, sudden reductions in federal aid. Assuming the state is basically comfortable with the allocation of resources across its various functions, it will seek additional funds to carry out the activities for which it anticipated receiving more federal aid.¹⁸³ This is likely to come from sharp reductions in fast-spending programs; in other words, those in which midyear cuts are likely to yield significant outlay savings in the current year.¹⁸⁴ As discussed below, this category of programs disproportionately includes those that aid low- and moderate-income people.¹⁸⁵ Thus, sharp shifts in federal fiscal policy are likely to impact low-income people to a considerably greater extent than the nominal distribution of those cuts

¹⁸¹ See IRIS J. LAV, CTR. ON BUDGET & POLICY PRIORITIES, DECLINE IN FEDERAL GRANTS WILL PUT ADDITIONAL SQUEEZE ON STATE AND LOCAL BUDGETS (2004), available at <http://www.cbpp.org/2-3-04sfp.pdf>; NAT'L ASS'N OF STATE BUDGET OFFICERS, FEDERAL BUDGET UPDATE: ADMINISTRATION'S BUDGET LEAN FOR STATES; CRACKS DOWN ON INTERGOVERNMENTAL TRANSFERS (2004), available at <http://www.nasbo.org/Publications/federalbudgetFeb2004.pdf>. President Bush's budget proposals for fiscal year 2006 would cut grants to state and local governments for programs other than Medicaid by 4.5% in a single year, after accounting for inflation. IRIS J. LAV, CTR. ON BUDGET & POLICY PRIORITIES, DEEP CUTS IN FEDERAL GRANTS IN FY 2006 BUDGET WILL SQUEEZE STATES AND LOCALITIES 1 (2005), available at <http://www.cbpp.org/2-7-05sfp.pdf>. President Bush's budget also includes deep Medicaid cuts, but because Medicaid spending is driven by health care inflation and changes in the population of eligible beneficiaries, projected spending levels are not as accurate a measure of his proposals as the estimated net impact of the policy changes he seeks. The President's proposed levels of non-Medicaid grants to state and local governments for fiscal year 2006 indicate a \$31 billion decrease (as measured in 2006 dollars) since fiscal year 2001, the last year for which a budget was enacted before the recent economic downturn. *Id.*

¹⁸² The federal fiscal year begins on October 1. The appropriations bills most important to states, particularly the Labor-HHS-Education and VA-HUD bills, are typically among the most controversial and hence are rarely completed more than a few days before the new fiscal year. In fiscal years 2003 and 2004, the federal government was unable to resolve most major domestic spending bills until well after the beginning of the *federal* fiscal year.

¹⁸³ See generally RICHARD P. NATHAN & FRED C. DOOLITTLE, THE CONSEQUENCES OF CUTS: THE EFFECTS OF THE REAGAN DOMESTIC PROGRAM ON STATE AND LOCAL GOVERNMENTS 189-204 (1983) (seeking to develop a systematic model of state replacement behavior).

¹⁸⁴ See *infra* section IV.C.1, pp. 2622-23.

¹⁸⁵ See *infra* Part IV, pp. 2614-40.

might suggest. Even reductions in grants to states for highway construction or the arts are likely to lead to cuts in aid to the poor.¹⁸⁶

C. Conflict and Cooperation in Raising Revenue

In the three decades since it launched the modern era of judicial regulation of fiscal federalism with *Edelman v. Jordan*¹⁸⁷ and *National League of Cities v. Usery*,¹⁸⁸ the Court has emphasized repeatedly that fiscal capacity is essential to states' performance of their vital functions within our federal system. It has focused, however, on only two relatively narrow threats to states' fiscal integrity: money judgments and the cost of compliance with federal regulations. Largely ignored have been the federal government's complex interactions with states over raising revenues. This section considers those ties. It finds that Congress and the Court have been weakening states' fiscal positions by hobbling states' revenue-raising capacities in ways difficult to reconcile with both institutions' strong pro-state rhetoric — and likely swamping the effects of any modest reductions in federal mandates. Section 1 sketches the interdependencies between the federal and state tax structures that are a crucial but poorly understood feature of fiscal federalism. Section 2 identifies important steps Congress has taken that directly and indirectly reduce states' tax bases. Section 3 then questions whether the Court's restrictions on state revenue-raising through the dormant commerce clause can be reconciled with the rest of its fiscal federalism doctrine.

1. *Cooperative Federalism in Taxation.* — Just as government spending is a complex mosaic of separate and cooperative ventures by federal and state governments that has changed dramatically over time, so too have the revenue-raising activities of the two levels of government become increasingly intertwined. Authority for raising revenue under the Constitution was originally strictly divided between the two levels of government. The federal government was supported primarily by tariffs and levies on goods moving in interstate com-

¹⁸⁶ Most states "ratified" — declined to offset — federal funding cuts from low-income entitlements in the early 1980s at the behest of President Reagan. They were somewhat more likely to replace operating and capital funds the federal government had cut. See NATHAN & DOOLITTLE, *supra* note 183, at 200–04. Cuts in federal aid to state-funded programs will have two opposite effects on state spending. First, the cuts will reduce the state's total revenues, increasing pressure on all state expenditures. Second, the particular programs receiving the cuts may have to reduce their services, causing them to appear needier than other programs that did not lose funds. Programs with strong, politically effective constituencies, such as highway construction and cultural institutions, are likely to be adept at drawing public attention to whatever shortfalls in funding they are facing, thus spreading the loss of funding to other programs in the state's budget.

¹⁸⁷ 415 U.S. 651 (1974).

¹⁸⁸ 426 U.S. 833 (1976).

merce; states retained sole effective ability to impose direct taxation, as well as to tax property and intrastate commerce. This division has largely collapsed, first with the enactment of the Sixteenth Amendment, which authorized the federal income tax, and then with the vast expansion of interstate commerce, which brought with it far greater opportunities for federal taxation. Thus, today, federal and state governments effectively compete for many of the same revenue sources. These interactions proceed under models analogous to those guiding cooperative spending programs.

The federal income tax allows state and local governments to shelter some taxpayers from federal taxation, both by allowing deductions for certain kinds of taxes paid¹⁸⁹ and by excluding income earned as interest from state and local government bonds.¹⁹⁰ Although these policies lack a rationale as cogent as the compensatory model of federal funding,¹⁹¹ they do suggest that model in that they seek to help state and local governments meet their basic needs for raising operating and capital funds without excessive federal competition.

The federal government also plays a leadership role in areas of joint taxation. It raises far more revenue than do states through income and estate taxes. Accordingly, many states have built their comparable taxation systems around the federal one. States define key concepts, such as adjusted gross income and the value of estates, with reference to the federal definition. Some states go considerably further — for example, defining their earned income tax credits (EITCs) for low-income workers as a percentage of the federal EITC. In this division of functions, the crafting of basic accounting concepts is left to the federal government.

This coordination has several significant advantages. First, it helps taxpayers by reducing the economic and psychic costs of compliance with the state tax system. Taxpayers can copy figures computed on their federal returns onto their state forms, apply a few state-specific surcharges and preferences, and rapidly compute their state taxes. Second, and related, coordination benefits the state by increasing the likelihood of compliance with its tax rules. Taxpayers are given fewer chances to err, innocently or otherwise. Many taxpayers who might be tempted to trifle with state tax rules will take care to prepare accurate federal returns, and inconsistent reporting on federal and state returns

¹⁸⁹ See I.R.C. § 164 (2000), amended by American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 501(a), 118 Stat. 1418, 1520-21.

¹⁹⁰ See I.R.C. § 103; see also Clayton P. Gillette, *Fiscal Federalism and the Use of Municipal Bond Proceeds*, 58 N.Y.U. L. REV. 1030, 1037-38 (1983).

¹⁹¹ Indeed, these policies have quite regressive distributional effects. See, e.g., IRIS J. LAV, CTR. ON BUDGET & POLICY PRIORITIES, A SALES TAX DEDUCTION WOULD LARGELY BENEFIT HIGH-INCOME TAXPAYERS AND CARRY A HIGH COST (2004), available at <http://www.cbpp.org/6-8-04tax.pdf>.

is an unlikely, and easily caught, error. And third, states can rely upon the Internal Revenue Service's superior capacity for enforcement of tax provisions they have in common with the federal system. This can increase deterrence of fraud, reduce states' total enforcement costs, and allow the states to provide stronger enforcement for features of their tax codes that lack analogues in the federal system. States' ability to enact property tax credits and similar state-specific revenue measures depends on the availability of significant enforcement resources to prevent abuses of these provisions. Thus, states' conformity with federal rules on matters where they have no strong independent policy preferences effectively expands their discretion to pursue their own priorities in other areas.

2. *Congressional Interventions.* — Despite their pro-state rhetoric and the passage of symbolic legislation such as UMRA, federal policymakers have shown a remarkable insensitivity to states in the area of revenue-raising. The deleterious effects of recent federal tax policies likely swamp any improvements in states' fiscal flexibility resulting from loosened conditions on federal aid to states. This section first examines Congress's increasing willingness to interfere directly with states' taxing authority and then considers the indirect but very real spillover effects of changes in federal tax policy.

(a) *Direct Restrictions.* — Rhetorical defenses of states' autonomy and importance in the federal system are difficult to reconcile with recent congressional efforts to restrict state and local governments' ability to tax sales over the Internet. Much of the growth in Internet sales has come at the expense of commerce in stores whose taxes provided a large portion of states' revenues. Accordingly, if states cannot follow this economic activity to the Internet, their revenues will erode steadily.¹⁹²

Given the federal government's traditional leadership role in designing tax systems, as well as its authority under the Commerce Clause, one might reasonably expect Congress to help states disentangle the complexity of taxing cyberspace commerce and to design a system balancing states' fiscal needs with the need to avoid duplicative or administratively burdensome taxation. Alas, when Congress intervened, it sought no such balance. The Internet Tax Freedom Act,¹⁹³ enacted in 1998, prohibits a broad range of state taxes on Internet

¹⁹² This problem is compounded by shifts in consumption from tangible goods, which state sales taxes effectively reach, to services that are far more difficult to tax. See generally MICHAEL MAZEROV, CTR. ON BUDGET & POLICY PRIORITIES, EXPANDING SALES TAXATION OF SERVICES: OPTIONS AND ISSUES (2003) (discussing the advantages of service taxes relative to sales taxes), available at <http://www.cbpp.org/3-24-03sfp.pdf>.

¹⁹³ Pub. L. No. 105-277, div. C, tit. XI, §§ 1100-1104, 112 Stat. 2681, 2681-719 to 2681-726 (1998) (codified as amended at 47 U.S.C. § 151 note (2000)).

transactions, with limited “grandfather exceptions” for states that already had enacted such taxes.¹⁹⁴ More recently, Congress has sought to expand and make permanent this prohibition.¹⁹⁵ Estimates of the ultimate cost to state and local governments of the various proposals under consideration have ranged from \$2 billion to \$9 billion per year.¹⁹⁶

State and local governments also derive approximately \$12 billion per year from the taxation of local and long-distance telephone service.¹⁹⁷ As this service, too, has come to operate increasingly over the Internet, Congress again has moved to prevent state tax systems from following this economic activity.¹⁹⁸ The loss, or even significant erosion, of this revenue stream will have far more impact on states’ ability to fulfill their traditional roles in the federal system than any economies states might be able to glean from the loosening of federal grant conditions.

(b) *Indirect Impacts.* — The linkages between federal and state revenue systems mean that changes in federal tax law can affect state revenues as well. Because states typically have their own tax rates, standard deductions, and personal exemptions, Congress’s changes in these areas generally affect few states. Thus, simple tax increases or cuts can proceed without significantly impacting state revenues. When, however, Congress changes the structure of the federal tax system’s inclusion or exclusion of items from the definition of adjusted gross income or taxable estates, it simultaneously increases or reduces states’ revenues, sometimes significantly. The Tax Reform Act of 1986,¹⁹⁹ for example, eliminated many federal tax deductions and other preferences²⁰⁰ to which states had conformed, providing significant new revenues to states. This allowed state officials to win political favor by simultaneously cutting taxes and expanding spending programs.

¹⁹⁴ See *id.* § 1104(10), 112 Stat. at 2681-726.

¹⁹⁵ See Internet Tax Nondiscrimination Act of 2005, H.R. 1684, 109th Cong.; Internet Tax Nondiscrimination Act, S. 849, 109th Cong. (2005).

¹⁹⁶ MICHAEL MAZEROV, CTR. ON BUDGET & POLICY PRIORITIES, MAKING THE INTERNET TAX FREEDOM ACT PERMANENT IN THE FORM CURRENTLY PROPOSED WOULD LEAD TO A SUBSTANTIAL REVENUE LOSS FOR STATES AND LOCALITIES 1 (2003), available at <http://www.cbpp.org/10-20-03sfp.pdf>.

¹⁹⁷ MICHAEL MAZEROV, CTR. ON BUDGET & POLICY PRIORITIES, A PERMANENT BAN ON INTERNET ACCESS TAXATION RISKS SERIOUS EROSION OF STATE AND LOCAL TELEPHONE TAX REVENUE AS PHONE CALLS MIGRATE TO THE INTERNET 1 (2004), available at <http://www.cbpp.org/2-11-04sfp.pdf>.

¹⁹⁸ See *id.*

¹⁹⁹ Pub. L. No. 99-514, 100 Stat. 2085 (codified in scattered sections of the I.R.C.).

²⁰⁰ See, e.g., *id.* §§ 131-132, 134-135, 142, 100 Stat. at 2113-20 (codified at I.R.C. §§ 67, 164(a), 274 (West 2002 & Supp. 2004)) (repealing deductions for two-earner couples, state and local sales tax, and adoption expenses, and limiting deductions for miscellaneous itemized deductions and entertainment expenses).

More recently, however, the trend has shifted significantly in the other direction. Congress, at the behest of the Bush Administration, legislated reductions in estate taxes and the exclusion of many kinds of investment returns from adjusted gross income, which have exacerbated states' fiscal crises significantly. Had states continued to conform to federal income and estate tax rules, they would have seen their revenues decrease by tens of billions of dollars over the next decade without passing any tax cuts.²⁰¹ Moreover, the timing of the major tax cuts in 2001 and 2003 made it very difficult for states to adjust to these losses: Congress enacted each of them in the late spring. By then, many states' legislatures had completed their constitutionally permissible sessions and lacked easy means of making offsetting changes in tax policy. Coming as they did during a sluggish economy, with states in severe fiscal crises, the timing of these changes could hardly have been more disruptive.

In the short term, these changes prompted significant state budget cuts, disproportionately felt by programs for low- and moderate-income people. In the longer term, a significant number of states reacted by "decoupling" their income and estate tax policies from federal policy in order to preserve needed revenues.²⁰²

The federal government's decision to structure its tax cuts in this manner²⁰³ significantly undermined the important principles that had led to federal-state coordination of tax policies. It increased the complexity of the federal-state tax system as a whole. By removing the IRS from an enforcement role in several problematic areas, it also increased the system's vulnerability to evasion and abuse, which is likely to weaken the ethos of voluntary compliance on which both federal and state tax systems still largely depend. More globally, these developments signal less a change of direction in federal leadership than a collapse of the leadership and superior capacity models' ability to motivate federal tax policy decisions. The long-term consequences of this change for the regime of fiscal federalism swamp those of the federal mandates that have been subject to far more public debate.

²⁰¹ See IRIS J. LAV, CTR. ON BUDGET & POLICY PRIORITIES, PRESIDENT'S TAX PROPOSALS WOULD REDUCE STATE REVENUES BY \$64 BILLION OVER 10 YEARS 1 (2003), available at <http://www.cbpp.org/2-04-03sfp.pdf>.

²⁰² See ELIZABETH C. McNICHOL, CTR. ON BUDGET & POLICY PRIORITIES, MANY STATES ARE DECOUPLING FROM THE FEDERAL ESTATE TAX CUT (2004) (advocating decoupling as a means of protecting state tax codes from federal tax changes by keeping state law linked to earlier federal law), available at <http://www.cbpp.org/5-23-02sfp.pdf>.

²⁰³ A reduction in federal tax rates, either in general or with respect to particular types of income or estates, would have affected relatively few states. Thus, Congress could have achieved comparable revenue reductions through other paths. But by increasing exclusions and eliminating the federal estate tax, the federal government imposed similar reductions in revenues for those states that failed to pass corrective legislation.

3. *Priorities Implicit in Judicial Limitations on State Revenue-Raising.* — All traditional models of federalism suggest the importance of state tax policy. States cannot redeem the promises of pluralism without adequate funding. Because “[t]he ability to raise revenue is critical to the performance of state policy objectives,”²⁰⁴ dual sovereignty models of federalism obviously depend upon states having sufficient resources to function as plausible sovereigns. And neither advantages in political process nor those in economic efficiency matter if a state lacks the revenue-raising capacity to provide services. Nonetheless, the solicitude that the “new federalism” has applied to states’ interests when the federal government seeks to preempt state regulatory authority or to impose financial liability has yet to find an equally vigorous echo in the Court’s treatment of states’ taxing authority.²⁰⁵

Whatever the merits of the Internet Tax Freedom Act, one could see its limitation on important areas of state taxation of interstate commerce as an indication that Congress is indeed fully engaged in overseeing state taxes affecting interstate commerce. This could justify greater judicial deference to states, and to Congress’s silence in other areas, when determining whether state taxes excessively burden interstate commerce. Unfortunately, the Court’s recent actions leave little room for optimism in this regard.

Although its cases on state revenue-raising power speak in terms of “discrimination” against interstate commerce, the Court has had considerable difficulty crafting a coherent definition of “discrimination.”²⁰⁶ For example, given a choice among many different tax bases, a state can be expected to select one that results in the heaviest tax incidence on nonresident businesses.²⁰⁷ Michigan will never be enthusiastic about taxing automobiles; North Carolina will not favor cigarette taxes. The Court cannot, and properly has not attempted to, eliminate all consideration of local economic factors in states’ decisions about taxation. Doing so would effectively require it to mandate a single nationwide system of state and local taxation — a task it properly eschews. The question, then, is which state policies with the purpose and effect of maximizing revenues from out-of-state entities are improper burdens on interstate commerce. Current standards compel the courts to engage in extremely complex and subjective inquiries into the relative burdens on in-state and out-of-state businesses.²⁰⁸ Thus, for

²⁰⁴ WALTENBURG & SWINFORD, *supra* note 18, at 105.

²⁰⁵ *See id.* at 105–06.

²⁰⁶ *See* DANIEL SHAVIRO, *FEDERALISM IN TAXATION: THE CASE FOR GREATER UNIFORMITY* 48–58 (1993) (describing some of the “inconsistencies and odd juxtapositions in recent [Supreme Court] cases concerning state taxes”).

²⁰⁷ *See id.* at 48–49.

²⁰⁸ *See, e.g.,* *Am. Trucking Ass’n v. Scheiner*, 483 U.S. 266 (1987); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

example, the Court has held that a spending program benefiting only in-state companies is constitutionally permissible although a credit reducing those companies' tax liability by the same amount — conveying precisely the same economic benefit — is not.²⁰⁹ It also has applied a subjective but apparently stringent test for measuring the nexus a state must have with the activity it is taxing,²¹⁰ which has resulted in considerable state confusion²¹¹ and is likely to permit considerable commercial activity to escape *all* taxation.²¹²

Although the Court's cases on states' taxing authority generally have not been brought into debates about the "new federalism," they should be. Because money is fungible, it is appropriate to compare judicial interventions across the range of policies affecting states' budgets. Imposing \$1 billion in liability upon states has the same impact upon their ability to function independently as does disallowing a tax with which they would raise a billion dollars. Because the Constitution does not speak clearly to either problem,²¹³ the Court may be

²⁰⁹ See *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278 (1988); see also Edward A. Zelinsky, *Are Tax "Benefits" Constitutionally Equivalent to Direct Expenditures?*, 112 HARV. L. REV. 379, 399 (1998) (criticizing the Court's doctrine that distinguishes between tax benefits and direct expenditures). Similarly, the Court's doctrine appears to require an arbitrary differentiation between tax benefits favoring local companies that are enacted simultaneously with tax increases, and tax benefits and increases that are enacted at different times. Compare *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199–201 (1994) (striking down a system of taxes on out-of-state producers and subsidies for in-state producers that operated outside the state's general fund), *with id.* at 210–11 (Scalia, J., concurring in the judgment) (suggesting that the state could achieve the same result by running both through its general fund). See also 1 TRIBE, *supra* note 27, § 6-23, at 1150; Dan T. Coenen & Walter Hellerstein, *Suspect Linkage: The Interplay of State Taxing and Spending Measures in the Application of Constitutional Antidiscrimination Rules*, 95 MICH. L. REV. 2167, 2174–75 (1997).

