POLICY report

Goldwater Institute

PR-224 | June 3, 2008

# Arizona's Struggle for Sovereignty: The Consequences of Federal Mandates

by Benjamin Barr[1]

## EXECUTIVE SUMMARY

Arizona is awash in federal money. In fiscal year (FY) 2007, Arizona received close to $8.5 billion in federal funds. This money funds programs that most Arizonans are familiar with, such as Medicaid and the No Child Left Behind Act (NCLB). Even though the inflow of federal dollars appears attractive, there is a catch: As federal dollars flow in, state dollars are fixed to ever-growing demands connected to these programs. In 2000, the State of Arizona used general funds at close to $463 million for Medicaid alone. By 2005, that figure had risen to $914 million, and it is projected to grow to $1.3 billion in FY 2008.

Federal spending in Arizona displaces the legislature's authority to act on its own. Currently, the legislature appropriates, or has control over, about one-fourth of the spending in the state. The structure of federal funding programs, combined with Arizona's own propositions to limit legislative authority, is the reason for this constraint. As Arizona locks itself into federal dollar-for-dollar matching programs, it is unable to ever release those funds. That type of funding constrains the legislature and continues to do so more and more every year, to the point that the state becomes a servant to Washington.

Federalism is rooted in the concept of dual sovereignty. State governments and the federal government operate to keep each other in check. Federalism has as its sounding principle that both state and federal governments have sufficient power to operate independently.[2] Yet as a state's reliance on federal mandates increases, the nation's underlying system of federalism shifts from one of partnership to a master-servant relationship.

This paper sketches possible reform solutions in both the short and long term. In the short term, it is advisable for the state to withdraw from NCLB. That would free Arizona of the law's convoluted requirements and permit it to exercise greater control over the direction of education policy for children in the state. And it can do so with minimal costs to the people of Arizona.

For the long term, several structural reform efforts exist that would help free Arizonans from the grip of overarching federal authority. Citizens may amend the U.S. Constitution to outright prohibit federal mandates or provide for a states' veto option to protect against them. Federal legislation that has already been enacted can be strengthened to provide genuine defense against these mandates. Lastly, when states have reached their limit, they can bring their federal taskmasters to accountability by bringing litigation defending the sovereignty of the states.

GOLDWATER INSTITUTE

# *Arizona's Struggle for Sovereignty: The Consequences of Federal Mandates*

by Benjamin Barr[1]

## INTRODUCTION

This paper discusses the problems and pitfalls of federal spending in Arizona. In fiscal year (FY) 2007 (ending June 30, 2007), federal transfer payments to the state were $8.5 billion[3]—more than 29 percent of the state's expenditures.[4] The paper explains the perils of the state's rapidly increasing reliance on federal transfers, and it sketches possible reform options.

At first impression, it may seem hard to see what those problems, perils, and pitfalls might be. After all, Arizona taxpayers will finance a good portion of federal payments to state and local governments—some 18 percent of total federal outlays—regardless of the level of federal spending in Arizona. Yet, in 2004, Arizonans received about $1.30 in federal payments for every dollar it paid to the federal government. One sensible course of action, it seems, is to ensure that as many of those dollars as possible make it back into Arizona. Governor Janet Napolitano has instituted an aggressive program to that effect.

*The reform that is worth having is to kick the habit.*

Upon inspection, however, large-scale federal funding of state services is a two-edged sword. For well over a decade, Arizona legislators have complained that federal funds distort legislative policy preferences and priorities, place bureaucratic agencies beyond legislative control, and lock the state into expensive funding commitments. These concerns are well founded.

To date, the search for solutions has focused primarily on procedural and institutional reforms. One perennial proposal is to permit the legislature to appropriate federal funds, an authority it is currently thought to lack. However, reforms of this type would do little to remedy the deleterious effects of the state's increasing dependence on federal largesse. Once states become habitual users of federal funds, they become dependent on them. That will be true regardless of the institutional arrangements—including the scope of legislative appropriation authority—within the state.

The reform that is worth having is to kick the habit—that is, to decline participation in federal funding programs that create more costs and risks than benefits within the state. With respect to many federally funded programs, that is difficult, and Arizona can aspire only to a marginal reassertion of control. In other cases, however, withdrawal is feasible and perfectly sensible. Other feasible pathways to reform will require states working together to opt out of these costly programs or to engage in lengthy litigation in defense of federalism.

The two largest categories of federal funds, Medicaid and K-12 education, fall at opposite poles of this spectrum. Few states can afford to withdraw from Medicaid; Arizona's most feasible option is to continue in the program and to minimize its collateral effects. In contrast, states *can* easily afford to decline participation in the K-12 education programs that fall under the 2001 No Child Left Behind Act (NCLB). Several states have contemplated a

unilateral withdrawal from NCLB funding and mandates. Arizona can and should take that step.

Part I of this paper describes the economics and incentive effects of federal funding. Part II discusses Arizona's financial situation and the role of federal funding, historically and in comparison to other states. Part III discusses the budgetary effects of Arizona's Medicaid program. Part IV examines education funding and especially NCLB. And Part V discusses the prospects and limits of reform.