²¹⁰ See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977) (establishing a four-prong test); *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992) (increasing the burdens imposed by the test). But see *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 200 (1995) (allowing taxation of the full price of interstate bus tickets under the *Complete Auto* test).

²¹¹ See generally John A. Swain, *Cybertaxation and the Commerce Clause: Entity Isolation or Affiliate Nexus?*, 75 S. CAL. L. REV. 419 (2002) (discussing the difficulty states are having in finding ways to tax the trillions of dollars of retail activity that are moving from physical stores to the Internet).

²¹² If only a narrow range of tax systems can pass constitutional muster, some states will be compelled to exclude income that no other state is taxing. In addition, interstate companies may be able to manipulate their structures to place each activity in a jurisdiction that does not tax, or lightly taxes, that activity. Moreover, states' legislative processes tend to be "sticky": when a business tax enacted during a fiscal crisis is struck down, the legislature may not bother to reformulate and reenact it if the state's finances have subsequently improved. If it eventually is reenacted, champions of those businesses may be able to exact new concessions in return — in addition to those they won when the original tax was enacted and that are likely still on the books. In-state businesses, by contrast, will be subject to continual taxation throughout this period and may be just as vulnerable to new taxes during the next fiscal crisis as are the interstate businesses whose tax burdens were judicially lowered.

²¹³ In *Alden v. Maine*, 527 U.S. 706 (1999), the Court's new federalist majority essentially conceded that its state sovereign immunity doctrine has arisen from a judicially constructed concept

criticized if the values it overrides when it extends states' immunity from liability have stronger claims to centrality in our constitutional system than those it upholds in striking down a state tax.

This kind of criticism is possible on several bases. First, the Court's current jurisprudence favoring broad state sovereign immunity over expansive state taxing authority intrudes unnecessarily upon democratic governance.²¹⁴ When it extends states' immunity from liability, the Court typically does so by striking down federal statutes. By contrast, many important decisions striking down states' taxes vindicate not federal statutes but the dormant commerce clause, a judicial construction of what Congress *might* have done.²¹⁵ Thus, were the Court to moderate both its federalist sovereign immunity jurisprudence and its antifederalist restrictions on state taxing authority, it could provide equivalent amounts of fiscal relief to states while privileging actual congressional enactments over judicial policymaking. In a democratic society, one that seeks to minimize conflicts between the branches of the federal government, this course seems superior.

Second, the private rights the Court overrides in many of its sovereign immunity cases have a substantially stronger claim to constitutional privilege than do the interests the Court upholds in its dormant commerce clause jurisprudence. To be sure, the Court's stringent application of the criteria Congress must meet in order to pass Section 5 legislation has effectively ensured that Congress can only abrogate state sovereign immunity when it seeks to guard a right or group that is protected by heightened scrutiny under the Fourteenth Amend-

of state sovereignty rather than from the textual dictates of the Eleventh Amendment. *See id.* at 727–30. For example, the Court's distinction between prohibited imposition of retroactive liability on the states and permissible imposition of prospective liability was justified not by text, but by the fact that retroactive liability is likely to have a larger fiscal impact on the states. *Compare* *Edelman v. Jordan*, 415 U.S. 651, 659 (1974) (disallowing a federal court award of wrongfully withheld welfare benefits), *with* *Milliken v. Bradley*, 433 U.S. 267, 277–79 (1977) (allowing a federal court to require a state to spend millions of dollars for buses needed for a school desegregation plan). This distinction thus appears in large part to be a practical attempt to preserve states' financial viability in the federal system. Although the centrality of federalism in our constitutional system certainly justifies that end, it is the end, rather than the particular means the Court has chosen to achieve that end, that has constitutional status. It is therefore appropriate to compare this doctrine with other means of achieving similar ends.

²¹⁴ Indeed, some have argued that the entirety of the Court's dormant commerce clause jurisprudence is illegitimate on this basis. *See, e.g.*, Patrick C. McGinley, *Trashing the Constitution: Judicial Activism, the Dormant Commerce Clause, and the Federalism Mantra*, 71 OR. L. REV. 409, 411 (1992); Martin H. Redish & Shane V. Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 1987 DUKE L.J. 569, 572.

²¹⁵ Alternatively, dormant commerce clause jurisprudence can be understood as a form of federal common law developed to implement the norm of free trade. *See* Henry P. Monaghan, *The Supreme Court, 1974 Term—Foreword: Constitutional Common Law*, 89 HARV. L. REV. 1, 17 (1975).

ment.²¹⁶ Nonetheless, even when abrogation was found impermissible,²¹⁷ the rights involved were still important: the Court has recognized that groups triggering only rational basis review are nevertheless sometimes subject to unconstitutionally discriminatory state action.²¹⁸ In other contexts, the Court has held that claims approaching constitutional status deserve significant respect even when they do not explicitly trigger the highest level of scrutiny.²¹⁹

By contrast, the commercial interests the Court seeks to protect when it invalidates taxes as burdens on interstate commerce are essentially the same ones it has designated for the least rigorous level of scrutiny in substantive due process and equal protection review.²²⁰ These interests gain ascendancy in dormant commerce clause jurisprudence not for their own intrinsic importance, but rather for the instrumental reason of promoting an integrated and competitive national economy. Yet even the most devoted champions of the Court's dormant commerce clause jurisprudence do not argue that it provides more than incremental benefits to that cause. Moreover, the Court is not the final line of defense for these rights: a holding that a state tax violates the dormant commerce clause implies that Congress would have the authority to protect that right directly if it so chose.²²¹ Particularly after the Civil War Amendments elevated the status of individual rights in our constitutional order, it is difficult to understand why interstate commercial interests that have failed to win direct constitutional protection should come out first in a three-way contest with

²¹⁶ Compare *Tennessee v. Lane*, 124 S. Ct. 1978, 1994 (2004) (permitting an abrogation intended to protect the fundamental right of access to the courts), and *Nevada v. Hibbs*, 538 U.S. 721, 736–40 (2003) (permitting an abrogation intended to prevent gender discrimination), with *Bd. of Trs. of the Univ. of Ala. v. Garrett*, 531 U.S. 356, 366, 374 (2001) (forbidding an abrogation intended to prevent disability discrimination), and *Kimel v. Fla. Bd. of Regents*, 528 U.S. 62, 83, 91 (2000) (forbidding an abrogation intended to prevent age discrimination). Cf. *City of Boerne v. Flores*, 521 U.S. 507, 534–35 (1997) (finding the same Section 5 power relied upon for abrogation insufficient to protect religious freedoms not recognized as fundamental rights).

²¹⁷ See, e.g., *Garrett*, 531 U.S. at 366, 374 (disability discrimination); *Kimel*, 528 U.S. at 83, 91 (age discrimination).

²¹⁸ See, e.g., *Romer v. Evans*, 517 U.S. 620, 631–32 (1996) (sexual orientation discrimination); *City of Cleburne v. Cleburne Living Ctr., Inc.* 473 U.S. 432, 450 (1985) (disability discrimination).

²¹⁹ See, e.g., *NLRB v. Catholic Bishop*, 440 U.S. 490, 504–07 (1979) (construing a statute narrowly to avoid a potential constitutional question without requiring that the constitutional claim in question be persuasive).

²²⁰ See, e.g., *Ferguson v. Skrupa*, 372 U.S. 726, 730–31 (1963) (substantive due process); *Williamson v. Lee Optical Co.*, 348 U.S. 483, 488–89 (1955) (equal protection).

²²¹ Indeed, the aggressiveness of the current Court's approach to the Commerce Clause where Congress has *not* acted stands in curious contrast to its efforts to restrict Congress's affirmative power under that clause.

the values of preserving state fiscal capacity and protecting para-constitutional rights.²²²

Third, in an era of rapidly increasing mobility of people, capital, and goods, the Court's application of the dormant commerce clause to state taxation is increasingly redundant with the constraints of the market. The distinction between in-state and out-of-state businesses is becoming increasingly obsolete. To the extent the distinction still exists, many states now tend to favor out-of-state firms. Far from punishing out-of-state businesses, states may grant them extensive tax breaks to encourage them to expand their activities within the state. Communities fully recognizing that General Motors and Wal-Mart will not be moving their corporate headquarters nonetheless compete for a new parts factory or superstore. More generally, debates about state taxation almost universally feature strong arguments for preserving or improving the "business climate." Out-of-state businesses also routinely contribute to state policymakers' campaigns, thus likely assuring themselves a more attentive hearing than smaller in-state companies could expect.²²³ With states competing for businesses, the market is likely to correct many tax burdens that are disproportionate to the costs imposed upon the state.

Finally, applying the dormant commerce clause to state taxation strains the courts' institutional competence far more than does applying it to regulatory issues and far more than would a more moderate doctrine of state sovereign immunity.²²⁴ When judging the impact of direct regulations, the courts can more easily focus on the particular sector at issue. On the other hand, policing in-state favoritism in state tax policy embroils the courts in detailed accounting controversies of the kind that, in other contexts, the Court has held beyond judicial competence.²²⁵ It also forces the courts either to analyze additional

²²² Put another way, the constitutional common law developed under the dormant commerce clause and used to address the constitutionality of state taxes should not only respect para-constitutional values such as the protection of vulnerable groups and the enhancement of religious freedom, *see* Monaghan, *supra* note 215, at 19, but also states' strong sovereignty interest in raising sufficient revenues.

²²³ This undercuts the argument, *see, e.g.,* 1 TRIBE, *supra* note 27, § 6-1, at 1024-29; Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895, 988-91 (1992), that the Court's review of state taxes under the dormant commerce clause is necessary to prevent states from oppressing those persons that have no voice in states' political deliberations.

²²⁴ Even when applied to state regulations, the dormant commerce clause places nontrivial burdens on the courts. *See* Edmund W. Kitch, *Regulation and the American Common Market, in* REGULATION, FEDERALISM, AND INTERSTATE COMMERCE 9, 30-36 (A. Dan Tarlock ed., 1981).

²²⁵ *Compare, e.g.,* ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 326-30 (1982) (developing an income tax exclusion for proceeds deemed attributable to out-of-state activities), *with* Jefferson v. Hackney, 406 U.S. 535, 545-51 (1972) (declining to determine whether the predominantly African American and Latino recipients of AFDC payments were unfairly disadvantaged

offsetting or compounding effects of spending programs or to ignore those effects and reduce the entire exercise to a symbolic gesture.²²⁶ It similarly calls for the courts either to undertake the almost impossible task of determining when business activity's marginal costs to state and local governments exceed the taxes being levied, or to force states to allow those businesses to exploit them.²²⁷ The Court could avoid these controversies by relaxing its dormant commerce clause jurisprudence and adjusting its sovereign immunity doctrine in counterbalance. Allowing Congress to authorize suits against states in the interest of important federal policies would not preclude the courts from exercising their traditional role of guarding against excessive intrusions upon states' interests.²²⁸

D. Conclusion

In constructing a coherent theory of fiscal federalism, two key distinctions from regulatory federalism must be accounted for. First, the potential for cooperation on fiscal matters is much greater than on regulatory ones. The two levels of government are far more likely to regulate toward different objectives than they are to fund programs with inconsistent substantive goals. This does not mean that conflict is lacking over fiscal matters; instead, it means that the nature and stakes of the conflict differ significantly from those in the regulatory arena. The two levels of government may compete to obtain political credit in areas of shared responsibility and may struggle to shift costs to one another while retaining as much policymaking control as possible.

Second, the fungibility of money enhances the importance of considering the cumulative effects of federal policies rather than assessing each in a vacuum. Viewed in this light, the recent initiatives of both Congress and the Court appear problematic. Congress enacted the analytically bankrupt and largely dysfunctional UMRA amidst much self-congratulation. Congress purported to give states more flexibility through block-granting programs but hobbled that flexibility with badly designed funding structures. At the same time, Congress was taking an extremely miserly approach to compensatory funding, aban-

relative to the predominantly white recipients of larger payments in parallel programs), *and* *Dandridge v. Williams*, 397 U.S. 471, 485–87 (1970) (declining to determine whether the state had adequately accounted for the needs of children in a large family).

²²⁶ See, e.g., *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278 (1988) (choosing to ignore the identical effects of spending programs while striking down a tax credit).

²²⁷ In other words, the courts must either assign a price tag to the services that state and local governments provide to particular kinds of business activity or bar taxation that is not anticompetitive but seeks merely to avoid losses to the state.

²²⁸ Cf. *Clinton v. Jones*, 520 U.S. 681 (1997) (directing lower courts to take precautions in suits against a sitting president).

doning programs that the federal government has superior capacity to fund, and undermining states' revenue bases through a range of direct and indirect initiatives. The deleterious effects of these assaults²²⁹ swamped whatever trivial advantage Congress conferred with its initiatives enacted in the name of federalism.

The Court, in turn, has also subtly undermined fiscal federalism. It has expanded states' immunity from suits, largely in areas where the state actions raise civil rights concerns, but little evidence suggests that liability for such conduct was a major burden on states' fiscs. At the same time, it has undermined severely states' ability to respond to a very real problem: stemming the loss of tax revenues as economic activity increasingly takes place across state lines. States' losses as a result of the Court's limits on their taxing power — losses that can be expected to escalate as the economy becomes increasingly national — likely dwarf the judgments states might have paid under a less vigorous doctrine of sovereign immunity.

A more analytically sophisticated account of fiscal federalism will allow the two levels of government to divide responsibilities more efficiently and effectively. In particular, proposed realignments of authority should be judged based on their sustainability under the compensatory, leadership, or superior capacity models. A proposal to devolve responsibility to the states that cannot persuasively be justified under any of these models is likely to lead fairly rapidly to federal abdication of fiscal responsibility. Because the compensatory model has proven ineffective at maintaining federal commitments over the long term and the leadership model is out of step with contemporary skepticism about the federal government's competence, the superior capacity model probably holds the greatest potential for shaping cooperative funding programs.

Unfortunately, many programs that might be justified in terms of the federal government's superior revenue-raising capacity have structures fundamentally at odds with the basic assumptions of that model. A more coherent theory of fiscal federalism also will allow a more thoughtful response to conflicts that arise when federal and state spending or revenue-raising efforts overlap. Finally, a more comprehensive concept of fiscal federalism may discourage federal policymakers from claiming to champion states' interests with modest initiatives while more than offsetting those actions with others that undercut states' fiscal stability.

²²⁹ See LAV & BRECHER, *supra* note 177, at 1 (finding that recent federal policies decreased total state and local revenues by more than eight percent).

III. STATE BUDGETS AND THE BUSINESS CYCLE

Despite their importance, both to the macroeconomy and in providing vital public services, state budgets are poorly understood. Far from being miniature versions of the federal system, as is assumed by most current models of federalism, they operate on a very different set of principles reflecting a very different set of historical influences. At a time when federal policymakers of both parties are proclaiming their trust in the wisdom of state governors and legislatures, the structures of states' constitutions significantly circumscribe those state officials' ability to live up to expectations. This Part offers a basic introduction to the structure and effects of states' fiscal constitutions. Section A describes those provisions and compares them to their federal counterparts. Section B demonstrates the inconsistency between states' budget rules and the Keynesian understanding of the business cycle that remains dominant in federal economic policymaking. Finally, section C provides an overview of states' fiscal policies over the last two business cycles, which corresponds roughly to the last two decades.

A. *Central Principles of State Fiscal Constitutions*

The terms of states' fiscal constitutions primarily reflect the concerns of two distinct historical periods: one in the middle of the nineteenth century and the other beginning in the last two decades of the twentieth century and continuing to this day.²³⁰ The concerns driving constitutional development during each of these periods were quite different.

In the mid-nineteenth century, Jacksonians feared that railroad companies and other business elites would capture state governments and divert public resources for their private enrichment.²³¹ This concern led to several types of corrective measures. State constitutions forbade special legislation that identified particular recipients of public

²³⁰ Although states have revised or replaced their constitutions more or less continuously since entering the union, fiscal provisions have been relatively static through most of this country's history. Newly admitted states based their constitutions on those of existing states, and most constitutional revisions have focused on matters other than fiscal affairs. See ALBERT L. STURM, THIRTY YEARS OF STATE CONSTITUTION-MAKING: 1938-1968, at 1-4 (1970) (finding that key deficiencies in state constitutions involved the functioning of the three branches of state government, the impairment of local home rule, requirements of overly long ballots, and cumbersome amendatory procedures); John P. Wheeler, Jr., *Changing the Fundamental Law*, in SALIENT ISSUES OF CONSTITUTIONAL REVISION 49, 58-62 (John P. Wheeler, Jr. ed., 1961) (finding that issues of popular sovereignty, obstructionist minorities, and public apathy were the most crucial to state constitutional revision).

²³¹ See Joan C. Williams, *The Invention of the Municipal Corporation: A Case Study in Legal Change*, 34 AM. U. L. REV. 369, 436-37 (1985).

largesse.²³² Similarly, they required taxation to be uniform, although provisions allowing classification of taxpayers provided a loophole for substantial tax subsidies.²³³ They also forbade legislation from addressing more than one subject,²³⁴ thus inhibiting efforts to buy swing votes by adding special projects. State constitutions created an extra opportunity to block corrupt diversions of public funds by allowing governors to veto individual spending items.²³⁵ They forbade the issuance of public debt for private projects or public operating expenses and generally limited the amount of public debt that could be issued.²³⁶ Most importantly, they required states to balance their budgets annually.²³⁷

The Jacksonian provisions of state fiscal constitutions can be seen in three layers. First, some explicitly prohibit the diversion of public resources to the kinds of activities Jacksonians found improper.²³⁸ Recognizing that those provisions would be difficult to enforce, a second layer structures state budget processes to obstruct offensive legislation.²³⁹ Finally, acknowledging the permeability of the first two layers, a final layer of constraints — the balanced budget requirement and the related limitations on public debt²⁴⁰ — limits the ability of corrupt or imprudent state government to inflict lasting harm. With these provisions in place, special interests might abscond with a significant share of tax revenues for a year or two, but once the public voted out the corrupt elements, the business of good government could resume. Thus, distrust of transient majorities and their lack of concern for the future was a key element of the Jacksonian fiscal constitution. The modern advent of term limits for state legislators has pro-

²³² See JAMES QUAYLE DEALEY, *GROWTH OF AMERICAN STATE CONSTITUTIONS FROM 1776 TO THE END OF THE YEAR 1914*, at 224–28 (1915); TARR, *supra* note 37, at 119.

²³³ DEALEY, *supra* note 232, at 235.

²³⁴ *E.g.*, CAL. CONST. art. IV, § 9.

²³⁵ See DEALEY, *supra* note 232, at 163.

²³⁶ See TARR, *supra* note 37, at 113–14.

²³⁷ See Robert Ward Shaw, *The States, Balanced Budgets, and Fundamental Shifts in Federalism*, 82 N.C. L. REV. 1195, 1196–97 (2004). To a similar effect, the so-called Dillon's Rule limited the activities of local governments — deemed even more likely to fall under the influence of special interests — to those expressly authorized by the state. See, *e.g.*, *Merriam v. Moody's Ex'rs*, 25 Iowa 163, 170 (1868) (Dillon, J.); see also TARR, *supra* note 37, at 19–20. This rule was named after John Forest Dillon, an Iowa Supreme Court Justice and author of an influential nineteenth-century treatise on local government law. See generally Edwin A. Gere, Jr., *Dillon's Rule and the Cooley Doctrine: Reflections of the Political Culture*, 8 J. URB. HIST. 271 (1982).