## I. FEDERAL FUNDING

### The Rapid Growth of Intergovernmental Transfers

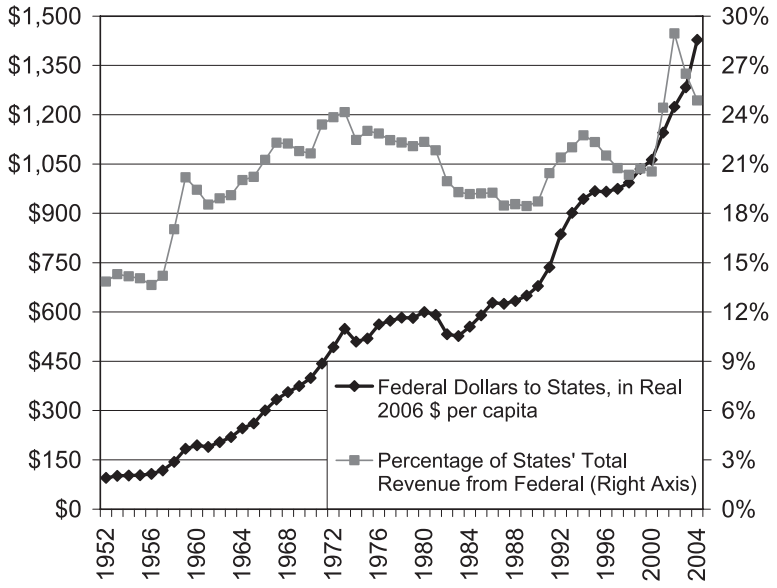
Broad-based, permanent federal funding programs to support state and local government functions date back to the New Deal. (Earlier experiments with such programs were small and often short-lived.) The programs mushroomed and expanded during the Great Society and throughout the 1970s. Today, practically all government services, from infrastructure to public health to education to environmental quality, are administered by state and local agencies and funded in part by the federal government.

Despite periodic efforts to rein in intergovernmental transfers (especially under the Reagan administration), payments have grown rapidly in absolute terms, in proportion to the federal budget, and most ominously as a percentage of state spending (see Graph 1).

Because the federal government can borrow more easily than the states, and because states (unlike the federal government) must fear that tax hikes will induce an exodus of productive citizens

*Today, practically all government services are funded in part by the federal government.*

**Graph 1**
**Federal Transfers to States, 1952-2004**



and businesses, one would expect taxes and spending to grow faster at the federal than at the state or local level. Strikingly, however, the opposite has happened. The federal tax receipts as a percentage of gross domestic product (GDP) have remained roughly what they were after World War II (about 17 percent). State and local tax revenues, in contrast, have almost doubled, from 5.5 percent of GDP in 1948 to 10.1 percent in 2005.[5] Although this trend surely has more than a single cause, it appears that federal funding has permanently inflated the demand for government.[6] Indeed, most federal grant programs have some substitution effect within the states, but their systemic, long-term effect is to *increase* state and local taxation and spending.

**Federal Funding's Expansionary Effects on State Budgets**

*The state can save only cents on the dollar by cutting the federally funded program.*

***Uncapped federal matching grants*** for state-provided services reduce the price for each unit of service provided by the state. Medicaid is far and away the biggest such program, accounting for $181.7 billion, or 42.6 percent of all federal transfer payments to states and localities in 2005. The federal government contributes between 50 and 77 percent of state spending on Medicaid services. The matching formula (the federal medical assistance percentage, or FMAP) depends on the state's wealth, with the poorest states receiving the most generous match.

Medicaid and similarly structured programs look like a bargain for the states. By accepting a one-for-one matching grant, wherein the federal government ends up funding half the total cost, a state can provide the service at up to twice the pre-grant level without raising taxes or shifting money from competing government programs. Of course, the balance looks yet more favorable at higher levels of federal funding, such as Arizona's Medicaid FMAP of 70 percent.[7] In 2004, a state with that FMAP percentage received about $2.36 from the federal government for each $1.00 in spent on Medicaid. So if the state were to reduce its state-level Medicaid funding by $1.00, its overall Medicaid program would be reduced by approximately more than $3.00 to save $1 in state funds. When flagging revenues or other factors force the state to reduce expenses, however, the state can save only cents on the dollar by cutting the federally funded program. The cut will look more expensive and require more draconian steps than an equivalent cut in a wholly state-funded program. Thus, even if the federally funded program is more generous than what the local citizens in the pre-grant world were willing to pay for, the state will prefer to cut competing state-funded programs or, failing that, raise taxes.

***Conditional, capped grants-in-aid*** are a common form of federal funding. Most education programs, including NCLB, operate on this principle. Unlike matching grants, grants-in-aid have an *income* effect but no *price* effect. To illustrate, suppose Arizona provides a basic education for $90 and the federal government offers $5 funding for, say, driver's education, at an additional cost of $5 to the state. If the state takes the fifty-fifty bait, its total education spending is $100. But the state's cost of providing a basic education remains unaffected.

When budget constraints force a five percent cut in education spending, Arizona should send the driving teachers and their federal paymasters packing, since it would be no worse off than in the pre-grant world. But that will not look like a five

percent cut. The "loss" of federal dollars will make it look like a brutal 10 percent cut. In other words, state officials and citizens will confuse the income effect of the grant-in-aid with a (nonexistent) effect on the price of education. Once that fiscal illusion takes hold, a grant-in-aid has the demand-inflating and crowding-out effects of a matching grant.

***Fully funded, time-limited federal grants*** pose a particularly acute danger to fiscal responsibility. For example, the Clinton administration's "100,000 cops" initiative in 1994 expanded state and local law enforcement personnel at effectively zero cost to state and local governments.[8] Termination of the federal payments, however, failed to have a symmetric effect. Because of the pressure of organized interests and local demand, the officers' salaries and pension plans eventually hit state and local budgets.[9]

Whatever their form, then, federal funding programs tend to expand state budgets. Over time, those programs grow faster than wholly state-owned functions and account for an ever-larger portion of state budgets. By making expansions look cheap and cuts outrageously expensive, the programs tend to exacerbate the states' boom-and-bust budget cycles. All along, citizens get more government than they are willing to pay for—though not necessarily better government.