²³⁸ See TARR, *supra* note 37, at 113–14.

²³⁹ See *id.* at 131–32.

²⁴⁰ Nineteen states had debt limits prior to the Civil War, with many Southern states enacting them during Reconstruction. See A. JAMES HEINS, *CONSTITUTIONAL RESTRICTIONS AGAINST STATE DEBT* 9 (1963). Every state admitted subsequently has included some debt limit in its constitution. See *id.*

vided additional justification for the temporal dimension to the Jacksonian fiscal constitution.

As the abuses that gave rise to the Jacksonian provisions faded from memory and an industrializing and urbanizing nation put more demands on its state and local governments, states relaxed some of the Jacksonian strictures. Prohibitions on special legislation have been interpreted narrowly,²⁴¹ and expanded borrowing has been permitted in support of public works projects. Nonetheless, whatever accommodations have been made to practical necessity, no comprehensive alternative theory of state fiscal management has emerged. The basic Jacksonian notion of fiscal probity has remained dominant.

The persistence of Jacksonian skepticism of public expenditures set the stage for the contemporary movement to limit state and local taxes and expenditures. This movement was inaugurated by Howard Jarvis's successful Proposition 13 in California and has since spread to other states.²⁴² It makes little effort, however, to buttress the first layer of the Jacksonian fiscal constitution — prohibitions on certain kinds of expenditures. Instead, it treats all public expenditures as inherently suspect and seeks to limit them in gross with procedural barriers and requirements of supermajorities or referenda to exceed rigid limits. For the most part, these initiatives have not imposed new restrictions on states' already-limited ability to shift costs to the future.²⁴³ As is discussed below, however, some have been constructed to ratchet down state taxes and expenditures over time.²⁴⁴

B. Pre-Keynesianism and State Budgets

When a slack economy caused federal revenues to decline, President Hoover followed the conventional economic wisdom of his time and cut spending. In so doing, he drained more money out of the

²⁴¹ See, e.g., *Chi. Nat'l League Ball Club, Inc. v. Thompson*, 483 N.E.2d 1245, 1249–52 (Ill. 1985) (upholding legislation crafted to cover only one baseball stadium); *CLEAN v. State*, 928 P.2d 1054, 1056 (Wash. 1996) (upholding legislation financing a baseball stadium in a single county). To similar effect, Dillon's Rule has been interpreted narrowly or abrogated outright in favor of home rule. See, e.g., *Town of Emerald Isle v. State*, 360 S.E.2d 756, 763 (N.C. 1987) (seeking to define a sphere of local autonomy).

²⁴² See TARR, *supra* note 37, at 159; Harvey E. Brazer, *On Tax Limitation*, in FINANCING STATE AND LOCAL GOVERNMENTS IN THE 1980S: ISSUES AND TRENDS, *supra* note 176, at 19, 25–30; see also Richard Briffault, *Foreword: The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 RUTGERS L.J. 907, 928–32 (2003). See generally PROPOSITION 13 AND ITS CONSEQUENCES FOR PUBLIC MANAGEMENT (Selma J. Mushkin ed., 1979); Howard Jarvis Taxpayers Ass'n, Prop. 13, at <http://www.hjta.org/prop13.htm> (last visited May 14, 2005).

²⁴³ Some, such as Michigan's Headlee Amendment, have tightened the longstanding requirement that voters approve any new assumptions of debt by local governments. MICH. CONST. art. IX, § 26.

²⁴⁴ See *infra* section IV.D.2, pp. 2632–39.

economy and exacerbated the Great Depression. Not long afterward, John Maynard Keynes popularized the concept that economies naturally cycle between booms and busts and demonstrated that the single-minded pursuit of balanced budgets tends to exacerbate these swings.²⁴⁵ Now it is widely believed that “the public accounts should be in surplus during booms and in deficit during recessions. One tradition in economics favours this because countercyclical fiscal movements provide an automatic Keynesian cushioning of the economy, restraining demand in good times and supporting it in bad.”²⁴⁶ The United States achieves a significant part of this cushioning through automatic stabilizers — features of entitlement programs and the tax code that respond to economic downturns by automatically raising spending and reducing the tax burden and that do the opposite during periods of strong growth.²⁴⁷

During many recessions, the federal government seeks to supplement automatic stabilizers with tax cuts or new spending programs, such as extended unemployment compensation. These legislative countercyclical spending interventions are not always well timed: by the time the economic news has been bad enough long enough to motivate Congress and the President to act, the recession may have ended. In addition, other political agendas may creep into these taxing and spending decisions. And more recently, the Republican Party has chosen to define itself by its commitment to cutting taxes.²⁴⁸ It has questioned those dictates of Keynesianism — increasing spending during downturns and maintaining or raising taxes during expansions — that are inconsistent with its “small government” program, while vigorously embracing those aspects — such as tax cuts to stimulate a sluggish economy — that fit its agenda.²⁴⁹ The ongoing, unresolved guerilla warfare over the proper scope of government spending has led to large, structural deficits that persisted even during expansions following the tax cuts of 1981 and of 2001 through 2003. Nonetheless, Keynesian rhetoric continues to permeate economic discourse and shape much of federal fiscal policy.

²⁴⁵ See JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY* ch. 22 (1936).

²⁴⁶ *Gaming the Surplus*, *THE ECONOMIST*, Mar. 11, 2000, at 84, 84.

²⁴⁷ See *Keeping a Lower Profile*, *THE ECONOMIST*, Sept. 28, 2002, at 9, 9–10.

²⁴⁸ See REPUBLICAN NAT'L COMM., 2004 REPUBLICAN PARTY PLATFORM: A SAFER WORLD AND A MORE HOPEFUL AMERICA (2004) (“We believe that good government is based on a system of limited taxes and spending. . . . The taxation system should not be used to redistribute wealth or fund ever-increasing entitlements and social programs.”), available at <http://www.gop.com/media/2004platform.pdf>.

²⁴⁹ See *id.*

Jacksonian fiscal constitutions, however, keep states mired in a pre-Keynesian world.²⁵⁰ All but one are required to balance their budgets annually.²⁵¹ They may borrow for capital projects,²⁵² but the limits on that authority generally make it ill-suited to pump-priming: the structure of that debt makes it difficult for states to systematically buy back outstanding bonds to “cool off” an overheating economy.²⁵³ Most fundamentally, states do not see themselves, and are not widely regarded by other policymakers or the public, as engaged in the management of the economy. When a downturn produces a perfectly predictable deficit, newspapers and opposition candidates wail about a “budget mess” that needs to be “cleaned up.” Conversely, of course, governors and legislators greedily take credit for surpluses generated not by their stewardship, but by an improving economy.

Indeed, states’ fiscal constitutions not only prevent them from assisting in the execution of countercyclical economic policy, they actually compel states to undermine federal initiatives in this area. Declining economic activity unbalances state and local budgets: revenues shrink while demand rises for some public services, such as welfare and Medicaid.²⁵⁴ Thus, far from being able to increase spending or cut taxes to “prime the pump” for their constituencies, state and local governments must cut spending or raise taxes.²⁵⁵ With state and local

²⁵⁰ See generally NAT’L ASS’N OF STATE BUDGET OFFICERS, BUDGET PROCESSES IN THE STATES (2002) (outlining current state budget processes and identifying trends in these conventions over time), available at <http://www.nasbo.org/Publications/budpro2002.pdf>.

²⁵¹ Neither Vermont nor Wyoming has a balanced budget requirement, but Wyoming “is required to balance in practice.” See GEN. ACCOUNTING OFFICE, GAO/AFMD-93-58BR, BALANCED BUDGET REQUIREMENTS: STATE EXPERIENCES AND IMPLICATIONS FOR THE FEDERAL GOVERNMENT 3 & n.3 (1993).

²⁵² See LENNOX L. MOAK & ALBERT M. HILLHOUSE, CONCEPTS AND PRACTICES IN LOCAL GOVERNMENT FINANCE 75, 88–89 (1975).

²⁵³ The federal government has been issuing debt for a sufficient amount of time, in sufficiently large amounts, and with sufficiently varied maturities that it had enough debt coming due to be retired naturally when its budget went into surplus in the late 1990s. By contrast, state debt tends to have a long maturity and hence comes due, or becomes subject to call, only occasionally.

²⁵⁴ See Donald Phares, *The Fiscal Status of the State-Local Sector: A Look to the 1980s*, in FINANCING STATE AND LOCAL GOVERNMENTS IN THE 1980s: ISSUES AND TRENDS, *supra* note 176, at 145, 159–61. The extent to which local governments face budgetary problems during recessions depends on several factors. For example, those localities that rely on sales or income taxes will see their revenues drop far more rapidly than those dependent on property taxes. Communities that depend on state aid may see the state pass along its fiscal woes to them. Local governments in states that require them to contribute to the cost of Medicaid, welfare, and other means-tested services, as well as those operating public hospitals or other facilities that provide in-kind aid to the destitute, also are more vulnerable during recessions — particularly if they have substantial populations of low-wage workers with little cushion against misfortune.

²⁵⁵ For example, based on my calculations, states raised revenues \$17.4 billion from 1982 to 1984 to cope with the decline in state revenues that the recession of 1981–1982 caused. States then raised revenues \$30.2 billion from 1990 to 1992 in response to the recession of 1990–1991. Then, after cutting taxes \$33.1 billion from 1995 to 2001, states again began to raise taxes as their budgets felt the effects of the 2001 recession. The pattern of state spending is less straightforward.

governments accounting for over two-fifths of total public spending in the United States,²⁵⁶ these actions offset a significant part of the stimulative effects of federal fiscal policies. Moreover, to the extent that some of the largest federal countercyclical programs — above all Medicaid — require states, and sometimes localities, to match spending, state and local budget cuts can have the effect of cutting federal spending with no action from Congress or the President.

Similarly, during economic expansions, states' revenues climb and demand for services to low-income people falls. This allows states to cut taxes or raise spending, stimulating the economy further at a time when that stimulus is unneeded or even counterproductive. Here again, the size of state and local governments' budgets relative to the federal budget — and indeed the national economy — makes the macroeconomic effect of these changes difficult to ignore. And here again, states' ability to increase spending in programs with an automatic federal match allows states significantly to override anti-inflationary federal fiscal policy.

Many states' constitutions and laws do make one concession to the business cycle by allowing legislatures to establish "rainy day funds."²⁵⁷ Monies a state deposits into these funds, presumably during an economic boom, can be applied to meet shortfalls during downturns. Less formally, some states may treat leftover balances in their general funds as the equivalent of additional rainy day funds. Some states also have found other ways to disinvest — selling assets, evading

ward, in part because of the effects of changing federal policies and in part because of health care inflation's impact on Medicaid. Nonetheless, the average annual real increases in state expenditures during the fiscal crises of 1982 through 1984 and 1990 through 1992 were substantially less than in the ensuing economic expansions, despite the greater need for anti-poverty programs during economic slumps. States did spend down their year-end balances and reserve funds at the beginning of recessions, but by 1984 and 1993, states had largely replenished those funds despite continuing fiscal distress. Calculations are based on data in NAT'L GOVERNORS ASS'N & NAT'L ASS'N OF STATE BUDGET OFFICERS, *THE FISCAL SURVEY OF STATES* (2004) [hereinafter *FISCAL SURVEY OF STATES*], available at <http://www.nasbo.org/Publications/fiscsurv/2004/fsapril2004.pdf>. By way of comparison, the poverty rate continued to rise after the 1990–1991 recession until 1993. See STAFF OF THE HOUSE COMM. ON WAYS & MEANS, 108TH CONG., 2004 GREEN BOOK: BACKGROUND MATERIAL AND DATA ON THE PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS app. G at 36 (Comm. Print 2004) [hereinafter 2004 GREEN BOOK]. Food stamp participation, another good measure of economic distress, did not peak until 1994. See *id.* § 15, at 24.

²⁵⁶ In 2004, state and local expenditures, exclusive of federal grants-in-aid, comprised forty-four percent of all governmental spending in the United States. ECONOMIC REPORT OF THE PRESIDENT 307 tbl.B-82 (2005).

²⁵⁷ See NAT'L CONFERENCE OF STATE LEGISLATURES, RAINY DAY FUNDS: APPENDIX A. STATE BUDGET STABILIZATION FUNDS, at <http://www.ncsl.org/programs/fiscal/rdffaxa.htm> (last reviewed Mar. 2004) (listing states that have budget reserve funds, whether those funds are constitutionally or statutorily authorized, methods for deposit, and methods for withdrawal).

restrictions on borrowing,²⁵⁸ accounting gimmicks, and the like — during recessions and at other times when political consensus on a balanced budget proves difficult to reach.

The effect of these measures, however, does not change the fundamentally procyclical structure of states' fiscal constitutions. First, nothing limits accounting gimmicks' application to recessions; these gimmicks are also available to policymakers unable to reach agreement about how to divide a surplus among various spending and tax cut proposals. Second, rainy day funds and other carryover funds essentially represent a political gift from one legislature to another across time. By its nature, this sort of gift cannot be repaid and hence has limited political appeal. As a result, rainy day funds receive only a small fraction of states' surplus revenues during booms and pale in comparison with the deficits that arise when the economy slows. Finally, because reserves are finite, policymakers may be reluctant to access them in fiscal crises whose duration and severity are uncertain.

C. States' Budgets During the Last Two Economic Cycles

The actual performance of states' budgets closely mirrors these predictions. The expansions of the 1980s and 1990s saw states surging into surplus.²⁵⁹ Some states made modest contributions to rainy day funds to prepare for the next recession. For the most part, however, states behaved as if the business cycle had been magically repealed. Many built new prisons and expanded health care coverage while governors and legislators competed for public favor by cutting taxes.

The recessions of 1990–1991 and 2001 therefore came as rude shocks. Even the states that had been relatively diligent in setting aside money faced shortfalls that dwarfed their reserves. In keeping with longstanding Jacksonian suspicions about government expenditures, and stoked by the tax cut movement, attention fell to government spending. Macroeconomic theory was invoked selectively: it figured prominently in arguments that a recession was the worst possible time to raise taxes but then vanished when the discussion moved to spending cuts — also ill-timed during a recession.

The programs that received the most scrutiny were those with the fastest-rising costs, especially Medicaid, which faced the double pressures of accelerated medical inflation and countercyclical increases in the eligible population.²⁶⁰ During the recession of 1990–1991, the in-

²⁵⁸ States' borrowing limits have long been somewhat porous. See HEINS, *supra* note 240, at 35. Nonetheless, when combined with public pressure to avoid indebtedness, *see id.*, they have helped avert wholesale fiscal irresponsibility.

²⁵⁹ See FISCAL SURVEY OF STATES, *supra* note 255, at 14.

²⁶⁰ Indeed, during the recession of the early 1990s, Medicaid faced a third major cause of increased costs: numerous hospitals and nursing homes won litigation under the Boren Amendment,

crease in fiscal pressure corresponded with the widespread proliferation of the first major scheme for producing sham state matching funds.²⁶¹ This scheme allowed over half the states to lower their effective matching obligations considerably.²⁶² Indeed, states taking the most blatant action probably reduced their total net Medicaid costs from prior years' levels even as gross Medicaid spending rose, allowing Medicaid to take pressure off the remainder of their budgets. Other states achieved substantial short-term savings by converting much of their caseloads to mandatory managed care.²⁶³ The pressures still were sufficiently severe to cause substantial reductions in Medicaid eligibility and services in many states. Then, by the recession of 2001, Congress had severely limited states' ability to manipulate Medicaid matching requirements, and mandatory managed care no longer was producing discernible savings. This produced another round of deep cuts in optional Medicaid eligibility categories and benefits.²⁶⁴ It also prompted demands, which the Bush Administration accommodated, for waivers to abandon Medicaid's statutory minimum benefit package.²⁶⁵

States' tactics were similar during each recession, but the relative importance of the measures varied considerably. During the fiscal crises that accompanied the recession of the early 1990s, states met their budget shortfalls with a fairly even mix of revenue increases, spending

42 U.S.C. § 1396A(a)(13)(A) (1994) (repealed 1997), and similar provisions requiring Medicaid to pay providers rates comparable to those in the private sector. *See, e.g.*, *Tallahassee Mem'l Reg'l Med. Ctr. v. Cook*, 109 F.3d 693, 694 (11th Cir. 1997) (per curiam); *Kan. Health Care Ass'n v. Kan. Dep't of Soc. & Rehab. Servs.*, 31 F.3d 1536, 1547 (10th Cir. 1994).

²⁶¹ *See* Donald J. Boyd, *Medicaid Devolution: A Fiscal Perspective*, in *MEDICAID AND DEVOLUTION: A VIEW FROM THE STATES* 56, 60–64 (Frank J. Thompson & John J. DiIulio Jr. eds., 1998); Judi Hasson, *States' Medicaid Funding Loophole Called a "Scam"*, *USA TODAY*, Nov. 20, 1991, at 6A; Spencer Rich, *State Medicaid Matching-Fund Schemes Could Cost U.S. Billions*, *Official Says*, *WASH. POST*, May 14, 1991, at A5.

²⁶² *See* Hasson, *supra* note 261.

²⁶³ States' experiences suggest that converting to managed care produces a one-time drop in Medicaid spending but that costs then rise from that lower base at roughly the same rate. *See* JOHN HOLAHAN & BRIAN BRUEN, *KAISER COMM'N ON MEDICAID AND THE UNINSURED, MEDICAID SPENDING: WHAT FACTORS CONTRIBUTED TO THE GROWTH BETWEEN 2000 AND 2002?*, at 3–4, 13–14 (2003) (finding that conversions to managed care had temporarily slowed increases in Medicaid costs but that managed care costs are now rising rapidly), *available at* http://www.urban.org/uploadedPDF/410875_medicaid_spending.pdf.

²⁶⁴ *See* VERNON SMITH ET AL., *KAISER COMM'N ON MEDICAID AND THE UNINSURED, STATES RESPOND TO FISCAL PRESSURE: STATE MEDICAID SPENDING GROWTH AND COST CONTAINMENT IN FISCAL YEARS 2003 AND 2004: RESULTS FROM A 50-STATE SURVEY* 18–32 (2003), *available at* <http://www.kff.org/medicaid/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=22126>.

²⁶⁵ *See* SAMANTHA ARTIGA & CINDY MANN, *KAISER COMM'N ON MEDICAID AND THE UNINSURED, NEW DIRECTIONS FOR MEDICAID SECTION 1115 WAIVERS: POLICY IMPLICATIONS OF RECENT WAIVER ACTIVITY* 6 tbl.2 (2005), *available at* <http://www.kff.org/medicaid/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=52128>.

reductions, and one-time measures such as budget gimmicks, drawing down rainy day funds, and borrowing. During the more recent fiscal crisis, states became a bit more Keynesian, albeit more for practical than theoretical reasons. They struggled more energetically to evade balanced budget requirements and related limits on borrowing and achieved modest success. They also relied heavily on one-time savings, which often were the equivalent of short- or long-term loans.²⁶⁶ The severity of this fiscal crisis, like the one a decade earlier, motivated governors of both parties to stake their political careers on attempts to raise taxes, but their constituents' economic distress doomed many of those efforts.²⁶⁷ For the most part, however, states still relied much more on anti-Keynesian spending reductions.

Although analyzing the allocation of these reductions among programs is difficult because some programs — particularly those serving low-income people and the unemployed — faced increased demand during recessions, some programs clearly fared particularly poorly. Among these were general assistance (GA) programs providing cash assistance for childless adults, including those with disabilities that did not meet the stringent definition of disability in the federal supplemental security income (SSI) program and related state indigent medical programs. Several states, including Connecticut, Michigan, and Ohio, eliminated their GA programs during the recession of the early 1990s.²⁶⁸ Others, such as Minnesota and Washington, limited these programs to persons with serious disabilities.²⁶⁹ During the state budget crisis following the recession of 2001, some of the few remaining states with GA for people with disabilities ended their programs.²⁷⁰

²⁶⁶ Some of these transactions were meaningful but effectively involved dissaving in the same way borrowing does. For example, a state could sell one of its office buildings and then lease back the space, which is little different in substance than taking out a loan and paying interest on it. Other transactions were completely artificial, producing paper savings in one year only to create a corresponding cost in another. For example, a state could postpone payments to employees or creditors from the end of one fiscal year until the beginning of the next.

²⁶⁷ During the state budget crisis of the early 1990s, Democratic and independent governors in Tennessee and Connecticut tried to win enactment of state income taxes; both were replaced by Republicans. During the more recent recession, Republican governors in Tennessee and Alabama tried to establish an income tax and to broaden the tax base, respectively, and failed. California's Democratic Governor Gray Davis was recalled in part because he declined to continue a reduction in vehicle licensing fees initiated during the preceding expansion.

²⁶⁸ Massachusetts, Pennsylvania, and some other states had dropped or radically reduced their GA programs before or during the recession of the early 1980s. See KATZ, *supra* note 3, at 303; KATZ, *supra* note 160, at 283–85.

²⁶⁹ Conversations with officials of Minnesota and Washington welfare departments, at the American Association of Food Stamp Directors Meeting, in Kissimmee, Fla. (Oct. 27–30, 2002).

²⁷⁰ See LEIGHTON KU & SASHI NIMALENDRAN, CTR. ON BUDGET & POLICY PRIORITIES, LOSING OUT: STATES ARE CUTTING 1.2 TO 1.6 MILLION LOW-INCOME PEOPLE FROM MEDICAID, SCHIP AND OTHER STATE HEALTH INSURANCE PROGRAMS 12

Countercyclical economics made these cuts particularly severe: a five percent reduction in a program with static needs would represent a far smaller cut than a five percent reduction in a program for which demand had increased by half.

If states' distribution of their surpluses during economic booms simply mirrored their austerity measures during and after recessions, the overall pattern of state revenues and spending would not change significantly over time. During the 1990s, however, that was not the case. States cut revenues during the boom of the late 1990s far more than they raised them during the preceding fiscal crisis. They raised spending during the boom, too, but not as much as they had cut it during the preceding recession and often not on the same things: spending reductions during the early 1990s focused on income security programs for low-income people, but spending increases later in the decade included health care as well as education and corrections. Most cuts to cash-assistance programs were not restored; indeed, the real value of most states' maximum welfare grants continued to deteriorate during the boom. The disparity between the substantial revenue cuts of the late 1990s and the modest revenue increases during the recent state fiscal crisis is even starker, suggesting that spending programs will remain under pressure for many years after states' economies return to growth.

IV. SUBSTANTIVE BIAS IN STATE BUDGET PROCEDURES

When faced with the states' troubling record at protecting public benefits, the natural tendency is to attribute the states' policy decisions to the will of incumbent political officials and the voters that elected them. Accordingly, debates about devolution of authority over welfare, job training, health care, and other programs targeting the needs of low-income people have focused on the sensitivity of state officials to — and whether they have any predisposition to neglect — certain segments of their constituencies.²⁷¹

In fact, however, even the best-intentioned state officials could have great difficulty adequately funding programs for low- and moderate-income people. This Part examines the numerous crucial — but sometimes hidden — biases against those programs. As a result of these biases, the funding that public benefits programs receive over time is likely to underrepresent the support those programs have in the state's political system. A closely related problem is that states' fiscal procedures are likely to favor programs that provide no counterweight to

(2003) (describing cuts in related health care programs during 2003 and 2004), available at <http://www.cbpp.org/12-22-03health.pdf>.

²⁷¹ See, e.g., Cashin, *supra* note 34, at 591–94.

the business cycle, or that even exacerbate its swings, over countercyclical programs that can help stimulate the economy during slumps.

Section A considers the effects of explicit preferences for particular kinds of public services in state constitutions. Section B shows that the common practice of privileging certain kinds of public activities with dedicated funding streams rarely benefits programs targeting low- and moderate-income people and, in fact, can undermine support for such programs. Section C discusses the ways in which states' budget processes favor programs that spend public funds either very slowly or in lump sums that are paid off over time through bond issues. Once again, the privileged programs are unlikely to be those designed to aid low- and moderate-income people or those that help offset the effects of economic swings. Finally, and most importantly, section D demonstrates that state balanced budget rules systematically disfavor countercyclical programs and tend to shift money out of those programs over the course of the business cycle, to the long-term detriment of low- and moderate-income people.

A. *Substantive Constitutional Preferences*

State constitutions tend to be longer than the federal Constitution and to contain more readily identifiable positive rights.²⁷² A few provisions direct state government to care for the poor,²⁷³ but their impact has been decidedly marginal: No court has ever held the aggregate level of a state's funding of antipoverty programs insufficient. Nor has any court required expenditures that the state could not have offset with reductions in other programs for low-income people.²⁷⁴ To be sure, states have not always pursued offsets of this kind — and hence have increased total expenditures for programs to assist low-income people as a result of some holdings — but aggregate spending for these programs has remained roughly as high, or as low, as the political

²⁷² See Hershkoff, *supra* note 35, at 1135.

²⁷³ See, e.g., ALA. CONST. art. IV, § 88 (“It shall be the duty of the legislature to require the several counties of this state to make adequate provision for the maintenance of the poor.”); N.Y. CONST. art. XVII, § 1 (“The aid, care and support of the needy are public concerns and shall be provided by the State”); N.C. CONST. art. XI, § 4 (“Beneficent provision for the poor, the unfortunate, and the orphan is one of the first duties of a civilized and a Christian state. Therefore the General Assembly shall provide for and define the duties of a board of public welfare.”); see also, e.g., *Tucker v. Toia*, 371 N.E.2d 449, 452 (N.Y. 1977) (finding complete denial of general assistance benefits based on family composition invalid under the New York state constitution but leaving legislature many options for compliance).

²⁷⁴ See, e.g., *Bernstein v. Toia*, 373 N.E.2d 238, 244 (N.Y. 1977) (holding that New York's constitutional provision mandating aid for the needy relates only “to questions of impermissible exclusion of the needy from eligibility for benefits, not to the absolute sufficiency of the benefits distributed to each eligible recipient”).

process has dictated.²⁷⁵ Thus, these provisions have not compelled states to increase countercyclical spending.

Furthermore, other substantive mandates contained in state constitutions have privileged noncyclical spending of various kinds at the expense of welfare programs. One such area that is important to low-income people is education. Many state constitutions require legislatures to provide for public education.²⁷⁶ Courts have construed these requirements to compel their respective legislatures to spend enough to ensure adequate and equal educational opportunities throughout those states.²⁷⁷ This expenditure level can be substantially higher than that which the political process otherwise would have produced and, as a result, may tend to crowd out spending on other programs.

Some state constitutions, particularly those of states that have enacted tax and expenditure limits, mandate that states maintain a certain level of aid to local governments.²⁷⁸ Privileging these payments, too, can crowd out other expenditures.

Although criminal justice policy is not commonly discussed in fiscal terms, some state constitutions effectively prioritize these expenditures as well. They may restrict the availability of pardons, parole, and other forms of early release.²⁷⁹ This means, in effect, that each time a

²⁷⁵ See, e.g., Opinion of July 25, 1951, 53 So. 2d 739, 740 (Ala.) (“The power of the legislature in this field is plenary in the absence of constitutional restriction.”).

²⁷⁶ See, e.g., MASS. CONST. pt. 2, ch. V, § II; MONT. CONST. art. X, § 1; OR. CONST. art. VIII, § 8; PA. CONST. art. III, § 14; S.C. CONST. art. XI, § 3.

²⁷⁷ See, e.g., *McDuffy v. Sec’y of Executive Office of Educ.*, 615 N.E.2d 516, 554 (Mass. 1993); *Columbia Falls v. State*, No. BDV-2002-528 (Mont. Dist. Ct. Apr. 2004), <http://www.mtsba.org/currenttemp/litigation/schoolfundingdecision.htm>; *Abbeville County Sch. Dist. v. State*, 515 S.E.2d 535, 540 (S.C. 1999).

²⁷⁸ See, e.g., CAL. CONST. art. XIII B, § 6 (prohibiting the state from increasing the fiscal obligations of local governments, whose tax-raising authority that article curtails); MO. CONST. art. X, § 21 (same).

²⁷⁹ Effective constitutionalization occurs because criminal justice initiatives are often passed through voter initiatives, see Kenneth E. Fernandez & Timothy Bowman, *Race, Political Institutions, and Criminal Justice: An Examination of the Sentencing of Latino Offenders*, 36 COLUM. HUM. RTS. L. REV. 41, 50–51 (2004), and some state constitutions protect initiative-based laws from amendment absent another public vote, see, e.g., CAL. CONST. art. II, § 10(c). Similar restrictions exist in many state statutes. See Victoria J. Palacios, *Go Sin No Move: Rationality and Release Decisions by Parole Boards*, 45 S.C. L. REV. 567, 601–02 & nn.257–59 (1994) (describing a class of statutes limiting the release of prisoners unless certain conditions are met).

State statutes further contribute to prison spending by requiring long minimum sentences. See Nancy J. King & Susan R. Klein, *Essential Elements*, 54 VAND. L. REV. 1467, 1492 (2001) (noting a trend toward higher criminal sentences). Both kinds of statutory provisions in theory are easier to amend than are constitutional provisions. In practice, however, modifying these statutes is seldom a practical option for relieving pressures on states’ budgets. See Elizabeth Napier Dewar, Comment, *The Inadequacy of Fiscal Constraints as a Substitute for Proportionality Review*, 114 YALE L.J. 1177, 1182–83 (2005) (exploring the difficulties of generating savings in this manner). First, criminal justice issues typically are seen as relating to morality or public safety rather than to the budget; they rarely appear in budgetary discussions. Second, even if the fiscal consequences of criminal justice policy were better recognized, state constitutional provi-

prisoner is sentenced, the court is committing the state to spend tens of thousands of dollars in each year of the sentence.²⁸⁰ States have some ability to reduce these expenditures by overcrowding prisons and otherwise allowing conditions of confinement to deteriorate. Although the political process rarely protects prisoners from harsh conditions, the Eighth Amendment of the U.S. Constitution, and similar provisions in many state constitutions, provides an outer limit on how small prison budgets can shrink.²⁸¹ The explosion in the number of inmates over the past few decades has stressed state corrections budgets to the point that many states have eliminated most significant discretionary items from their prison spending.²⁸² Prison expenditures are therefore effectively privileged and likely to further crowd out other expenditures.

B. Dedicated Revenue Sources

A large and increasing share of state and local revenues comes in streams explicitly dedicated to particular spending programs. Some bridges and highways long have been supported by toll collections, state universities by tuition, and public transit systems by fare box receipts. In recent years, however, a variety of business interests have found new ways to tie services they value to specific funding

sions prohibiting legislation from encompassing more than one object make it difficult to amend these laws as part of the budget process. See *Harbor v. Deukmejian*, 742 P.2d 1290 (Cal. 1987) (enforcing state constitutional bar on including any other material in budget legislation); *Dep't of Educ. v. Lewis*, 416 So. 2d 455, 459–61 (Fla. 1982) (same); see also Millard Ruud, “No Law Shall Embrace More than One Subject”, 42 MINN. L. REV. 389 (1958) (analyzing the history, purpose, and use of these state constitutional provisions). Finally, some of the laws with the greatest fiscal consequences — those imposing mandatory minimum sentences — have most of their impact beyond the next fiscal year or biennial budget period. State budget processes that operate only a year or two at a time therefore will not recognize the costs of most sentencing mandates or the potential savings from shortening minimum sentences. A handful of states did release prisoners early in the recent state fiscal crisis, but for the most part, corrections expenditures remained privileged in state budgets.

²⁸⁰ In 2001, the average annual operating cost per state prison inmate was \$22,650. BUREAU OF JUSTICE STATISTICS, U.S. DEP'T OF JUSTICE, SPECIAL REPORT: STATE PRISON EXPENDITURES, 2001, at 1 (2004), available at <http://www.ojp.gov/bjs/pub/pdf/spe01.pdf>.

²⁸¹ See, e.g., *Moore v. Morgan*, 922 F.2d 1553, 1558 (11th Cir. 1991) (remanding for a determination of damages for prison overcrowding); *Tillery v. Owens*, 907 F.2d 418, 421–25, 431 (3d Cir. 1990) (upholding district court's injunction against constitutional violations from overcrowding, inadequate lighting, ventilation, plumbing, fire safety, health care, and security in prison); *Balla v. Idaho State Bd. of Corr.*, 869 F.2d 461, 470–73 (9th Cir. 1989) (upholding district court's order requiring the state to remedy unconstitutional prison overcrowding); see also WYO. CONST. art. I, § 16 (creating a right to “safe and comfortable prisons”).

²⁸² See, e.g., Cameron McWhirter & Steve Visser, *Crisis Stirs Calls for New Jail*, ATLANTA J.-CONST., Mar. 14, 2004, at A1 (reporting that a county jail had only one-seventh the number of guards for which it was designed); Rick Pearson, *Prisons, Schools Could Face Court-Ordered Reforms*, CHI. TRIB., Apr. 5, 1993, § 2, at 1 (describing the severe strain on the Illinois prison budget).

streams.²⁸³ And some states have persuaded voters to accept controversial revenue sources, such as gambling, by tying the resulting proceeds to highly popular types of spending, such as education.²⁸⁴

The nature of most of these dedicated revenue sources makes it unlikely that they will be applied to programs targeting low- and moderate-income people. Many operate as a sort of bargain in which the government extracts funds from a subset of taxpayers in exchange for dedicating the proceeds to those taxpayers' benefit.²⁸⁵ Indeed, some states permit special assessments only if the government can prove that it is returning the proceeds to the specific property owners paying them.²⁸⁶ Little redistribution of resources is possible under this approach, and low-income communities are unlikely to have the funds to support improvements in this manner.²⁸⁷ More broad-based revenue streams tend to be dedicated to programs with particularly broad appeal, such as education or infrastructure projects thought to create broad benefits. Although low- and moderate-income people obviously benefit from education and other universal social service programs, the programs that serve them specifically are rarely so popular.²⁸⁸

²⁸³ For example, convention centers may be subsidized by taxes on hotel, bar, and restaurant charges. Business improvement districts (BIDs) may impose incremental property taxes to fund road improvements, flood control, special police patrols, increased sanitation, or other services valued by local businesses. See Richard Briffault, *A Government for Our Time? Business Improvement Districts and Urban Governance*, 99 COLUM. L. REV. 365, 368–73 (1999) (describing the basics of BIDs). Similarly, a state or local government may finance investments in infrastructure with bonds that it pledges to pay off by taxing affected parcels' increase in value that is attributable to those improvements. Instead of increasing property tax rates, this "tax increment financing" (TIF) seeks to recapture the benefits of the investments made by dedicating revenues that theoretically would not have existed but for the improvements. In practice, attributing any increase in property value to a particular public infrastructure investment is often highly speculative. See, e.g., *McNally v. Township of Teaneck*, 379 A.2d 446, 453 (N.J. 1977) (striking down some assessments as excessive). Infrastructure investments are frequently planned for areas that are already beginning to show economic promise. Thus, if properties in that area rise in value, it may be impossible to determine if the increase results from the infrastructure project or preexisting conditions.

²⁸⁴ See NAT'L CONFERENCE OF STATE LEGISLATURES, LOTTERIES IN THE UNITED STATES, at <http://www.ncsl.org/programs/econ/lotto.htm> (updated Jan. 13, 2004) (detailing the use of revenues from the lotteries of forty states and the District of Columbia).

²⁸⁵ See generally Laurie Reynolds, *Taxes, Fees, Assessments, Dues, and the "Get What You Pay for" Model of Local Government*, 56 FLA. L. REV. 373 (2004) (describing a "dues mentality" in which citizens become accustomed to specific charges in exchange for specific services).

²⁸⁶ See, e.g., *Harrison v. Bd. of Supervisors*, 118 Cal. Rptr. 828, 832 (Cal. Ct. App. 1975); *McNally*, 379 A.2d at 449. See generally Briffault, *supra* note 283, at 446–54 (explaining that state taxation requirements demand "that the benefit a payer receives must be as large as the assessment he or she pays").

²⁸⁷ These assessments typically fund highly localized projects. Because residential segregation by wealth is so pervasive in this country, this localized focus typically means that affluent property owners pay special assessments for services largely benefiting themselves.

²⁸⁸ See Super, *supra* note 156, at 1289–93 (discussing the negative perceptions associated with "welfare" programs such as AFDC).

Although commonly described as supplemental to the general activities of government, these dedicated funding streams tend to crowd out spending on basic programs. Affluent people who can address their local infrastructure needs through special assessments are unlikely to be enthusiastic about also paying taxes to support similar work in other communities. Special police patrols and garbage collection may be nominally supplemental to those provided by general government, but by allowing affluent people to purchase their own services rather than support community-wide improvements in policing and sanitation, they reduce the political constituency for the revenue increases that may be needed to improve services throughout the jurisdiction.

Special assessments therefore apply the state's coercive powers on behalf of those who already have the means to pay for services, allowing them to opt out of the commonweal and leave the less affluent to fend for themselves. Special assessments convert government from a social and political community into a kind of business, more responsive to major customers than to a broader community. People in need of assistance have far more ability to make claims on a community of which they are members than they do on a *de facto* business.²⁸⁹ Thus, not only are dedicated funding streams most unlikely to support programs that disproportionately benefit low- and moderate-income people, they actually tend to undermine support for such programs. Indeed, they allow general public-service programs whose benefits would otherwise be roughly proportionate to become regressive, with the total value of general and special services received in wealthy communities outstripping the total value in poorer ones.

As discussed below, debt financing can make the dedication of revenue streams to particular purposes irrevocable.²⁹⁰ Rather than making improvements concurrently with receipt of revenues from a dedicated stream, the government can issue bonds to allow it to make the improvements all at once and then dedicate the revenue from the special assessment to paying off those bonds. The government thus obliges itself to continue the special assessment for the life of the bonds. Since these payments are not producing any current public services, they may further contribute to property owners' sense that they are overtaxed and sharpen their resistance to taxes supporting the general fund.

²⁸⁹ See, e.g., *Ball v. James*, 451 U.S. 355, 366–71 (1981) (excusing a water district from compliance with one-person, one-vote requirements); *Blackwell v. City of St. Charles*, 726 F. Supp. 256, 258 (E.D. Mo. 1989) (permitting city to require outlying areas to consent to future annexation in exchange for utility service); *Sloan v. City of Conway*, 555 S.E.2d 684, 686–87 (S.C. 2001) (allowing municipal utility to discriminate against nonresidents in setting water rates).

²⁹⁰ See *infra* section IV.C.2, pp. 2624–26.

Revenue streams dedicated to broader purposes, such as education, create an analogous problem. First, because legislators and voters know that their highest funding priorities will be met through dedicated funding streams, they have less reason to support the raising of adequate revenue for the general fund and the programs it supports. Once again, disaggregation of the works of government — here along functional rather than parochial lines — undermines programs targeting low- and moderate-income people.²⁹¹ Second, an additional problem results from the fact that many of the funding streams dedicated to popular programs — such as gambling and additional sales taxes — are regressive.²⁹² Thus, establishing a lottery to support education may both take money disproportionately out of low-income communities and undermine support for taxes supporting programs that return money to those communities: it may lead both revenues and spending to become more regressive.

Having a dedicated revenue stream greatly strengthens the position of a spending program relative to other programs lacking dedicated funding. If the dedicated funding stream produces more than the annual budgetary process would otherwise provide the favored program, the program's administrators nonetheless can probably spend it. Any attempt to divert funding from the designated program will be denounced as "raiding" the fund or "cutting" the program,²⁹³ even if its important needs have been fully satisfied and the revenue source is producing more than had been anticipated. On the other hand, if the dedicated funding stream proves inadequate, the program remains free to appeal for a share of the general fund.²⁹⁴ In contrast, other programs cannot access funds from special funding streams, yet have no immunity from cuts to pay for more popular activities whose dedicated funds prove inadequate.