Political scientists and economists have observed that federal funding may have several adverse effects:

- Large-scale federal funding inflates the size of state government far beyond the median voter's preference—or, put differently, the size of government for which citizens in each state would be willing to tax themselves.
- Where federal funds must be matched by state funds, the state's own policy and spending priorities will be distorted. Federally favored and funded programs will be overfunded by the state, while state functions that do not receive federal support will be shortchanged. Some valuable programs may be crowded out altogether.
- Federal funding may produce a practically irreversible ratchet effect toward higher taxes and spending.[10] Federal grants may have those effects, regardless of their form.

## II. FISCAL AFFAIRS AND FEDERAL FUNDING IN ARIZONA

*State functions that do not receive federal support will be shortchanged.*

Arizona's fiscal and budgetary history over the past decades is characterized by:

- a relatively stable tax burden;
- a consistently favorable "balance of payments" vis-à-vis the federal government;
- an erosion of the state legislature's authority to appropriate funds, which is partly a result of voter initiatives and referenda and partly due to increased federal funds; and
- escalating health care expenditures (beginning in 2000), which threaten to crowd out other state functions.

### Tax and Spending Trends in Arizona

Despite its relatively conservative political climate, Arizona used to be a high-tax state. Over the decades, however, Arizona's tax burden has remained roughly constant, while that of many other states has risen. As a result, Arizona has improved its

position relative to other states. By the most widely used measure (the Tax Foundation's) Arizona is now near the median in terms of combined state and local tax burden on citizens (see Graph 2).

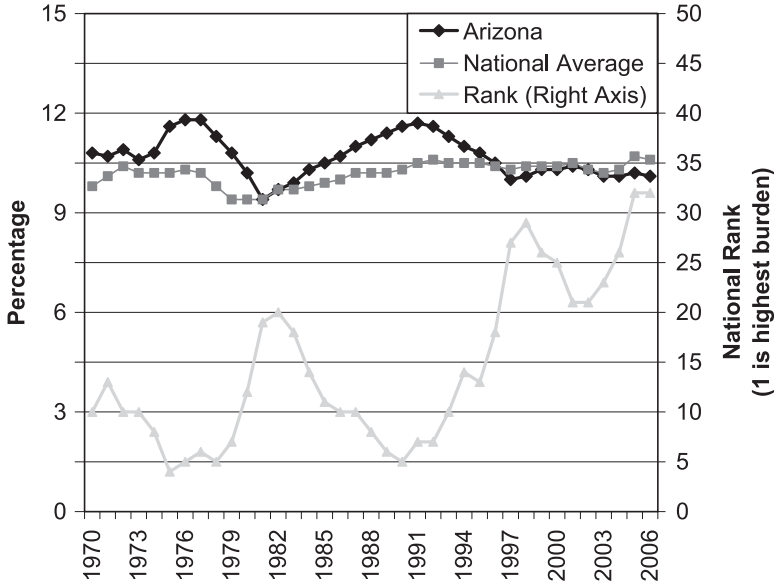
Restraint at the tax front, however, has not been accompanied by an equal measure of discipline at the spending front—at least not over the past decade. Between 1992 and 2005, real, inflation-adjusted per capita spending increased by one-third from $3,115 to $4,157 (see Figure 3). Two factors explain the situation. First, sustained economic growth has so far covered a multitude of errors that might otherwise have proven awkward and expensive. Arizona has outperformed the U.S. economy for four consecutive decades. (The 1990s were especially kind to Arizona; the real size of its economy nearly doubled from 1990 to 2000.) Second, generous—and lately rising—federal transfer payments have helped Arizona to sustain and expand the size of government without having to resort to commensurate tax increases.

*Restraint at the tax front has not been accompanied by discipline at the spending front.*

## The State's Positive Balance of Payments with the Feds

For the last quarter century, Arizona citizens and businesses have paid less to the federal government in taxes than the state has received from the federal government in the form of spending (see Figure 4). Both federal taxes and federal spending have increased since 1981, with especially rapid growth during the Clinton administration. During George W. Bush's tenure, Arizonans' federal taxes have actually fallen significantly; the per capita federal tax burden in 2004 was $5,568, 13 percent less than the peak of $6,786 in 2000 (both amounts in inflation-adjusted 2006 dollars). Federal spending in the state has also fallen, if somewhat less, by about 10 percent (from $7,988 per capita in 2000 to $7,241 in 2004, again in inflation-adjusted 2006 dollars).

**Graph 2**
**Average State and Local Tax Burden**




*Source: Tax Foundation calculations using data from U.S. Census's Consolidated Federal Funds Report and the Bureau of Economic Analyses, U.S. Department of Commerce.*

Arizona has consistently received 10 to 30 percent more from the federal government than it has paid in taxes, with fluctuations between these extremes (see the bars in Figure 4). Arizona's receipt-to-tax ratio has returned to the upper part of its range under the George W. Bush administration, so that in 2004 Arizona received about $1.30 for every dollar it paid to the federal government, up from $1.14 in 2001. These numbers are subject to high measurement error, as well as definitional disputes (e.g., Is the construction of a federal facility in a given state a federal transfer payment?). It is clear, however, that Arizona's balance of payments has been consistently positive.[11]