²⁹¹ One apparent exception to this pattern would be the dedicated funding streams for programs serving low-income people that emanate from the federal government. As discussed above, however, the conditions on these funding streams constrain states far less than the conditions on money originating within states, allowing states to supplant state revenues with federal funding and effectively vitiating the dedication of the federal funding stream to a meaningfully defined set of activities. See *supra* notes 164–165 and accompanying text.

²⁹² See, e.g., Ronald J. Rychlak, *Lotteries, Revenues and Social Costs: A Historical Examination of State-Sponsored Gambling*, 34 B.C. L. REV. 11, 50–52 (1992) (describing the regressive nature of lotteries).

²⁹³ In some states, this is more than just a political concern: it may be unconstitutional to divert money raised for one purpose to meet other needs. See, e.g., ALA. CONST. art. XIV, § 260 (dedicating certain funds to education); MICH. CONST. art. IX, § 9 (dedicating certain funds to transportation); S.C. CONST. art. X, § 5 (requiring the purposes of taxes to be specified upon enactment).

²⁹⁴ Indeed, if the designated programs are financed outside of the normal budget process, appropriators may feel they have to supplement the dedicated funding stream to gain any credit for supporting the popular program.

C. Method and Timing of Expenditures

The biggest obstacle that proponents of most tax reductions and spending initiatives face is not substantive hostility to their proposals but competing demands for the resources at issue. Large tax or spending changes tend to be harder to enact because they require displacing more competing claimants for funds. Strategies for winning enactment of a costly proposal, then, typically involve both mobilizing the proposal's potential beneficiaries and muting opposition from competitors.

Programs serving politically weak groups, such as low-income people, are at a relative disadvantage in this process: these groups often have less ability to fight for proposals that benefit them, and their programs thus seem inviting targets for those desiring resources for other initiatives. They also, however, may face other, more subtle disadvantages when competing for resources in the state budgetary process.

One of the best ways of overcoming political opponents is to keep them from realizing that their interests are at risk or, if that fails, to spread the costs of the initiative widely enough that few will find it worth their while to protest.²⁹⁵ Pushing the costs of a program into the future is an excellent way of achieving both goals. Some potential adversaries will completely fail to recognize the costs displaced, while others will see the costs but be uncertain whether they will be asked to bear them. Still others will recognize the likely impact but discount their prospective losses enough that they refrain from objecting.²⁹⁶ Thus, the ability to fund current tax cuts or spending increases from future, preferably undefined, revenue sources confers a powerful advantage on an initiative's advocates. The economic cycle often compounds this advantage, insulating the program from political and budgetary pressures during economic downturns and leaving remaining programs to absorb disproportionate shares of necessary cuts.

This section explores how advocates of slow-spending programs — to which funding must be committed long before the costs actually accrue — are able to avoid having to finance expenditures, an advantage not available to programs that rapidly meet immediate needs. With the exception of public housing construction — which is rare in contemporary state budgets — programs that focus on low-income people generally spend money rapidly, and legislators must find the political capital to support financing these programs at the time they initiate them. Similarly, programs to relieve distressed families and municipi-

²⁹⁵ See generally MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (1965) (arguing that small groups with focused interests will often prevail over larger, more diffuse groups).

²⁹⁶ See *id.* at 46–52 (explaining why very large, so-called “latent groups” are unlikely to take political action).

palities in an economic slump must spend rapidly to accomplish their purpose. Section 1 focuses on the advantages of programs that convert appropriations into outlays over many months, or even years, thus shifting the burden of financing to future legislatures. Section 2 considers other ways in which current legislatures may bind their successors without making formal appropriations. Most obviously, programs that state constitutions allow to be financed through debt enjoy a huge advantage over those with costs subject to annual balanced budget requirements. Section 3 shows that the advantages discussed in the first two sections are not inevitable: the federal budget process contains a number of measures designed to reduce the advantages of spending initiatives with delayed impacts. Unfortunately, states' fiscal constitutions largely lack these safeguards.

1. *Advantages for Slow-Spending Programs.* — Different government activities spend money at different rates. Increasing compensation to workers already on the state payroll or increasing cash aid to recipients already participating in transfer programs results in outlays almost immediately. In-kind benefits spend out more slowly because time passes while vendors bill the state and the state reimburses them. Money designated for new employees or new benefit programs will spend even more slowly because of the time required to post and fill the positions or to establish and take applications for the new programs. A multiyear construction project typically will show only a small portion of its total cost — perhaps the expenses of engineering studies and the like — in its first year.

If budget rules only hold legislators accountable for outlays during a single budget year or biennium, legislators may be able to embark on large, slow-spending projects while finding the resources for only a modest share of the costs. Indeed, crafty legislators can reduce the first-year cost of new spending programs or tax cuts by making them effective only at the end of the year or biennium.²⁹⁷ Alternatively, they can phase changes in over several years, leaving future legislatures to accommodate the cost. In theory, future legislatures may try to abort

²⁹⁷ Some states, particularly those with part-time legislatures, have two-year budget cycles. See W. Mark Crain & Lisa K. Oakley, *The Politics of Infrastructure*, 38 J.L. & ECON. 1, 9 (1995) (reporting that “[t]wenty-one states operate on a 2-year budgeting cycle”). This schedule may narrow the class of slow-spending programs to major capital projects and somewhat narrow the differences among programs in the percentage of current appropriations spent in the current budgetary period. For example, a program that spends its appropriation in months thirteen through twenty-four will not affect the balance of an annual budget but will have to be funded in a biennial one. On the other hand, biennial budgeting depends on longer-term — and hence more imprecise — spending and revenue estimates. Thus, advocates of an initiative with an uncertain spend-out rate may readily contend that it will in fact spend little during the first biennium. A similar opportunity is not available for public benefit programs, whose rapid spend-out is obvious.

these programs, but in practice, once a program has begun — once the site and design of the building have been announced or applications for a benefit program have been accepted — any move to terminate the program is likely to be perceived as a cut, creating political vulnerabilities for any legislators that dare to trim its costs.²⁹⁸

Slow-spending programs also have advantages during economic downturns. Because most of the money they spend in any given year was appropriated in an earlier budgetary cycle, their outlays will remain largely unaffected for some time even if the state's new appropriations tumble. This could, of course, mean that these programs also recover more slowly when the state's budgetary picture improves. In practice, however, savvy administrators likely can prevent this result unless the state's fiscal crisis is particularly protracted. Once new appropriations become more readily available, they may be able to speed up spending to avoid a hiatus.

Programs targeting low-income people, and particularly countercyclical programs, are the least likely to have slow spend-out rates and the attendant political advantages. As noted above, programs providing benefits to individuals intrinsically spend appropriated funds quickly after identifying a need. Since the construction of new public housing was largely abandoned in the 1980s,²⁹⁹ few means-tested programs involve the kind of infrastructure construction that spends out over several years. The rationale for most programs targeting low-income people — relief of severe hardship — makes it difficult for proponents to justify delaying the programs' start dates as a means of obscuring their ultimate costs. This limitation is particularly true of countercyclical programs, which may fail to fulfill their purposes if spending is delayed. Finally, even if a means-tested program is given an artificially delayed effective date, the beneficiaries that might perceive its subsequent cancellation as a cut tend to be politically weak, leaving the program vulnerable to cancellation before any benefits are distributed.³⁰⁰

²⁹⁸ Thus, even if the cost of a spending program or tax cut, once fully phased in, cannot be sustained within the existing budgetary framework, legislators may be as likely to look to other programs or revenue sources to fill the gap as they are to discontinue the project.

²⁹⁹ See Stephen B. Kinnaird, Note, *Public Housing: Abandon Hope, but Not Privatization*, 103 YALE L.J. 961, 984 n.168 (1994) (noting that "[a]nnual public housing completions . . . fell precipitously in the late 1980's").

³⁰⁰ Some such programs may nonetheless survive if they also benefit powerful provider constituencies. For example, some Medicaid expansions enacted in the 1980s were phased in over as many as eighteen years with no serious attempts to freeze or roll back implementation. See 42 U.S.C.A. § 1396a(l) (West Supp. 2004). This may be attributed in part to the appeal of the benefit — health care for children — and perhaps in part to the political support of the health care industry, which saw the expansion as reducing their costs for uncompensated care. By contrast, food stamp expansions enacted in 1993 and scheduled to be phased in over three years were frozen when Republicans took control of Congress in 1994 on a platform skeptical of means-tested pro-

2. *Binding Future Legislatures.* — Some deferred outlays cannot lawfully be cancelled, and their continuing costs squeezes out other programs. The most important of these outlays are debt service payments. State constitutional balanced budget requirements typically exclude borrowing for capital projects from their calculations, which gives policymakers strong incentives to borrow to finance projects rather than to pay for them on a cash basis. Issuing bonds will have no effect on the current year's budget, though even a slow-spending project is likely to generate some outlays in the current year.³⁰¹ Once enacted, a spending project (or tax cut) that is financed with the issuance of bonds becomes effectively immune to reduction in future years. Thus, for example, while a state could pay the bills for construction of a sports stadium, convention center, or bridge as they come in, issuing bonds for the project postpones most or all of the outlays into future budget years.

To much the same effect, if the state sells a needed asset — such as a state office building — with the intent of leasing it back, future legislatures will have little choice but to continue to lease that or a similar asset. Although future legislators technically are not required to renew the lease, the sale precludes them from using the asset without including lease payments in their budget — in the same way that issuing bonds precludes future budgets from omitting debt service payments. Thus, spending programs or tax cuts financed by asset sales also shift costs into future years under terms effectively barring their repudiation.

A legislature can commit future resources in other ways. For example, it can give discretionary or even frivolous expenditures constitutional status by incorporating them into contracts. If the state contracts with a private party to make payments in future years, the Contracts Clause would prevent it from reneging even if it had lost interest in that project. Once a contract is signed for the construction of a marina in an affluent community, for example, the state may face severe penalties if it cancels the project.

A similar effect can be achieved by offering third parties a long-run financial benefit in return for some near-term consideration. For example, suppose the government offers private parties the opportunity to prepay taxes at a discount. A simple cut in rates can be reversed in future years. Allowing persons to pay some additional taxes now in exchange for future immunity from a much larger amount of taxes, on the other hand, will tie the hands of future legislators. For example,

grams. See Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, § 809, 110 Stat. 2105, 2309–13 (amending 7 U.S.C. § 2014(e)).

³⁰¹ See RICHARD BRIFFAULT, *BALANCING ACTS* 7–14 (1996) (noting that “most states finance some capital projects by borrowing rather than on a pay-as-you-go basis”).

when Congress lowered the rate of taxation on capital gains, many individuals chose to realize gains on assets they had been holding, paid the reduced taxes, and received an increased basis that immunized them from future taxation on the gains they had been holding.³⁰² Similarly, when Congress authorized taxpayers to convert traditional IRAs to Roth IRAs by paying tax on the value of the accounts, it effectively enabled individuals to choose to make traditional IRA balances, and appreciation on those balances, tax exempt in the future.³⁰³ On the state level, this effect may be achieved through tax abatements offered to induce private businesses to locate or stay in a community.³⁰⁴ Once the commitment is made and the business has declined other offers, the government cannot cancel the abatement even if it becomes convinced it received little value for the foregone revenues. Each of these tax expenditures is locked in, and effectively guaranteed against future changes in the political winds, in a way that most spending programs cannot be.

These methods for committing but postponing expenditures tend to advantage fiscal choices that disproportionately benefit more affluent people. Wealthier people are more likely to engage in the relatively complex transactions that can be structured to benefit from tax advantages. They have the resources to prepay taxes at a discount.³⁰⁵ They also are more likely to own businesses large enough to enter into significant contracts with the government. They have greater interstate mobility — and political desirability — and hence can extort tax abatements from the government. And many of the projects that benefit them most — such as stadiums, highways, and university

³⁰² See JOEL FRIEDMAN ET AL., CTR. ON BUDGET & POLICY PRIORITIES, ADMINISTRATION'S TAX CUTTING AGENDA WOULD COST \$2.7 TRILLION THROUGH 2013, at 3 (2003) (explaining that accelerated realizations of capital gains induced by tax cut would all but eliminate revenue losses during that cut's early years), available at <http://www.cbpp.org/11-22-03bud.pdf>.

³⁰³ See CTR. ON BUDGET & POLICY PRIORITIES, DISTRIBUTION OF BUDGET AGREEMENT'S TAX CUTS FAR MORE SIMILAR TO CONGRESSIONAL BILLS THAN TO PRESIDENT'S PLAN (1997) (describing the long-term budgetary consequences of Roth IRAs), at <http://www.cbpp.org/731taxba.htm>.

³⁰⁴ For a description of these tax subsidies and some doubts about their effectiveness as tools of economic growth, see Kary L. Moss, *The Privatization of Public Wealth*, 23 FORDHAM URB. L. J. 101, 106–11 (1995).

³⁰⁵ A limited parallel exists in time-limited cash assistance benefits. Families working at low-wage, part-time jobs may qualify for partial checks, but most states count those checks against the recipients' eligibility time just as they do full checks. See LIZ SCHOTT, CTR. ON BUDGET & POLICY PRIORITIES, STATE CHOICES ON TIME LIMIT POLICIES IN TANF-FUNDED PROGRAMS 7–8 (1998), available at <http://www.cbpp.org/9-1-98wel.htm>. A family can maximize its total lifetime receipt of benefits — even when future benefits are discounted to a present value — by foregoing partial checks and “banking” months on their eligibility time clocks. Despite this opportunity, however, studies indicate that many low-income families are so desperate that they accept the partial checks to supplement their wages. See *id.*

buildings — tend to have costs in their initial year that are a small fraction of the resources they ultimately will require.³⁰⁶ Even among large capital projects, those disproportionately benefiting more affluent people are more likely to be financed with bonds, and therefore more likely to be in the budget, because they are more likely to produce dedicated revenue streams that can be committed to debt service.³⁰⁷

As a result, programs serving low- and moderate-income people are at a distinct disadvantage when competing against capital projects and tax expenditures, which disproportionately benefit the affluent. Large capital projects and measures offering affluent citizens opportunities to prepay taxes at a deep discount are far easier for governors and legislators to accommodate in their annual budget than are programs serving low-income people. For example, a stadium that will require \$100 million of debt service over the next ten years will require little or no displacement of other priorities in the current year's budget, but a \$10 million-a-year nutrition assistance program — with the same ten-year cost — will require about \$10 million to be found in the first year's budget. Projects that defer costs have an even more detrimental impact on programs targeting low- and moderate-income people if the economy worsens. Once bonds are issued, the project they support and their debt service costs become essentially impervious to any budgetary reverses the state may suffer. If the state's budget must be cut ten percent overall, all other programs will have to be cut by *more than* ten percent to make up for the inability to reduce the bond payments. Taken together with the advantages of slow spending programs, these political maneuvers make the state budget process quite hostile to programs for those least advantaged by society.

3. *Methods of Limiting Temporal Budgetary Manipulations.* — This bias is especially salient because many public benefit programs have been devolved to the states in the name of federalism. Although far from perfect, federal budget procedures have less structural bias against these programs. In particular, the federal budget process recognizes the advantage of slow-spending programs and tries to amelio-

³⁰⁶ Public housing projects, of course, cost relatively little in their first years: perhaps just the cost of planning and design work. This country, however, largely stopped building new public housing some decades ago. See Kinnaird, *supra* note 299, at 984 n.168. Some long-term public transit investments also benefit low-income people, although new rail public transit in much of the country targets suburban commuters. The transit expenditures that disproportionately benefit low-income people — buses — can be purchased within a single budget year.

³⁰⁷ Thus, because public housing and recreational facilities in low-income communities operate at a loss, they are more likely to be funded directly by the government. If a project loses political favor and is prematurely terminated, the government may have to pay some penalty to its contractors, but it can cancel the project. When the government has issued bonds, on the other hand, it has obligated itself to numerous bondholders to complete the project so that the revenue stream can come into being.

rate the bias in several ways. These measures are not completely successful, but they do have some effect. The general absence of analogous measures at the state level increases the relative bias in favor of programs with slow spend-out rates, whether natural or contrived, and those programs in which current policymakers can commit their future counterparts to continue a particular type of spending or tax expenditure.

First, federal budget rules typically have measured legislation's fiscal effect over several years. For example, during the 1990s the Senate developed rules that measured proposed legislation's compliance with budgetary targets in the first year, in the aggregate of the first through the fifth years, and in the aggregate of the sixth through the tenth years.³⁰⁸ Legislation that exceeded specified limits over any one of these three periods was subject to a point of order no matter how it fared under the other two. To be sure, recent Congresses have allowed many of these rules to lapse and have proven adept at designing tax cuts the full impact of which is postponed beyond even a ten-year window.³⁰⁹ Nonetheless, these extended accounting periods help level the field among spending programs, as few delay their outlays so much that their impact is not apparent by the tenth year. By contrast, state balanced budget requirements typically apply only one year at a time.³¹⁰

Second, federal budget legislation tracks spending in two separate ways: outlays (funds actually transferred to others) and budget authority (commitments to make payments). Both the Bush Administration and the liberal Center on Budget and Policy Priorities base their analyses of discretionary appropriations primarily on budget authority.³¹¹ In fast-spending programs like food stamps or SSI, the distinction is essentially meaningless: the government does not commit to

³⁰⁸ See 2 U.S.C. § 642(a)(2)(A) (1994); H.R. Con. Res. 67, 104th Cong. § 202(b)(2), (g) (1995) (enacted) (imposing separate budgetary constraints on legislation's cost during the first year, the first five years, and the second five years after its enactment, but expiring for legislation considered after the end of federal fiscal year 2002).

³⁰⁹ See JOEL FRIEDMAN ET AL., CTR. ON BUDGET & POLICY PRIORITIES, NEW TAX-CUT LAW ULTIMATELY COSTS AS MUCH AS BUSH PLAN: GIMMICKS USED TO CAMOUFLAGE \$4.1 TRILLION COST IN SECOND DECADE 1 (2001), available at <http://www.cbpp.org/5-26-01tax.pdf>.

³¹⁰ See, e.g., MONT. CONST. art. VIII, § 9; TENN. CONST. art. II, § 24.

³¹¹ See, e.g., JAMES HORNEY & RICHARD KOGAN, CTR. ON BUDGET & POLICY PRIORITIES, ASSESSING THE ADMINISTRATION'S FIVE-YEAR APPROPRIATION "CAPS": ADMINISTRATION'S FIVE-YEAR CAPS ON APPROPRIATIONS WOULD LEAD TO SUBSTANTIAL REDUCTIONS IN IMPORTANT DOMESTIC PROGRAMS (2005) (describing Bush proposals in terms of "funding levels," that is, budget authority), available at <http://www.cbpp.org/2-28-05bud.pdf>; Joshua B. Bolten, *Today's Debate: Washington's Spending Habits: Bush on Track with Budget*, USA TODAY, Sept. 5, 2003, at 12A (deputy director of the OMB describing the Administration's discretionary spending record in terms of its budget authority).

making any particular expenditure appreciably in advance of making the payment.³¹² But for slow-spending programs, such as the construction of naval vessels, limits on budget authority offer the only meaningful constraint on spending.³¹³ If new budget authority is capped at levels similar to the cap for new outlays, the government may continue with roughly the same mix of fast- and slow-spending programs; budgeteers cannot, however, expand spending by shifting to slow-spending programs (including expenditures financed with debt or locked in with contracts).³¹⁴ No similar principle applies to state budgets, in which expenditures are typically expressed in terms of current outlays alone.³¹⁵

Third, after some bad experiences in the 1980s, Congress amended federal budget process law in 1990 to disregard the proceeds from most asset sales when determining compliance with spending limits.³¹⁶ This rule does not prevent the current majority from selling off public assets to the detriment of future legislators, but it does prevent budget rules from providing an incentive to do so. By contrast, states' constitutions typically lack the kind of detailed accounting rules required to disallow transactions, such as asset sales, that artificially mask the net cost to the government of the current budget.

Fourth, federal budget process law raises special procedural barriers to tampering with the program most susceptible to timing shifts: Social Security. Including a change to Social Security in a budget rec-

³¹² On occasion, a notice declaring a claimant eligible for funds may arrive shortly before the actual check or transfer. Most payments, however, are made to ongoing recipients. And even when a new applicant receives notice of her or his first benefits, this would cause budget authority to differ from outlays only if the notice occurred at the end of one fiscal year and the payment was processed in the next.

³¹³ If military expenditures were constrained based only on current year outlays, the Pentagon could "pay for" fleets of new tanks, warships, or airplanes by forgoing purchase of a modest amount of ammunition in the same fiscal year.

³¹⁴ Budgeteers still may shift some costs to future legislators by creating programs or tax cuts that are politically, but not legally, impossible to repeal. The Bush Administration and its allies in Congress relied on this device — a tax cut with an expiration date never intended to take effect, *see* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (codified in scattered sections of the I.R.C.) — to enact tax cuts with a true cost far exceeding the amount they were able to persuade Congress to allow in its budget resolutions.

³¹⁵ *See, e.g.*, IND. CONST. art. X, § 5; W. VA. CONST. art. X, § 4. Imposing an additional constraint on budget authority would require a mechanism for specifying the permissible level of budget authority. It also might require some algorithm for allocating the necessary reductions should the legislature breach the cap. And it would almost certainly require empowering some neutral, or at least trustworthy, entity to make authoritative estimates of the spend-out rate of proposed fiscal legislation. Presumably the legislature could increase slow-spending programs if it similarly legislated increases in revenues that took effect in future years.

³¹⁶ *See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, §§ 13112(a)(2), 13211(a), 104 Stat. 1388, 1388-607 to 1388-608, 1388-620 (codified at 2 U.S.C. § 622(1), (2), (6) (2000)) (defining the deficit in terms of outlays, and defining outlays (and budget authority) in terms that provide no offset for the proceeds of asset sales).

conciliation bill subjects the entire bill — not just the offending provision — to a point of order in the Senate that requires a supermajority of sixty votes to waive.³¹⁷ Thus, purporting to pay for other spending or tax cuts by changing the dates of Social Security checks is impossible without substantial bipartisan support — the same level of support that would be required to dispense with an offset altogether.³¹⁸ Here again, states' constitutional balanced budget requirements typically lack the sophistication to recognize artificial shifts of expenditures into an earlier or later budget year. Accordingly, states are free to postpone payments to state employees, health care providers, or other major vendors that are due at the end of a fiscal year to achieve artificial balance.

Finally, federal budget process laws set uniform standards under which Congress and the administration must account for government credit. These standards do not directly prevent transient majorities from shifting costs to future generations by assuming new debt. Indeed, the absence of a balanced budget requirement allows Congress to incur debt as it sees necessary. But these standards do increase the transparency of some complex budgetary transactions and therefore the potential for holding lawmakers politically accountable. By contrast, these standards are largely absent from the states. Some states' constitutions do prohibit one kind of deceptive debt-related transaction: lending states' credit to private enterprises.³¹⁹ But for the most part, states' fiscal rules focus on keeping the state from using many kinds of debt altogether. As a result, when the state does incur debt, it generally does so by structuring the debt such that it is either invisible to or permissible under the rules. In either case, the focus on prohibiting debt leaves states' fiscal constitutions ill-prepared to ensure the transparency of that debt that is incurred.

D. Cyclical Biases

Probably the most important substantive bias hidden in states' budgetary rules works against countercyclical programs. State and local countercyclical spending is intended to cushion the impact of eco-

³¹⁷ See 2 U.S.C. §§ 641(g), 644(b)(1)(f). If the point of order is sustained, the whole bill is sent back to committee. *Id.* § 643(f).

³¹⁸ Sixty votes — which requires bipartisan support — are also necessary to waive the point of order against including Social Security cuts as offsets in budget reconciliation programs. See 2 U.S.C. § 644 (allowing a point of order for inclusion of a Social Security cut as an offset); Congressional Budget Act of 1974, Pub. L. No. 93-344, tit. IX, § 904(c)(1), (d)(2), 88 Stat. 297, 331 (codified as amended at 2 U.S.C. § 621 note) (requiring a three-fifths vote to waive the point of order). Those same sixty votes, however, would be sufficient to waive any point of order that could arise from the lack of an offset. See Congressional Budget Act of 1974 § 904 (as amended).

³¹⁹ See, e.g., IOWA CONST. art. VII, § 1; MD. CONST. art. III, § 34; UTAH CONST. art. VI, § 29.

conomic downturns, primarily for low- and moderate-income people. The interaction between states' budget rules, the business cycle, and state revenues' sensitivity to the business cycle yields powerful pressures that cause these countercyclical programs to ratchet downward over time. Moreover, fluctuations over the course of the business cycle — as well as current ideological preferences — also tend to favor the most regressive taxes and those that exacerbate the business cycle's corrosive impact on means-tested programs.

This section explains the operation of this ratchet. Section 1 shows how the business cycle affects different kinds of taxes and classes of programs. Section 2 then demonstrates how these differences are likely to cause some programs' funding to ratchet down over the course of each budget cycle. Finally, section 3 identifies classes of programs particularly vulnerable to lasting damage as states' budgets wax and wane over the business cycle.

1. Programs' and Taxes' Varying Sensitivity to the Business Cycle.

— State spending programs can be divided into three categories based on their relationship with the business cycle. First, some programs are countercyclical: they tend to spend more during economic downturns. Subsidies for low-income people and the unemployed constitute a large share of state countercyclical spending. Second, some programs are noncyclical: their spending is largely unaffected by the business cycle. Funding for primary and secondary education, policing, and corrections are major examples of this type.³²⁰ And third, some programs' spending is relatively discretionary: because it responds to long-term rather than short-term needs, the precise year in which it takes place can be somewhat flexible. These programs have the potential to be, but often are not, delayed during economic downturns. No matter how strong the substantive or political arguments may be for new buildings at public universities, acquisitions for public museums, highway construction, and stadiums, the timing of these expenditures generally is discretionary: an extra lane on a major highway will still be useful a few years in the future.³²¹

³²⁰ To be sure, crime rates may rise during economic slumps, placing additional demands on the police and ultimately the corrections system. State and local governments, however, need only increase spending modestly to cope with this problem: jail overcrowding and declining ratios of correction officers to incarcerated persons likely have costs, but not in the budgetary sense. Even if a surge in crime during a recession leads to more convictions, the variation in trial, incarceration, and release dates is likely to attenuate any connection with the business cycle.

³²¹ In theory, a fourth category of state expenditure programs would comprise those that are procyclical: those that spend more during economic booms. For example, staffing, maintenance, and police protection in vacation destinations may need to rise somewhat during booms, when more people can afford to travel. In practice, these and similar costs comprise too trivial a fraction of states' budgets to have much policy significance.

To be sure, not all countercyclical spending benefits low-income people. The federal government, for example, has provided costly loan guarantees and other subsidies for manufacturers, airlines, and other companies when economic conditions caused losses,³²² and federal deposit insurance comes to the fore when a recession causes more loan defaults than banks can handle. People of all income levels are more likely to retire and begin drawing Social Security benefits when recessions make jobs scarce. And unemployment insurance covers earners of all incomes.

At the state level, however, countercyclical programs disproportionately serve low- and moderate-income people. These programs include cash assistance, Medicaid, child care subsidies,³²³ and a host of services provided by county and municipal governments, often with state aid.³²⁴ Operating support for higher education also can have countercyclical effects to the extent it allows colleges and universities to respond to increased need for financial aid during slumps. Thus, at the state and local level, pressures on countercyclical programs typically result in losses to low- and moderate-income people.

States' revenues generally are elastic with respect to the business cycle: they rise in real terms during economic expansions while shrinking during downturns. Some taxes, however, are much more sensitive to the business cycle than others. Property tax revenues are among those that fluctuate the least because they depend on assessed valuations rather than current economic activity:³²⁵ a recession may depress the housing market, but it is unlikely to lead to a wide-scale reduction in assessments of the value of real estate. Income tax revenues fluctuate more with economic activity. Moreover, to the extent that low- and moderate-income people bear the brunt of economic downturns, revenues from flat-rate income taxes are likely to fluctuate more over the business cycle than are revenues from graduated taxes that draw a larger fraction of their receipts from more affluent people. Sales tax revenues generally are the most volatile: spending drops with income, and spending on items covered by the sales tax probably drops even

³²² See, e.g., Cheryl D. Block, *Overt and Covert Bailouts: Developing a Public Bailout Policy*, 67 IND. L.J. 951 (1992) (discussing government subsidies to Chrysler, Lockheed, and other large corporations on the brink of collapse and the corresponding policy implications).

³²³ The increased demand for child care subsidies during a recession may seem odd given that the recession reduces the number of jobs for which parents need child care. But recessions also depress wage rates and work hours, causing more workers who were able to afford child care on their own in a better economy to seek public assistance.

³²⁴ For example, public hospitals operate in good times and bad, but their uncompensated care burdens — and hence the subsidies they require — are likely to rise during economic downturns: some of their longstanding patients may no longer be able to pay, and private hospitals may send them patients that have lost their health insurance.

³²⁵ See REAGAN & SANZONE, *supra* note 36, at 38–39.

faster because households are less free to reduce their spending on other items, such as rents and mortgages. Thus, a state that depends heavily on the most procyclical revenue sources — sales taxes and flat-rate income taxes — will have larger revenue shortfalls in recessions than a state that leans more on noncyclical revenue sources such as property taxes and a graduated income tax. Conversely, once a state has reduced spending to equal available revenues in a downturn, a state that relies on property taxes and graduated income taxes will experience less of a budget surplus when the economy rebounds.

2. *The Competitive Disadvantage of Countercyclical Programs and Taxes.* — Cyclical state fiscal crises exert pressure across states' respective budgets. That pressure, however, is not evenly shared across programs. For several reasons, countercyclical programs come under disproportionately greater pressure during economic downturns and are likely to bear a disproportionate share of cuts.³²⁶ Similarly, noncyclical taxes — those best able to maintain their performance during economic downturns and moderate the need for budget cuts — also will face intense pressures for reductions during recessions. Moreover, in neither case is the end of the recession likely to result in the restoration of the recession-driven cuts. This section addresses these structural biases disadvantaging countercyclical programs.

(a) *Countercyclical Spending Programs.* — As discussed above, some programs are effectively exempt from significant budgetary pressure. Debt service and other legally obligated payments cannot be cut. Many large discretionary spending programs (for example, road, prison, and stadium construction) are either financed by bonds or carried out under long-term contracts with penalty clauses that eliminate any short-term savings from cancellation. This arrangement leads to

³²⁶ Based on my calculations from data contained in the NAT'L ASS'N OF STATE BUDGET OFFICERS, ANNUAL STATE EXPENDITURE REPORTS (1989 and 2001), states' spending on all public welfare programs declined from 4.9% to 2.2% of their total spending from 1989, the eve of the penultimate recession, to 2001, the last fiscal year for which states budgeted prior to the most recent recession. The share of state budgets dedicated to aiding low-income families was cut in half and assistance to childless adults was largely eliminated. (Because federal law makes it difficult for states to cut aid to the elderly and persons with disabilities, that aid likely remained constant.) To be sure, Medicaid, which also serves many low-income people, grew from 10.8% to 19.6% of states' budgets during this period. These increases, however, were driven by many factors other than compassion for low-income people. Health care costs throughout this period rose considerably faster than general inflation. See 2004 GREEN BOOK, *supra* note 255, app. C at 5–6. Moreover, the fastest-growing component of Medicaid spending is long-term care, which serves a large number of middle-income people and has a powerful provider lobby. See James W. Fossett, *Managed Care and Devolution*, in MEDICAID AND DEVOLUTION: A VIEW FROM THE STATES, *supra* note 261, at 106, 144–45. When Medicaid is excluded from states' budgets, most functions — elementary and secondary education, higher education, transportation, and miscellaneous expenditures — consumed roughly the same shares of states' budgets in 2001 as it did in 1989. According to my calculations, expenditures for corrections rose significantly over this period, while expenditures for public welfare shrank.

the perverse result that largely discretionary projects — those that state and local governments could most easily afford to postpone until better fiscal times — are the most fully immunized from budget cuts during fiscal crises.

In addition, the costs of the state government's physical plant — office space, classroom buildings, and the like — are largely immune from short-term reduction, as they often take the form of either mandatory debt service payments or long-term leases.³²⁷ Even without formal legal protection, many of the substantial operating costs of state government's infrastructure are effectively immune from cuts. A state facing a ten percent budget deficit is not going to close down the offices of ten percent of the legislators. States will be reluctant to lay off highly trained experts or specialized managers that may be difficult to replace once the crisis passes. Thus, if the state must reduce its overall expenditures by a given percentage, those programs that are not legally or practically exempt — such as most countercyclical programs — will have to bear a substantially greater cut to make up for those programs that are not contributing savings.

Even among nonexempt programs, those with countercyclical spending patterns are likely to face serious disadvantages. Because they generally spend appropriations rapidly, cuts in their budgets will produce immediate relief for strapped state budgets. By contrast, many of the savings from slow-spending programs will not affect outlays until subsequent fiscal years: twenty dollars of cuts may be required, for example, to achieve ten dollars of savings.³²⁸ Assuming they are faced with similar political resistance to each dollar of cuts in slow- and fast-spending programs,³²⁹ rational budgeteers will target

³²⁷ For other explanations of the relative strength of capital spending in state budgets, see Crain & Oakley, *supra* note 297, at 3; and Amihai Glazer, *Politics and the Choice of Durability*, 79 AM. ECON. REV. 1207, 1207 (1989).

³²⁸ This is simply the mirror image of the point made above, *supra* section IV.C.1, pp. 2622–23.

³²⁹ To be sure, interest groups supporting a slow-spending program may discount future outlays modestly in calculating their present value. Budgeteers also may persuade some naïve groups not to object strenuously to reductions in programs with outlays that will not occur until future years, as the funds cut may nonetheless be restored in a subsequent year before the outlays are due to occur. But savvy advocates draw no comfort from these claims for several reasons. First, such claims misunderstand the nature of slow-spending programs, which are structurally incapable of spending quickly because budget authority must be committed years in advance to produce outlays. Thus, to spend money building a prison in year three requires construction contracts to be signed in year one; cutting funds from the construction program in year one will make it impossible to spend that money by year three even if the state's budget improves or political forces reach a different constellation by year two. Second, the opportunity to seek additional funds in subsequent years is present whether or not the program is cut in the current year; the "opportunity" to seek restoration of cuts, even if timely restoration were possible, is indistinguishable from the opportunity the program's supporters previously had to seek further expansions. In fact, because program supporters who have accepted previous cuts must expend resources just to restore a budget's previous status quo, the value of the potential to seek additional funds will be substan-

fast-spending programs because doing so will achieve the required level of outlay savings in the current budget year with the lowest gross amount of appropriations cuts.

Countercyclical programs also fare badly in the political processes that states commonly rely upon to bring their budgets into balance when facing a large deficit. The brevity of states' legislative sessions — in some states limited to sixty days and in almost all convening just a few months before the state fiscal year begins on July 1³³⁰ — precludes a thorough reexamination of budgetary priorities or a protracted battle among competing interest groups. Accordingly, the starting point for many gubernatorial and legislative budget proposals is either a freeze at the prior year's level or an across-the-board reduction from that level. This is a sensible way of reaching a rapid political agreement: the current allocations of funding presumably reflect the relative strength of the competing interest groups, so a freeze or an across-the-board cut will not drive any one group into opposition (or facilitate formation of an obstructionist bloc of "losers").

For most programs, the impact of these freezes and cuts is transparent: a freeze requires a program to cut its budget enough to offset the effects of inflation, and a percentage reduction requires additional trims in the stated amount.³³¹ For a countercyclical program, however, the prior year's spending may significantly understate the current year's need. If an economic slump has increased the number of people needing or qualifying for aid by fifteen percent, the practical effect of a budget freeze is to reduce the percentage of need the program can meet by fifteen percent after the effects of inflation are taken into account:³³² under such circumstances, the program must either cut the value of the assistance provided to each recipient or deny aid alto-

tially diminished. Finally, supporters of slow-spending programs have the opportunity to substitute timing shifts — revising contracts to make payments due shortly after the close of the current fiscal year — in lieu of bearing actual cuts. (This opportunity obviously is largely unavailable to champions of fast-spending programs.) If anything, advocates for slow-spending programs might become even more incensed if budgeteers reject timing shifts to demand real cuts from their programs.

³³⁰ Alabama, Michigan, New York, and Texas have different fiscal years. See NAT'L ASS'N OF STATE BUDGET OFFICERS, *supra* note 250, at 4 tbl. A (reporting that all but four states' fiscal years begin in July).

³³¹ For a handful of procyclical programs, a freeze actually may not impair their capacity to meet public need. For example, when a recession reduces the number of commuters and tourists on the state's highways, the state's need for road maintenance crews and state troopers may decline.

³³² Assuming three percent inflation, a program that provided \$1 million of aid in the prior year would require about \$1.18 million to meet the same proportion of the now-increased need. Freezing the program's budget at \$1 million would represent a \$180,000 cut, or an effective reduction of a little over fifteen percent.

gether to a larger proportion of needy claimants.³³³ The program's champions might argue that any across-the-board reduction ought to be applied to the program's projected, rather than historical, budget. But suspicions about the subjectivity of budgetary projections and concerns about undermining the apparent evenhandedness of across-the-board freezes and cuts make this a difficult sell.

Particularly severe difficulties arise when legislatures or governors must achieve additional savings in the middle of a fiscal year to offset unanticipated spending — commonly on countercyclical programs — or weaker-than-anticipated revenues. Here again, debt service and other contractually obligated expenditures are immune from consideration, forcing the remainder of the budget to bear a disproportionate share of reductions. Yet even among the remaining portion of the budget, many programs are effectively off limits. Because income taxes are calculated on an annual basis, raising rates or trimming deductions and credits midyear has a prohibitively retroactive component. Reductions in slow-spending programs that have not been contractualized — such as major capital acquisitions — may produce few or no savings in the time required if their costs are expected to fall in the following budget year. Only cuts to fast-spending programs — such as personnel or direct grants-in-aid — are likely to achieve significant outlay reductions within the months remaining in the fiscal year. Even here, however, rules requiring advance notice of layoffs may permit only modest savings from midyear personnel cuts. Thus, even if policymakers might prefer to “spread the pain,” only a handful of programs are realistically available for cuts to bring the budget back into balance. Those programs are disproportionately countercyclical programs serving low- and moderate-income people.

This would be a serious but transitory problem if countercyclical programs enjoyed corresponding advantages during economic recoveries. Alas, they do not and hence are unlikely to recover the ground they lose when states slip into fiscal crisis. Having reduced the number of people served or the amount of aid provided when their budgets were cut, they now must compete with other existing and proposed programs for resources to expand their services back to the prior level. New programs may enjoy some advantage, as politicians prefer initiating projects that voters will readily identify with them over modifying programs their predecessors designed. More significantly, however,

³³³ A third possibility is to manipulate application or requalification procedures to increase the cost of participating and thus discourage some eligible claimants from pursuing benefits. *See generally* Super, *supra* note 34 (arguing that these tactics are becoming increasingly dominant means of restricting payments without spurring political opposition). In effect, however, this combines an inefficient reduction in (net) benefit level with an informal tightening of eligibility criteria. *See id.* at 850–56.

countercyclical programs will see demand for their services decline as the economy improves and will naturally reduce their spending further unless the legislature takes affirmative steps to expand their coverage. Even a five percent increase in eligibility or benefit levels may be more than offset by falling demand, leaving the program with a still-smaller budgetary baseline. Thus, these programs' budgets are vulnerable to budget-driven cuts in bad economic times and demand-driven reductions in good ones. By contrast, noncyclical programs experience stable demand; any expansions in their services are accompanied by an expansion in the budgetary baselines from which their budgets in future years will be calculated.