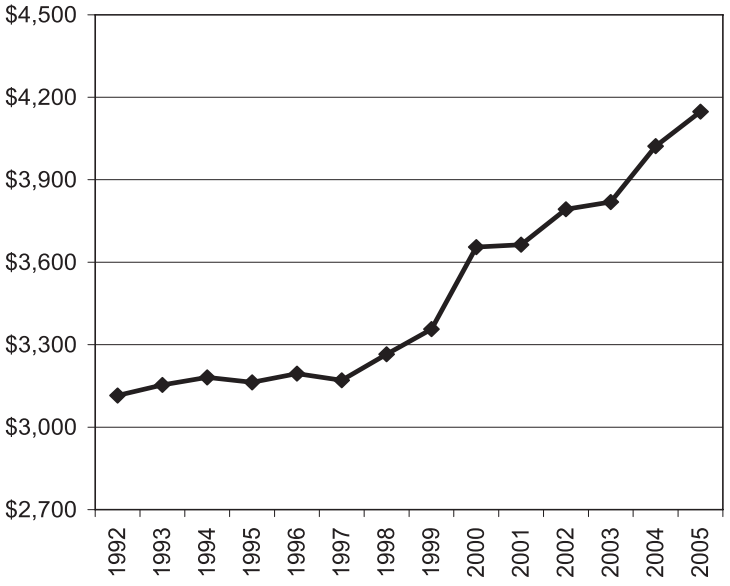
**Federal Funds Sustain Health and Welfare, Aid Education**

Arizona law requires the Governor's Office of Strategic Planning and Budgeting to prepare a biennial report detailing the use of federal funds in Arizona. An August 2006 report takes up more than 300 pages and includes data for 46 state agencies receiving federal revenue.[12] The funds come from many different federal agencies, of which the Department of Health and Human Services is clearly the leader.

Two functions—health and welfare, and education—receive the lion's share of federal transfer payments. Of the $8.5 billion in federal funds received in FY 2007, $6.8 billion (about 80 percent) was devoted to health and welfare, while $1.42 billion (16 percent) was designated to education. The agency receiving the most funds was the Arizona Health Care Cost Containment Service (AHCCCS), which administers the state's Medicaid program. AHCCCS received about $5.8 billion in FY 2007, or 68 percent of the total federal funds. Arizona's Department of Economic Security, with a panoply of services from food stamps to assistance for the disabled to

*Two functions—health and welfare, and education—receive the lion's share of federal transfer payments.*

**Graph 3**
**Arizona's Per Capita Expenditures (in real $2006), 1992-2005**




*Sources: U.S. Census of Governments, State Finance section; U.S. Census Population Estimates.*

adoption aid, received an additional $430 million in federal funds. Federal support for education in Arizona is approximately $1.15 billion. In Arizona, as elsewhere, federal funding principally sustains the modern welfare and service state, rather than the physical infrastructure. Arizona's Department of Transportation received $748 million in federal funds in 2007.

**Why Have a Legislature?**

The Arizona legislature is severely constrained in its taxing and spending authority—arguably, more constrained than the legislature of any other state. By passing propositions that expand federal program eligibility for Arizonans and limit legislative authority, voters have tied the hands of legislators behind their backs in dealing with fiscal challenges. The erosion of the Arizona legislature's appropriation authority has reached troubling proportions, partially as a consequence of federal funding.

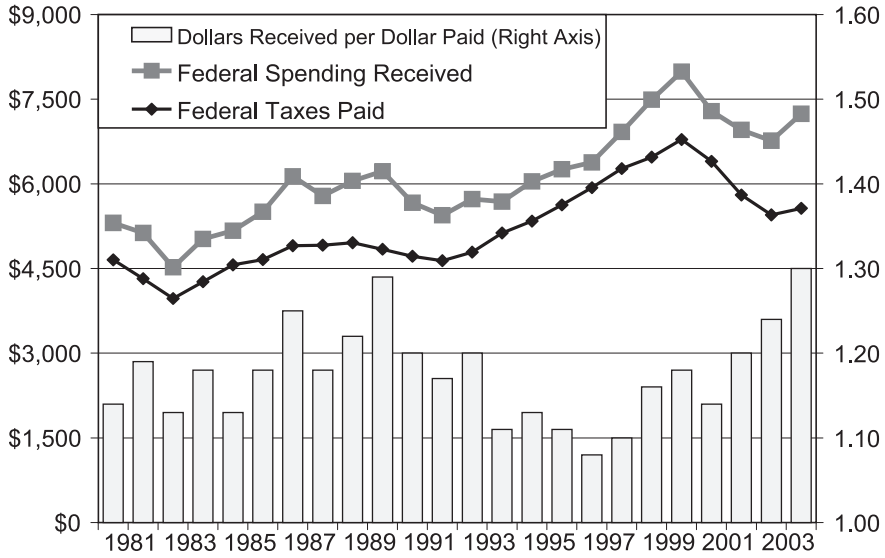
*The Arizona legislature is severely constrained in its taxing and spending authority.*

The full budget cost of state government in Arizona—not including local governments—for FY 2008 is projected at $27.3 billion. It breaks down as follows:

- General Fund spending ($10.4 billion, or 38.1 percent).
- Other appropriated funds ($2.85 billion, or 10.4 percent).
- Non-appropriated funds ($6.04 billion, or 22.1 percent).
- Federal transfer payments ($7.94 billion, or 29.1 percent).[13]

By way of explanation, "other appropriated funds" are funded from revenues that are earmarked specifically for a specific purpose. Examples include the State Highway Fund (estimated at $399 million in FY 2008) and the so-called Tobacco Tax and Health Care Fund administered by AHCCCS (estimated at $83 million in FY 2008), which directs the proceeds of a tobacco tax hike to the

**Figure 4**
**Federal Taxes Paid and Spending Received per capita by Arizonans, in Real 2006 $, 1981-2004**



state's Medicaid program for a variety of purposes (discussed further below). "Non-appropriated funds" are mostly direct user fees for specific purposes. Examples are the Game and Fish Department and the Medicaid-related payments from counties to AHCCCS or the Department of Health Services.