(b) *Noncyclical Revenue Sources.* — To stimulate a state's economy during recessions and to help keep it from overheating during booms, Keynesian economics favors countercyclical taxes, all other things being equal. Under this approach, receipts from income and sales taxes decline with the economy, wages, and consumer spending, leaving more money in a slack economy, then rise as the economy recovers. Balanced budget requirements, however, largely prevent states from providing any net stimulus to the economy. As a result, if states' revenues are countercyclical, their spending must be procyclical to compensate. States, for example, might build new highways, prisons, schools, and college dormitories during booms. This spending would be mistimed from a macroeconomic point of view, but the taxes supporting it would not be.

If the federal government bore sole financial responsibility for means-tested programs and other countercyclical spending, this reliance on countercyclical taxes might be a plausible approach given states' constitutional inability to operate on a net countercyclical basis. With the increasing devolution of countercyclical spending programs to states, however, states' reliance on countercyclical revenue sources devastates aid to those displaced during recessions.³³⁴ Even before devolution, countercyclical revenue streams undermined the states' ability to fund their share of countercyclical programs' costs. This problem continues in Medicaid and is even more severe in programs in which the federal government has capped its financial commitment.

The most stable funding source for countercyclical programs would be procyclical taxes. Having taxes take more money out of the economy as the economy slows would be dubious macroeconomic policy, but it would help the state afford programs for persons in economic

³³⁴ The scale of dislocation during even a mild recession swamps the capacity of private charities to provide relief. In addition, charitable donations are themselves procyclical, but legislation regulating tax-exempt status makes it difficult for charities to build up reserves during economic expansions even if they are inclined to do so. Procyclical funding thus leaves charities with the least capacity to provide aid during those points in the business cycle when aid is needed most.

distress. In practice, however, no significant state taxes are procyclical. Thus, states' tax revenues come almost entirely from countercyclical taxes — those that shrink with the economy — and noncyclical taxes with yields that vary relatively little with the business cycle. Therefore, the more a state can rely upon noncyclical taxes, the less it will have to cut spending during economic downturns. Similarly, the more a state relies on noncyclical revenue streams, the less it will experience huge cyclical surpluses during booms, which induce wasteful spending or permanent tax cuts, which in turn compound the state's fiscal difficulties during the next recession. Unfortunately, noncyclical taxes, like countercyclical spending programs, come under intense pressure during downturns, with the result that they are likely to ratchet down over time.³³⁵

All household expenditures tend to receive additional scrutiny during hard times, and tax payments certainly are no exception. Countercyclical taxes shrink along with households' budgets. A household with lower income pays less income tax;³³⁶ a household purchasing fewer taxable items pays less sales tax.³³⁷ Property taxes, however, remain relatively constant even as an economic downturn causes households' incomes to decline. Thus, property taxes tend to consume an increasing proportion of households' incomes, drawing critical attention.³³⁸ Families hard-pressed by an economic downturn will be eager to have any tax burdens lifted, but they will be acutely conscious of property taxes. The potential enforcement of property taxes with a lien on the family home, and those taxes' perceived targeting of homeowners,³³⁹ can make them seem particularly threatening. It thus

³³⁵ See Glenn W. Fisher, *The Changing Role of Property Taxation*, in FINANCING STATE AND LOCAL GOVERNMENTS IN THE 1980S: ISSUES AND TRENDS, *supra* note 176, at 37, 52–58 (charting the property tax's decline and warning of potentially dangerous consequences); NAT'L CONFERENCE OF STATE LEGISLATURES & NAT'L GOVERNORS' ASS'N, FINANCING STATE GOVERNMENT IN THE 1990S, at 57–62 (Ronald Snell ed., 1993) (same).

³³⁶ More formally, income taxes are elastic with respect to income. See SCOTT MACKEY, NAT'L CONFERENCE OF STATE LEGISLATURES, TAX POLICY HANDBOOK FOR STATE LEGISLATORS 10 (1997).

³³⁷ Sales tax elasticity depends upon what is included in the taxable base. Regressive sales taxes that include food are less elastic than those comprising a higher percentage of discretionary purchases. See *id.* at 16–17. Thus, states with progressive sales taxes will be most vulnerable to revenue losses during economic downturns when more consumers limit their expenditures to tax-exempt necessities.

³³⁸ See DAVID H. BRADLEY, CTR. ON BUDGET & POLICY PRIORITIES, PROPERTY TAXES IN PERSPECTIVE 1 (2005), available at <http://www.cbpp.org/3-17-05sfp.pdf>.

³³⁹ Because landlords pass on property taxes through higher rents, the true incidence of these taxes is unlikely to be very different between homeowners and renters. Moreover, income taxes may also be enforced with liens on the homes of those failing to pay. Thus, property taxes' perceived special hostility toward homeownership has little basis in reality. Expressively, however, they appear to punish an important American value. See David A. Super, *The New Moralizers*:

should not be surprising that states generally have had limited direct access to property tax revenues. This reliable but unpopular tax primarily funds schools and other services that property owners value enough to tolerate the tax through recessions.

If distressed voters' complaints lead to cuts in property taxes, the state's tax system will become even more countercyclical. Sales and income taxes will grow rapidly during the next expansion; as these taxes become a larger share of the state's overall tax base, the rate at which state revenues grow during booms will also increase. Just as many budget cuts made involuntarily during revenue crises may be relatively inefficient,³⁴⁰ so, too, the unplanned spending choices governments make when suddenly flush may deliver inferior value. Moreover, these cyclical revenue surges are likely to prompt politicians to curry the voters' favor with tax cuts that will not only prevent spending programs from recovering fully from cuts inflicted during the prior downturn, but also further weaken the state's finances during the next slump.

Here again, the process is unlikely to reverse itself during other phases of the business cycle. During booms, states will face pressure for tax cuts because they do not need all of the revenues they are reaping, and during recessions, middle-income families will seek tax cuts to help them make ends meet. The state will not necessarily honor all of these calls for tax cuts. Indeed, upon exhausting the legally and politically acceptable spending cuts and borrowing devices, states may even raise taxes modestly during a recession. Over time, however, the combined effect of these cyclical political pressures — one increasing the demand for tax cuts, the other reducing the near-term cost of providing them — is likely to continue eroding the state's financial capacity.³⁴¹

A special problem, exacerbating all of these effects, occurs under state tax and expenditure limits. At a minimum, these limits cap the state's ability to increase spending on countercyclical programs during downturns and compel tax cuts during booms that exacerbate states' vulnerability during the next recession. Even more troubling is a par-

Transforming the Conservative Legal Agenda, 104 COLUM. L. REV. 2032, 2069 (2004) (finding an increasing rhetorical pattern that treats taxes as punishing the activity taxed).

³⁴⁰ To the extent the state does try to extract savings from programs covered by long-term contracts, it may have to pay penalties. Expert staff laid off during a recession may have to be replaced at a premium if they find other jobs before the state can recall them. More generally, if the savings that can be achieved with reasonable efficiency fall short of the amount needed to close a budget hole, the state will have to rely upon inefficient cuts.

³⁴¹ See James M. Poterba, *State Responses to Fiscal Crises: The Effects of Budgetary Institutions and Politics*, 102 J. POL. ECON. 799 (1994); James A. Zingale & Thomas R. Davies, *Why Florida's Tax Revenues Go Boom or Bust, and Why We Can't Afford It Anymore*, 14 FLA. ST. U. L. REV. 433, 438–39, 458–60 (1986).

ticularly pernicious feature of Colorado's Taxpayers' Bill of Rights³⁴² (TABOR) — and similar proposals pending in other states — which ratchets down revenues and spending over time. TABOR bases permissible taxation and spending on the previous year's levels, adjusted for inflation and population growth.³⁴³ During booms, when revenues grow faster than those factors, this formula requires tax cuts, as in other states with revenue limits. During recessions, however, revenues decline below the ceiling. The reduced revenues for that year will form the base from which future years' limits are calculated. Therefore, unless the legislature raises taxes to the permissible limit each year — an unlikely event politically — the applicable limit will ratchet down during each slump and be unable to return to its pre-recession levels afterward. Over several business cycles, this effect can dramatically reduce revenues and hence spending, with countercyclical programs likely suffering the most damage.³⁴⁴

Even without the compounding factor of tax and expenditure limits, however, the differing sensitivities of various spending programs and taxes to the business cycle lock state budgets into alternating booms and busts. Over time, these alternations will tend both to shrink states' revenue bases and to make those revenue bases more countercyclical — and hence even less able to support countercyclical spending programs.

3. *Differences Between Popular and Vestigial Programs.* — The political processes that give rise to spending programs also vary considerably. Some programs have more-or-less permanent support from particular interest groups. For example, year in and year out, the same groups are likely to support higher education funding or nursing home coverage in the state's Medicaid program. Other programs, such as the state police or corrections, may not depend specifically upon interest group advocacy for continued funding, but the political consequences of cutting them significantly remain fairly constant over time.

Still other programs, on the other hand, are established or expanded in response to transitory political stimuli. For example, a poli-

³⁴² COLO. CONST. art. X, § 20.

³⁴³ See *id.* § 20(7)–(8); see also NICHOLAS JOHNSON ET AL., CTR. ON BUDGET & POLICY PRIORITIES, COLORADO'S FISCAL PROBLEMS HAVE BEEN SEVERE AND ARE LIKELY TO CONTINUE: COLORADO'S STRINGENT "TABOR" LIMIT HAS WORSENED THE PROBLEMS 6 (2004), available at <http://www.cbpp.org/3-17-04sfp.pdf>.

³⁴⁴ For example, although TABOR permitted Colorado to raise \$8.1 billion in 2002, the State only actually received \$7.8 billion due to the economic downturn and TABOR-driven tax cuts. As a result, its permissible revenue ceiling for 2003, which would have been \$8.7 billion had the state collected the full amount permitted the previous year, was only \$8.3 billion. This \$400 million reduction in the revenue ceiling will apply to all future years regardless of economic conditions; Colorado can never catch up. See JOHNSON ET AL., *supra* note 343, at 6. For this reason, bond rating houses lowered Colorado's credit outlook and *Governing* magazine ranked Colorado's finances as among the worst-managed in the country. See *id.* at 5.

tician may create a program to fulfill a campaign promise, then leave office or move on to other concerns. The September 11 attacks engendered strong sympathy for aiding New York City; as those attacks receded into memory, that aid lost its special appeal. Some programs for low-income people similarly reflect short-term stimuli. Many general assistance programs for childless adults originated as responses to the mass dislocations of the Great Depression; with that crisis now a distant memory, these programs may have become politically brittle due to the lack of public sympathy for the recipient population. The increasing number and visibility of homeless people in the 1980s impelled the creation of programs to prevent homelessness and to aid those already on the streets. As society has become more accustomed to homelessness, or has found ways of making it less visible, the impetus for these programs has dissipated.

To the extent that means-tested programs have long-term supporters, they are still unlikely to be able to protect those programs during fiscal crises. A small, committed core of true believers may be able to block attempts to eliminate a vestigial program, particularly if it lacks sufficient funding to be an attractive target for raids. The fiscal crises that accompany recessions, however, are likely both to create pressures for budget cuts that few programs can resist and to increase interest groups' incentives to raid even relatively small programs. Absent a recurrence of the circumstances that led to its creation, a program's supporters will have virtually no chance of restoring the lost funding when the state's fiscal picture improves.

The boom-and-bust cycles that states' fiscal constitutions compel may be particularly devastating to programs serving low-income people for another reason. The stimuli that generate public support for these programs, such as news stories about families in hardship, are far more likely to occur during economic downturns, when material hardship is more widespread. At these times, however, states' cyclical fiscal crises prevent them from responding vigorously. A strong enough public outcry may yield *some* new funding, but only a fraction of what similar public concern could have generated during a boom. By the time the state again has the fiscal capacity to act forcefully, the sense of urgency is likely to have dissipated. Thus, means-tested programs are likely to find themselves at a disadvantage even relative to other programs created in response to fleeting political concerns: their initial funding is likely to reflect their support less adequately, yet they face the same perils during fiscal crises.

V. TOWARD A NEW FISCAL FEDERALISM

The foregoing sections paint a bleak picture of states' fiscal capacities. Particularly with regard to countercyclical programs, states' fiscal constitutions are largely incapable of reflecting fairly the political

wishes of their citizens. States' cyclical fiscal crises suggest that they may be unreliable partners of the federal government in funding programs for low- and moderate-income people. Against this backdrop, the reader could be forgiven for concluding that involving states in the funding of important federal programs is an enterprise so manifestly doomed as to be not worth pursuing.

Giving up on cooperative fiscal federalism would, however, be a mistake. States have a central role in our system of government. They have much to contribute, both conceptually and administratively. States' participation in federal programs gives them direct opportunities to raise design and administrative problems in those programs with federal policymakers, free of the pressure to conform that subordinate federal employees may feel. And because state employees typically earn considerably less than federal civil servants, states often can administer programs more inexpensively. The value of state and local experimentation may be even greater for fiscal matters than it is for regulatory ones.³⁴⁵ And state participation in design and delivery of services may allow those services to be tailored to local conditions in ways that will improve their effectiveness and acceptance.

This Part sketches some steps that policymakers at both levels of government can take within the current broad political framework to repair cooperative fiscal federalism to the benefit of both partners. In particular, it seeks ways of ameliorating the strong biases in states' fiscal constitutions and of designing federal programs to respond more sensitively to the remaining bias. Section A proposes reforms to states' budget processes; section B explores reforms at the federal level.

A. Reforming State Budgetary Procedures

States' processes for crafting fiscal policy require considerable updating. Much has changed since they were put in place, over a century ago in many cases. Economists now have a far more sophisticated understanding of the business cycle. Partly as a result, the roles of state governments, and their relationships with the federal government, have changed dramatically. People and capital have become far more mobile. And, not surprisingly, with many decades of practice, policymakers have developed ways of evading the limits placed on their ability to bind future legislatures. The pursuit of these loopholes distorts the political process.

As part of their budgetary reforms, states should eschew artificial tax and expenditure limits. Nothing in recent history suggests that opponents of taxation require extraordinary protection against the regular majoritarian process; without these limits, huge tax cuts have

³⁴⁵ See *supra* pp. 2567–68.

passed at both the federal and state levels despite impassioned pleas for greater fiscal caution and the preservation of government services. Even without the insidious downward ratchet of Colorado's TABOR amendment and its imitators, these devices continually obstruct reasoned fiscal policymaking. Among other things, these limitations leave state and local governments ill-prepared to respond to new demands for public services, including both recessions and emergencies such as those springing from the September 11 attacks.

States should not, however, abandon their constitutional balanced budget requirements completely. The massive federal tax cuts enacted without fiscal offsets from 2001 through 2003 suggest that antitax extremists would likely seize that opportunity to devastate state budgets over the long term. The lower profiles of state governments make such covert fiscal sabotage more viable in state capitals than it has been in Washington. Just as balanced budget rules were originally enacted in part to avoid covert raids by economic groups, they should be retained to avoid covert raids by groups of ideologues. The advent of legislative term limits in many states further reduces the likelihood that legislators will concern themselves with the long-term fiscal consequences of their actions.

A middle ground is needed that will preserve long-term fiscal discipline among often short-sighted legislators and governors while reducing state budgets' sensitivity to the fluctuations of the business cycle. The following sections provide a sensible alternative to the extreme tax and expenditure limitations being advocated by those that wish to "reduce [government] to the size where [they] can drag it into the bathroom and drown it in the bathtub."³⁴⁶ Taken together, these reforms would introduce a modestly countercyclical character to state budgeting without abandoning the fundamental concept of annual balance. They also would reduce biases against countercyclical aid.

1. *Financing Public Programs During Economic Downturns with Open Borrowing and Rainy Day Funds.* — States can reduce their structural biases against countercyclical programs and reduce the severity of swings in their fiscal positions throughout the business cycle in part by reforming their rules for borrowing and saving. This strategy would include two complementary components.

First, states and localities should be permitted to borrow openly during economic downturns. As noted above, a considerable amount of de facto borrowing took place in the recent fiscal crisis. The inability to issue bonds openly, however, forces states to pursue inefficient and less transparent means of accomplishing the same goal, such as as-

³⁴⁶ *Morning Edition: Roll Call Question and Answer* (NPR radio broadcast, May 25, 2001) (quoting Grover Norquist, President, Americans for Tax Reform).

set sales. Increasing a state's debt limit when unemployment rises and lowering it when the economy improves could produce better value for states. It also would allow budgeting rules to be rewritten to curtail the existing methods of evading debt limits and to guard against extravagance during flush economic times.

Second, states' rainy day funds can partially counteract the effects of the business cycle if properly funded. In practice, their funding has fallen far short of meeting states' needs during economic downturns.³⁴⁷ Even states that appeared to have relatively robust rainy day funds at the beginning of a recession exhausted those funds long before their revenues began to rebound. Although an economic slump of greater duration or severity than the preceding boom could exhaust even a conscientiously maintained rainy day fund, lack of political commitment is the primary cause of this deficiency. Operating as they do, as political gifts from one period's policymakers to some unknown successors, rainy day funds in their current form seem unlikely to provide a comprehensive solution to state fiscal crises.³⁴⁸

Some measures, however, could help rainy day funds play more substantial roles. First, deposits into and expenditures from rainy day funds should be exempt from balanced budget calculations and expenditure limits.³⁴⁹ Second, state law should require legislatures to set aside monies for their rainy day funds when unemployment dips below a certain level,³⁵⁰ with the amount of the contribution depending upon the strength of the economy.³⁵¹ This, too, would allow states' budgets

³⁴⁷ BOB ZAHRADNIK & ROSE RIBIERO, *CTR. ON BUDGET & POLICY PRIORITIES, HEAVY WEATHER: ARE STATE RAINY DAY FUNDS WORKING?* 3-5 (2003).

³⁴⁸ To the extent that other measures proposed here moderate cyclical pressures on state budgets, those changes could further discourage governors and legislators from setting funds aside for rainy day funds. In particular, if countercyclical reforms depend upon the actual degree of states' fiscal distress, they could create a moral hazard, further discouraging states from averting that distress through contributions to rainy day funds. For this reason — and to minimize difficult measurement problems — relief should be tied to economic changes (and those changes' impact on states' revenue bases and demands for services), not to states' actual fiscal conditions.

³⁴⁹ One of the more bizarre aspects of Colorado's TABOR amendment is that it counts expenditures from the state's rainy day fund toward annual expenditure limits. *See* COLO. CONST. art. X, § 20(1)(e); *see also* JOHNSON ET AL., *supra* note 343, at 6. Although a rainy day fund can offset some recession-induced declines in revenues, it cannot reliably meet the increasing demand for services from people displaced in a recession. Thus, budgetary rules passed in the name of fiscal responsibility actually reduce lawmakers' incentives to invest in rainy day funds.

³⁵⁰ An alternative approach would require contributions whenever revenues exceed projections or whenever spending on entitlements falls short of budgeted levels. Unless the state has a means of protecting its projections from political tampering, however, this strategy would invite gaming. It also would require contributions when the economy is improving, without regard to its absolute strength. Thus, a state just coming out of a severe recession would have to contribute to the fund even though its fiscal position is far below historical levels. By contrast, a state with plentiful but stable revenues in the midst of a boom would not have to contribute.

³⁵¹ Required contributions should not be calculated as a percentage of states' projected surpluses. Doing so would give policymakers a perverse incentive to shrink those surpluses arbitrar-

to provide a modest degree of countercyclical correction. It also would reduce the funds available for unnecessary and unaffordable spending projects and tax cuts during economic booms.

2. *Restricting Borrowing for Capital Projects.* — State and local governments should have less ability to borrow for capital projects. The timing of many of these projects is essentially discretionary, and a state's borrowing to build a stadium or expand its highway system shifts irreducible costs into future periods of economic crisis when the state can ill-afford them. Requiring states to fund these projects out of their operating budgets will push states to concentrate them during periods of fiscal health, when the projects are most affordable. The state might not pay for a multiyear project in a single year, but it should be required to fund the project up front. Thus, in the language of the federal budget, the balance of a state's budget should be determined in terms of budget authority instead of outlays. The legislature would be required to pay for all fiscal commitments it makes whether or not the money in question is spent immediately. Conversely, the state would exclude expenditures committed to large capital projects authorized and funded in prior years when balancing its budget in an economic downturn. This accounting method could lead to greater scrutiny of large capital projects than commonly occurs now, when legislators may push most of the costs into future years. It also may reduce the incentive during economic booms to enact unaffordable tax cuts that exacerbate subsequent crises.

3. *Balancing Budgets, Not Outlays.* — States also should explicitly adopt the dichotomy between budget authority and outlays central to the federal budget process. Because these concepts are real facets of public finances, they already have some implicit recognition in states.³⁵² The lack of clear, explicit definitions, however, has invited considerable confusion and obfuscation.³⁵³ A clear definition of these

ily with midyear spending increases or tax cuts. Instead, contributions should be calculated from a formula relying upon indicators of the state's economic health — such as the unemployment rate — that indicate its likely revenue base and demand for countercyclical aid relative to the average for the business cycle.

³⁵² For an in-depth discussion of how such long-term planning might be accomplished, see BRUCE BAKER ET AL., INTERTEMPORAL STATE BUDGETING (Nat'l Bureau of Econ. Research, Working Paper No. 9067, 2002); and NAT'L ASS'N OF STATE BUDGET OFFICERS, BUDGETING AMID FISCAL UNCERTAINTY: ENSURING BUDGET STABILITY BY FOCUSING ON THE LONG TERM (2004).

³⁵³ An example of such obfuscation can be found in states' financial reporting for the TANF grants and State Children's Health Insurance Program (SCHIP) block grants in the late 1990s. In both programs, states had been running considerable surpluses, which led Congress to discuss cutting TANF and reallocating unspent SCHIP funds to other states. When Congress asked for more information, some states' financial reporting to the U.S. Department of Health and Human Services accurately showed large and building surpluses. Others, however, consistently designated large amounts of money "obligated" — and hence presumably unavailable for transfer or to

two concepts, and financial reports comparing states' positions under each of them, would be an important improvement in itself.

Adopting this dichotomy, the best approach is one that construes balanced budget requirements as applying only to the budget as originally enacted by the state. If subsequent economic changes in the economy cause revenues to fall or expenditures to rise, the state should be permitted to borrow to close the gap. Conversely, if the economy improves and the state runs a surplus, the legislature and governor should not be permitted to invade those funds for spending increases or tax cuts.

A more modest approach would be one that adopts federal budget law's treatment of entitlements and revenues.³⁵⁴ Rather than holding states accountable for the actual performance of these parts of their budgets, states would only be required to pass budgets that were estimated to be balanced. Appropriations for entitlements would be deemed equal to the cost of benefits paid under the terms specified in the legislature's budget. If demand for benefits fell short, the appropriation would automatically shrink, leaving no excess funds to be reallocated. Increased spending driven by unanticipated demand would not require emergency cuts or a supplemental appropriation.

These reforms would allow states to spend federal funds more efficiently. At present, the inability to overspend fixed appropriations forces state administrators to err on the side of underspending. In programs with federal support, this effectively limits the states' ability to draw down federal funds. In matched programs, the forced parsimony with state funds concomitantly limits the federal funding coming into the state. In categorical and block grant programs with fixed federal funding, the inflexibility of state appropriations forces state officials to err on the side of underspending their federal grants, as they cannot make up for any shortfalls with state funds. Due to the inevitable uncertainties of estimation,³⁵⁵ significant federal and state appropriations may be left on the table. Over time, a system that severely punishes overspending but not underspending will result in levels of program activity consistently below those that Congress and state legislatures selected when they passed appropriations acts.

offset future federal spending reductions — even though most of these funds did not subsequently appear as expenditures. These states might have had very long-term, slow-spending contracts for services — but they more likely had clever budget officers.

³⁵⁴ This approach would continue current practices for programs whose spending depends upon annual appropriations rather than upon the number of people eligible and applying for benefits. Thus, money that an art museum had not spent by midyear on acquisitions could be reallocated to the tourism promotion budget.

³⁵⁵ See Super, *supra* note 167, at 672–82 (describing the inefficiency and error inherent in attempts to estimate the spending of programs with capped funding).

More importantly, this accounting method would reduce, though not eliminate, state budget rules' bias against relatively fast-spending programs, including those benefiting low- and moderate-income people.

4. *Construing Linkages Between Federal and State Tax Systems.* — Linking federal and state taxation systems makes inherent sense. As noted above, reducing differences between the two systems saves resources for taxpayers and states alike, while also improving compliance. Also, somewhat paradoxically, states conforming to federal definitions have more flexibility to shape their own revenue policies than those wasting taxpayers' time and their own administrative resources implementing idiosyncratic definitions of basic concepts.³⁵⁶

Congress's recent habit of changing those definitions in ways creating sudden, large gaps in states' budgets, however, endangers the vitality of linkage and the efficiencies it brings. The simplest and best solution to this problem is for Congress to craft its tax cuts in terms of rate reductions, preserving the stability of the tax structure it shares with the states. Given that Congress has shown little sensitivity to this problem, however, state-level remedies are urgently needed.

Under some state revenue codes, the linkage with the federal system is clear and inescapable. In many instances, however, references to federal definitions and terms are ambiguous. For example, when a state legislature establishes a tax of five percent on federal adjusted gross income, it could mean adjusted gross income as defined by the federal government at the time the legislature acted, or it could mean adjusted gross income as defined by the federal government when the tax is imposed. The former answer produces the substantive result — the level of revenues — the legislature envisioned; the latter achieves the legislature's presumed procedural goal of simplification. The latter, allowing state tax liability to decline with liberalization of federal definitions, has the effect of allowing Congress to legislate reductions in state taxes — and to do so without purporting to invoke its powers of preemption.

As the Court's new federalism jurisprudence makes clear, federal judges should not presume congressional intrusions into the basic workings of state government absent a clear statement of congressional intent.³⁵⁷ State courts should adopt a similar policy. Without a clear indication that the state legislature intended tax policy to vary with federal changes, and with Congress presumed not to be interfering in state tax policy, state courts should hold that their legislatures intended

³⁵⁶ See *supra* p. 2594–95.

³⁵⁷ See *Gregory v. Ashcroft*, 501 U.S. 452, 460–61 (1991) (“[I]t is incumbent upon the federal courts to be certain of Congress’ intent before finding that federal law overrides’ this balance.” (quoting *Atascadero State Hospital v. Scanlon*, 473 U.S. 234, 243 (1985))).

to rely upon the then-existing definitions in federal tax law. Should the state legislature prefer to preserve alignment with the federal system, it can do so by enacting appropriate budgetary offsets, something courts are ill-equipped to do.

5. *Budget Transparency.* — Writing in 1915, Professor James Q. Dealey declared that “[n]o state yet has a really good budget system[,] but there are signs of promise.”³⁵⁸ Almost a century later, the wait continues. Fortunately, over that period, and particularly in the three decades since enactment of the Congressional Budget and Impoundment Control Act of 1974,³⁵⁹ policymakers have learned a great deal about how to improve the clarity of budgeting choices.

Although not a perfect analogue, the federal budget process³⁶⁰ provides a useful starting point for the consideration of helpful state reforms. Among the most basic rules that many states lack is a requirement of clear, detailed statements of past, current, and projected expenditures for all state programs. When Medicaid costs soar, for example, lawmakers should be able to assess whether increased provider reimbursement rates, increased provider utilization, expensive new prescription drugs, increased enrollment, enrollment of an increasingly ailing population, or some combination of these or other factors is responsible, as each might call for a different policy response — or none at all. State budget analysts should be required to prepare and present estimates for each major tax and spending initiative, showing optimistic, pessimistic, and intermediate impacts and explaining the assumptions behind each. These estimates should include the next ten years in order to reduce legislatures’ opportunity to conceal long-term costs by shifting them beyond the budget year.³⁶¹

Having baselines that reflect changing needs for services can also reduce the attractiveness of simple nominal dollar freezes or across-the-board reductions. Programs that, for demographic or economic reasons, are likely to experience reduced demand will be less likely to retain their unneeded surpluses, while legislatures can calculate the budgets of programs with rising demand based on more realistic estimates of the costs of maintaining current services to the same fraction of the eligible population. Greater transparency in state budget processes also is likely to reduce vulnerability to impetuous or corrupt deci-

³⁵⁸ DEALEY, *supra* note 232, at 236 (footnote omitted).

³⁵⁹ Pub. L. No. 93-344, 88 Stat. 297 (codified as amended primarily in scattered sections of 2 and 31 U.S.C.).

³⁶⁰ See generally SENATE COMM. ON THE BUDGET, 105TH CONG., THE CONGRESSIONAL BUDGET PROCESS: AN EXPLANATION (Comm. Print 1998), available at http://www.senate.gov/~budget/republican/major_documents/budgetprocess.pdf.

³⁶¹ Cf. H.R. Con. Res. 67, 104th Cong. § 202(b)(2) (1995) (enacted) (now-expired Senate rules requiring all tax and entitlement legislation to conform to budgetary limits for the first year, the first five years, and the second five years after enactment).

sions that hobble states' long-term solvency and their ability to respond to economic downturns.

B. The Federal Role

States' current structural incapacity to provide consistent support to countercyclical programs, particularly those in aid of low-income people, poses two distinct challenges for the federal government. On the one hand, it may need to take additional measures to stimulate the economy during recessions, and to cool it during booms, in order to offset the effects of state budget policies. Stronger support for countercyclical aid for low- and moderate-income people provides one important means of doing so. On the other hand, the federal government also has a strong interest in improving states' capacity to choose and implement fiscal policies without the chaos and waste of an exacerbated boom-and-bust budgetary cycle. Section 1 suggests some ways of moving toward both of these objectives by restructuring federal spending programs. Section 2, however, cautions that these reforms may be largely for naught if the federal government continues cavalierly to disrupt states' capacity to raise revenues.

1. *Spending Programs.* — The most fundamental reform needed to improve federal-state programs to assist low- and moderate-income people is a theoretical one. Three-quarters of a century after the federal government first intervened on a broad basis to help state and local governments relieve people displaced during the Great Depression, the basis of that intervention should be made clear: state and local governments do not need federal leadership nearly so much as they need federal fiscal capacity. Programs built on the leadership model tend to be disbanded when social changes rob the content of that leadership of political support. To be sure, the compensatory model often will preserve much of the funding of the disbanded program for a time, perhaps in the form of a block grant. Funding for most programs relying on the compensatory model, however, tends to erode fairly quickly.

Accepting that the superior capacity model is the primary justification for federal financial participation in cooperative federal-state programs would avoid the collapse of these programs when the particular direction in which the federal government has been leading falls out of favor. For example, instead of converting AFDC to a block grant and, over time, forfeiting the federal government's superior fiscal capacity, that program's open-ended match should have been retained but its

content adjusted to reflect changed norms.³⁶² Further, the adoption of the superior capacity model may allow states greater flexibility than the leadership model allows by responding to concern about federal mandates.³⁶³

Greater reliance on the superior capacity model also would indicate several helpful proactive changes the federal government should consider. First, states' fiscal limitations, particularly during recessions, should lead federal policymakers to assume full responsibility for all countercyclical programs' financing. One successful example of this approach is the Food Stamp Program, which, along with unemployment compensation, is one of the two most effective countercyclical programs,³⁶⁴ and provides benefits funded entirely by the federal government. States retain involvement through administering the program and providing half of the program's administrative costs. Consistent with pluralist and comparative process visions of federalism, states also have broad policymaking authority over matters on which local variation might be necessary or instructive, such as the design of work programs mandated by the Food Stamp Act.³⁶⁵ If the federal government is not prepared to increase its overall financial support of state governments, it could fully finance countercyclical programs in exchange for a reduction of funding for other, noncyclical programs that states are better able to support on their own.

Second, to the extent it wishes to continue to involve states in financing these programs, the federal government should adjust the matching rates to respond to the business cycle. For example, rather than establishing an average fifty-seven percent matching rate through good times and bad, Medicaid should provide considerably more generous matching rates when unemployment rises and should require states to assume half or more of the program's costs when unemploy-

³⁶² See David A. Super, *Are Rights Efficient? Challenging the Managerial Critique of Individual Rights*, 93 CAL. L. REV. (forthcoming July 2005) (arguing that elimination of the federal entitlement actually undermined the 1996 welfare law's substantive purposes).

³⁶³ As discussed above, the superior capacity model generally requires programs to impose sufficient conditions to ensure that states are spending the funds consistent with the purposes intended by the federal government. It lacks, however, the leadership model's presumption that states lack sufficient vision and need guidance from Washington.

³⁶⁴ Effectiveness here is defined in terms of elasticity of participation with respect to unemployment. Food stamp participation rises by roughly six people for every ten additional people that become unemployed. Telephone Interview with Dorothy A. Rosenbaum, former Analyst, Congressional Budget Office (Sept. 15, 1997). Programs with substantial state funding of benefit costs, such as Medicaid and SCHIP, change by only a fraction of that amount. *Id.* Indeed, cash assistance programs funded with the TANF block grant continued to shrink throughout the recent economic slump, even as the number of families in poverty rose. States applied the savings to meet other budgetary needs when their general revenues stagnated or declined. Full federal funding would eliminate states' incentives to restrict eligibility or to discourage applications during economic downturns.

³⁶⁵ See 7 U.S.C.A. § 2015(d)(4) (West 1999 & Supp. 2004).

ment falls.³⁶⁶ Like other reforms discussed above, this approach would have the helpful secondary effect of absorbing excess state funds during economic booms and thus reducing temptations for fiscal imprudence. The federal government also could replicate the example of its other leading countercyclical program, unemployment compensation, and routinely loan funds to states to cover benefits during economic downturns.³⁶⁷

And third, with the states unable to support countercyclical fiscal policy — and often compelled to undermine it both in expansions and in recessions — the federal government should strengthen its own capacity to provide countercyclical correction.³⁶⁸ One approach would be to make some permanent provision for automatic aid to states during economic downturns. Waiting for a fiscal crisis to develop enough visibility to induce Congress to act ensures that considerable damage already will have occurred.³⁶⁹ Although Congress did provide a modest amount of such aid during the current fiscal crisis, it came more than two years after the onset of the recession and expired while states were still in distress.³⁷⁰

2. *Revenue Collection.* — A remarkable feature of current debates on federalism is how much credit the current Congress and Supreme Court majorities have received for relatively limited interventions on

³⁶⁶ State-to-state differences in fiscal capacity could still be handled by comparing state median incomes over the past few years. To provide more rapid responses to changing economic conditions, however, those levels should be adjusted based on much more recent unemployment data. To be sure, this method will prevent state legislators from knowing precisely what federal match they will receive when they enact their budgets. The nature of the adjustment, however, should minimize the net effect on states' overall budgets: a drop in unemployment would reduce the federal government's matching contributions below projected levels, but it also should reduce the eligible population and increase state revenues relative to projections as well.

³⁶⁷ Should a state fail to repay loans to its unemployment systems when its economy recovers, employers within the state are subject to a modest tax surcharge. See Al Baker, *State's Failure To Pay Off Debt to U.S. Will Cost Employers*, N.Y. TIMES, Nov. 12, 2004, at B9.

³⁶⁸ Unfortunately, far from reforming states' fiscal constitutions to allow them to respond better to the business cycle, some have advocated limiting the federal government's ability to do so. These proposals seek to shrink the federal government's spending generally, either as an end in itself or as a means of opening space for states to occupy. If successful, they could sideline the federal government in combating recessions much as obsessions with balanced budgets did in the early stages of the Great Depression.

³⁶⁹ See, e.g., CLIFFORD JOHNSON, CTR. ON BUDGET & POLICY PRIORITIES, TOWARD A NEW GENERATION OF COMMUNITY JOBS PROGRAMS (1997) (describing tardiness of prior attempts at countercyclical public job creation programs), available at <http://www.cbpp.org/1219cfed.htm>; John Ellis, *Clinton's Fatal Mistake: Underestimating the Power of Bob Dole*, L.A. TIMES, Apr. 25, 1993, at M2.

³⁷⁰ Reflecting the continued dominance of the leadership model of cooperative fiscal federalism even when the problem being addressed is explicitly state capacity, some federal officials criticized states' spending of this money. See, e.g., GEN. ACCOUNTING OFFICE, GAO-04-736R, FEDERAL ASSISTANCE: TEMPORARY STATE FISCAL RELIEF 11-13 (2004) (prepared by Patricia A. Dalton). But see NICHOLAS JOHNSON & EDWIN PARK, CTR. ON BUDGET & POLICY PRIORITIES, A RESPONSE TO GAO'S CRITICISMS OF STATE FISCAL GRANTS (2004).

behalf of state autonomy while their other fiscal policies were imposing harsh burdens on those very states. In particular, Congress's sudden abandonment of its leadership role in structuring the federal-state tax system has been irresponsible. The resulting loss of revenues severely undermined state autonomy at the very time states were reeling from recession-induced fiscal crises. The balkanized tax system that this abdication leaves in its wake will reduce efficiency and increase non-compliance. And Congress's zealous protection of Internet-based businesses from taxation comparable to that levied on their terrestrial competitors provides both an unjustified thumb on the economic scales and an undeserved thumb in the eyes of state and local governments. Congress should apply its professed concern for states' fiscal well-being to revenue matters. At a minimum, UMRA or a similar device should compel a separate vote whenever Congress acts to impair states' revenue-raising capacity significantly.

Given Congress's extensive involvement in regulating state tax collections, any areas of tax policy affecting interstate commerce in which Congress has not intervened can reasonably be regarded as areas in which Congress intended to leave states a free hand. Judicial invalidation of state tax rules under the dormant commerce clause³⁷¹ is therefore inappropriate. Moreover, the complexity of valuing a national company's connection with a particular state ought to give the courts pause in finding state revenue schemes invalid under the Equal Protection Clause and other constitutional provisions.³⁷²

More generally, the behavioral assumption implicit in the Court's jurisprudence restricting states' taxation of interstate entities is seriously oversimplified. To be sure, states will sometimes want to shift tax burdens to companies whose bases are primarily out-of-state. On the other hand, states also spend billions of dollars on tax preferences and subsidies to induce out-of-state businesses to open operations within their boundaries. This situation, then, can be the exact opposite of the familiar problem on the regulatory side in which states seek to regulate in order to repel unwanted businesses or to protect local businesses against foreign competition: some states privilege out-of-state companies to increase economic activity. The Court should abandon its complex and analytically unpersuasive attempts to regulate facially neutral state revenue rules under the dormant commerce clause.

³⁷¹ See, e.g., *Quill Corp. v. North Dakota*, 504 U.S. 298, 319 (1992).

³⁷² See, e.g., *Metro. Life Ins. Co. v. Ward*, 470 U.S. 869, 874 (1985) (Equal Protection Clause); *Austin v. New Hampshire*, 420 U.S. 656, 657 (1975) (Privileges and Immunities Clause).

CONCLUSION

Despite its prominent role in modern American governance, fiscal federalism has evolved with remarkably little scrutiny. Politicians, judges, and scholars all too often have imposed upon it theoretical frameworks developed for the quite different problems of regulatory federalism; what focused analysis fiscal federalism has received has tended to be static, atomistic, or both. As a result of this confusion, many efforts Congress and the Court have made to aid states have been relatively ineffectual. Other policies have seriously damaged states' ability to sustain themselves. More generally, debates about fiscal federalism have tended to hinge on impressionistic rather than analytic factors.

Nowhere has this confusion caused more severe problems than with respect to countercyclical programs, particularly those that aid low-income people. Congress has increasingly sought to shift financial responsibility for these programs to state and local governments. Unfortunately, states' inability to borrow to meet operating needs during economic downturns, along with numerous structural biases against these programs hidden in states' fiscal constitutions, ensures that states will be unable to meet the needs of people displaced during recessions.

Although these problems are serious, they are correctable. The basic concerns that have driven the evolution of states' fiscal constitutions and the fundamental values underlying our system of federalism can all be accommodated within a structure that responds appropriately to the business cycle and that allows federal and state polities to maintain the kinds of humanitarian programs they desire. A better appreciation of the federal government's superior fiscal capacity and state and local governments' administrative advantages would yield a more effective and sustainable division of responsibility between the two levels of government.