Only the General Fund and "other appropriated funds" are subject to the legislature's appropriation authority. Non-appropriated funds are on autopilot (as their title suggests.) Of the $27.3 billion total state spending, $6.04 billion is not appropriated, and $7.94 billion comes from federal transfers. That leaves the General Fund of $10.4 billion and "other appropriated funds" of $2.85 billion. Because 60 percent of General Fund spending is an autopilot (set funding formulas), only 40 percent, or about $4 billion, actually gets appropriated by the legislature. Add the $2.85 billion from "other appropriated funds" and you get a total of $7.01 billion—or 25 percent of total state government spending—that is appropriated by the legislature. Again, within the General Fund, about 60 percent of spending is essentially nondiscretionary and is automatically set to increase or decrease each year with certain variables and without legislative intervention.[14] An example of this nondiscretionary spending includes capital improvement projects and building expenses connected with schools.[15]

The legislature included in the FY 2006 budget a $25 million "savings" from "revenue maximization" efforts—that is, then-unidentified *federal* funds to be obtained through bureaucratic effort. That gimmick, though small, illustrates that the potent incentive effects of federal funds will dominate legislative as well as executive decisions at the state level.

State legislators are further constrained by several successful referenda of the past two decades.

- Proposition 108, adopted in 1992, requires a two-thirds supermajority in both houses to make a net increase in the state's revenue collection. This basically takes legislated tax increases off the table in addressing financing issues.[16]
- The 1998 Arizona Voter Protection Act requires a three-fourths supermajority of legislators to alter spending on programs created by referendum, regardless of the level of need. The effect has been to prevent lawmakers from weighing need in one area against another where the voters have intervened by referendum.
- Perhaps the most restrictive proposition, and certainly the biggest one in terms of driving the growth of spending (both state and federal), has been Proposition 204. Enacted by popular referendum in 2000, Proposition 204 greatly expanded Medicaid eligibility and dedicated the proceeds from the state's 1998 settlement with the major tobacco producers for AHCCCS.

*A total of $7.01 billion—or 25 percent of total state government spending is appropriated by the legislature.*

This leaves us with a system of state government highly dependent on the federal government for its funding. But such an arrangement is diametrically opposed to the Founders' vision for America. In their vision, governments would be dependent upon the people and other branches of government, so that they could fully exercise their judgment rather than being concerned about another branch or body of government retaliating against them.[17]

While there was great debate at the time of the founding of this nation between Federalists and anti-Federalists, nearly all agreed on "republicanism, consisting at a minimum of a non-monarchical government that institutionalized the rule of law, and as to most matters rule by a majority of voting citizens. Other principles almost universally held were a wide citizen franchise (i.e., avoidance of aristocracy), political liberty, some sort of federalism."[18] Today's unfortunate arrangement of massive money transfers from the federal government to state government undermines the very promise of republicanism.

## III. THE MEDICAID MENACE

*Massive money transfers from the federal government to state government undermine the very promise of republicanism.*

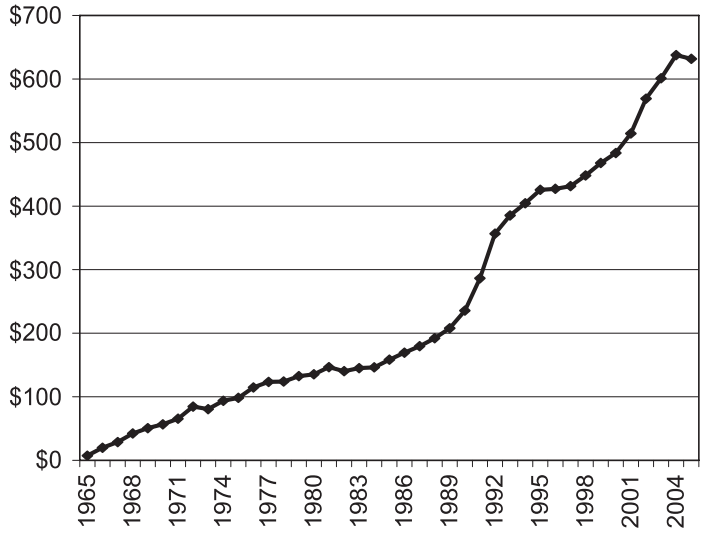
### Exponential Growth in Medicaid Spending

Since its creation in 1965 as a modest assistance program for the poor, Medicaid has been the primary cause of a huge increase in federal grants to the states. Over the four decades of Medicaid's existence, the real per capita size of these grants has grown almost exponentially (see Graph 5).

Medicaid expenditures constitute an ever-growing share of state expenditures. In 1987, that share amounted to slightly more than 10 percent. In 1992, the number was 17.8 percent; in 2006, 22.2 percent.[19]

State officials often attribute exploding Medicaid expenses to federal mandates and to health care inflation, especially rising prescription drug costs. These representations are almost entirely false. While Medicaid does mandate the coverage of certain population groups, the lion's share of Medicaid expenses is being incurred for "optional" services and population groups (especially among the elderly), which the states may but need not provide as a condition of federal funding.

**Graph 5**
**Federal Outlays for Grants to States for Medicaid in Real 2006 $ Per Capita**




*Sources: FY 2007 Budget, Office of Management and Budget, Historical table 12.3; U.S. Census population estimates; and the Implicit Price Deflator from the St. Louis Fed.*

Moreover, throughout the Clinton and Bush administrations, the federal government has readily granted the states waivers from Medicaid mandates.

The principal reason for Medicaid's stupendous growth is that its generous funding formula gives states a huge incentive to expand their programs.[20] Some states now cover families with incomes of up to 275 percent of the poverty level. Almost all provide optional prescription drug benefits and long-term care for the poor and low-income elderly. In a few states, one-third of the population is now on Medicaid. In post-Proposition 204 Arizona, about one-fifth of the population receives health care coverage through AHCCCS.

**The Folly of Relying on Tobacco Money**

***Late to the Party.*** Arizona's own involvement with Medicaid did not begin until 1982, with the creation of the Arizona Health Care Cost Containment System. Previously, Arizona had been the only state in the union to reject federal Medicaid funds. Individual counties provided a piecemeal system of indigent health care for the state's citizens. AHCCCS was the first statewide Medicaid program to use managed care, offering recipients a variety of private and public health plans that channeled them into private physician offices. The plans are paid a monthly capitation amount for each member enrolled, which was patterned after private health care. As recently as 2002, AHCCCS has been cited as a model Medicaid program. However, AHCCCS has become a source of dismaying fiscal and budgetary developments. Those difficulties can be traced to the enactment of Proposition 204 in 2000.

***Proposition 204.*** In 1998, state attorneys and the country's major tobacco companies signed the so-called Master Settlement Agreement (MSA), which established a nationwide regulatory regime for the sale and marketing of tobacco products and, moreover, entitled the states to a stream of payments, originally estimated at $246 billion over the first 25 years of the MSA. Arizona's share of those proceeds is 1.5 percent.[21]

Nominally, the payments were supposed to make the states whole for tobacco-related health care expenditures under Medicaid. Of course, the larger share of those expenditures had been paid by the federal government, and under then-existing law, that share of any Medicaid cost recovery had to revert to the federal government. But when the Clinton administration proposed to enforce that provision, the states protested loudly and Congress hastily amended the Medicaid statute, allowing the states to keep the tobacco bounty.[22]

*The principal reason for Medicaid's stupendous growth is that its generous funding formula gives states a huge incentive to expand their programs.*

As if to illustrate Medicaid's pernicious incentive effects, many states decided to leverage the "recovery" of expenditures they had not incurred into yet more federal dollars, by dedicating the tobacco payments to Medicaid programs. That, in substance, was the intent behind Proposition 204, which dedicated the windfall of the tobacco settlement to expanding the state's Medicaid-eligible population and services.[23]

Graphs 6 through 8 illustrate the effects. In one sense, the Proposition 204 maneuver seems to have paid off: After several "flat" years, federal funds as a proportion of Arizona's budget rose as the effects of Proposition 204 kicked in (see Graph 6).

Much of the increase is attributable to Proposition 204, and the collateral effects have not been beneficial. Medicaid spending in Arizona has risen from under 15 percent of total spending (2000) to well over 20 percent. Perhaps more surprisingly, and contrary to the pro-204 campaign rhetoric at the time, *General Fund* spending on Medicaid has also risen sharply, from roughly 8 percent to more than 12 percent and a projected 13.5 percent in FY 2007.

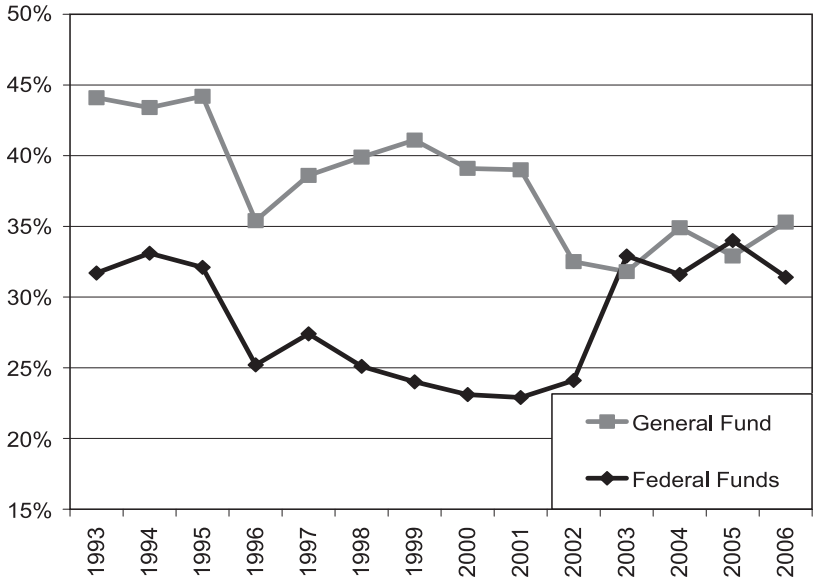
The raw numbers are even more bracing. In 2000, Arizona General Fund spending on Medicaid was just $463 million. By 2005, that figure had risen to $914 million, and it is projected to grow to $1.3 billion in FY 2008.[24] The reason for this 50 percent-plus increase in terms of Medicaid's share of General Fund revenues is that the tobacco funds, and the federal dollars that they leverage, were not remotely sufficient to pay for Proposition 204's expansion of the Medicaid population.[25]

*Arizona General Fund spending on Medicaid is projected to grow to $1.3 billion in FY 2008.*

Graph 7 is of limited use, both because of the large year-to-year fluctuations (caused by state-specific events and substantial irregular federal Medicaid payments) and because differences in what states do and do not include in their "general fund" make cross-state comparisons difficult. We show the figure to contrast the relatively stable pre-Proposition 204 environment with the lack of budgetary stability, and the remarkable increase in Medicaid's share of General Fund spending, after Proposition 204's enactment. (Note that the difference between 8 and 12 percent is not 4 percent, but 50 percent.)

Total state spending on Medicaid is a truer measure, both historically and comparatively. Graph 8 compels the conclusion that the principal effect of Proposition 204 has been to transform Arizona, previously a Medicaid outlier, into a "normal" Medicaid state. That is no cause for celebration: As the third-youngest

**Graph 6**
**Arizona Spending Source Composition, 1993-2006**




*Source: National Association of State Budget Officers, State Expenditure Reports, 2005 and earlier, Tables 3,7,12,18,28, and 43.*

state in the nation, Arizona should have relatively low Medicaid expenditures. More unfortunately still, "normal" means wrenching Medicaid-induced budget crises in lean years: The program drives state costs but is virtually impossible to contain, as recouping funds previously earmarked for Medicaid will mean a cut of roughly two federal program dollars for every state dollar saved. The program tends to exacerbate Arizona's boom-and-bust budget cycles.

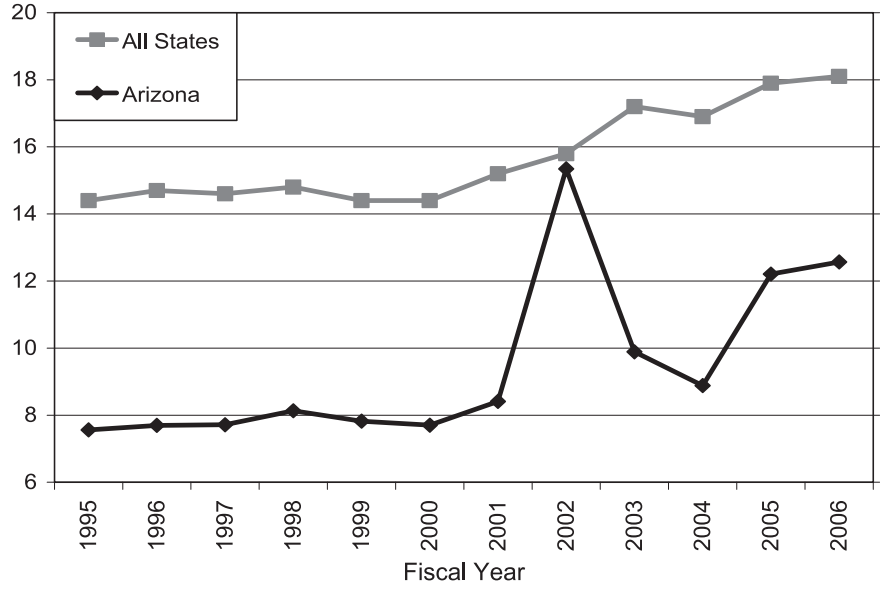
Indeed, Arizona faced a monumental challenge in addressing its budget for FY 2008. House Appropriations Committee Chairman Russell Pearce depicted Arizona as facing "one of the most difficult times in state history as far as the economy and budget go."[26] Predictions for deficit and debt spending in FYs 2008, 2009, and 2010 are not good. While it is too soon to tell, as Medicaid continues to swallow more of the General Fund, budget crises, like the one currently faced by Arizona, may become more severe.

Graph 8 shows total state Medicaid spending for all states and for Arizona. FY 2006 appears to show some moderation. That may continue in FY 2007 and 2008, but one should be cautious in drawing inferences. As a result of the implementation of the new federal drug benefit under Medicare Part D, some costs previously shared by the states through Medicaid will now be borne entirely by the federal government. To celebrate such cost-shifting as genuine cost control on the part of the states is a dangerous deception. Realistically, Arizona's prospects are grim:

- MSA tobacco payments have fallen well below predicted levels and will continue to fall short, due mainly to declining smoking rates. To that extent, Medicaid expenses will hit the General Fund.
- In 2002, Arizona voters passed Proposition 303, dedicating the proceeds of an increase in the tobacco excise tax

*The Medicaid program tends to exacerbate Arizona's boom-and-bust budget cycles.*

**Graph 7**
**Percentage of General Fund Spent on Medicaid, 1995-2006**




*Source: National Association of State Budget Officers, State Expenditure Reports, 2005 and earlier, Tables 3,7,12,18,28, and 43.*

to various programs within AHCCCS. The measure made AHCCCS programs yet more vulnerable to reduced smoking rates.

- The 1998 Voter Protection Act locks in Proposition 204-required spending unless three-fourths of both houses of the legislature vote to overrule. As a result, Arizona will have even less flexibility than other states in addressing Medicaid's contribution to future budget difficulties.[27]

With this expense representing such a large part of Arizona's state budget and tax revenues, it is hardly surprising that state government officials try to finance as much of this program as possible with federal dollars. Governor Janet Napolitano's Office of Strategic Planning and Budgeting has aggressively pursued policies of revenue maximization "designed to increase federal Title XIX Medicaid reimbursement."[28] Obviously, however, these strategies do nothing to redress the warped incentives, such as Medicaid's generous funding formula, that lie at the heart of the Medicaid morass.

*Education, traditionally a local and state concern, has been increasingly federalized.*

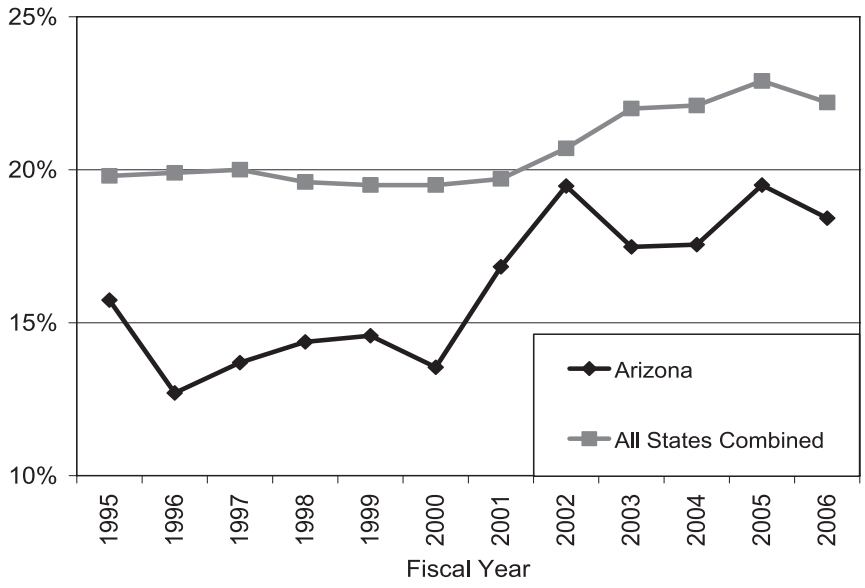
## IV. EDUCATION

### No Child Left Behind and the Federalization of Education

Education, traditionally a local and state concern, has been increasingly federalized. The Bush administration's NCLB is the most recent and dramatic chapter in this history. Even NCLB *champions* (e.g., the Fordham Foundation's Chester Finn) have described it as "probably the most intrusive piece of federal education legislation in history."

Unlike Medicaid, NCLB has a much smaller role in Arizona than in other states. In the long term, withdrawal from the

**Graph 8**
**Percentage of Total Budget Spent on Medicaid, 1995-2006**




*Source: National Association of State Budget Officers, State Expenditure Reports, 2005 and earlier, Tables 3,7,12,18,28, and 43.*

program might have positive fiscal effects. Arizona's K-12 schools had total revenues of $8.8 billion in the 2005-2006 school year. About $1.15 billion, or 13 percent of the total, were derived from the federal government.[29] Only about half of those federal dollars, however, fall under NCLB.[30]

The late Senator Daniel Patrick Moynihan compared a more modest but similarly inspired education initiative (the Clinton administration's Goals 2000) to a Soviet grain production quota. The far more ambitious NCLB approximates that production model quite closely. Its core provisions require states to set testing standards. Every school and every district must then meet Adequate Yearly Progress (AYP) standards each year for grades 3 to 8. Not only must each school and district comply, but every subgroup of students within the school must also meet the AYP. The point of this disaggregation is to ensure that *no* child or group of children is left behind—socio-economically disadvantaged, Latino, black, Native American, learning disabled, or those with "limited English proficiency."[31]

States may calibrate their own AYP targets, meaning that they can decide that a school or district in which just 40 percent of students achieve a score of "proficient" is passing in 2005. Those figures, however, must reach 100 percent compliance by the 2013-2014 school year. Schools or districts that fail to meet the AYP targets—for *every* subgroup of student, *every* year—are designated "failing." Significant numbers of schools have already been found to be failing, and the count is sure to increase as 2013 approaches.

NCLB imposes an escalating program of sanctions for failing schools. Schools failing two consecutive years must give their students the option to go to a non-failing school in the district, regardless of cost or space constraints. After three years, free tutoring must be provided to students upon request. After four years, the school must draw up a major restructuring plan, and after five, implement it. "Restructuring" is defined as reopening as a charter school, replacing staff, turning the school's management over to a private company, or "any other major restructuring of the school's governance designed to produce major reform." The money for implementing all these requirements must come from so-called Title I funds—that is, federal education funds that participating states receive under Title I of the Elementary and Secondary Education Act.

**Arizona's Response to NCLB: Take the "Dumb Down" Route**

*Arizona, by all indications, has taken the "dumb down" route.*

NCLB presents states with an unpleasant and somewhat bizarre policy choice. States that maintain meaningful student achievement standards run the risk of having large numbers of schools declared "failing." That risk, and the attendant costs and consequences, will increase in tandem with NCLB's progressively more stringent quotas and escalating sanctions. However, since the states themselves, rather than the federal government, determine the substantive standards by which AYP is to be measured, states have a second option: relax testing standards, label everyone "proficient," and thus avoid the messy fallout of failing schools while continuing to collect federal dollars.

Arizona, by all indications, has taken the "dumb down" route. From 2003 to 2005, Arizona's state tests went from earning a B- to a D+ in terms of substantive

requirements when compared with the National Assessment of Educational Progress (NAEP), widely viewed as the most reliable measure of student achievement. Arizona students who are scored "proficient" on Arizona exams increasingly fail to earn that same distinction on the NAEP.[32]

Some schools already find themselves in the "restructuring" phase. In Arizona, this figure was 27 in the 2005-2006 school year.[33] When school administrators are confronted with NCLB's draconian requirements, they typically opt for make-believe remedies—for example, by hiring a "coach" to advise and implement improvement plans.[34] Such remedies add an extra layer of bureaucracy but are of doubtful efficacy in terms of helping students.

*NCLB has already produced a compliance regime in which states attempt simply to mollify the federal authorities through bureaucratic acrobatics.*

**Other States Consider Defiance**

Promising are the acts of defiance of several school districts across the nation, including two in suburban Chicago and one in Colorado Springs, which have declined funding in exchange for liberation from federal overlords. Kit Carson, Colorado, passed a referendum to levy additional property taxes to replace federal funding after its school board chose to decline federal funding for the 2006-2007 school year.[35]

The typical state response to a federal conditional funding program is to demand a more favorable mix of mandates and money: "Give us more dollars, and leave us alone." That has also been the predominant response to NCLB. In 2004 alone, lawmakers in 31 states proposed legislation to gain greater flexibility within the program or limit their state's compliance efforts, but few have gained significant traction.[36] Neither the Congress nor the administration, however, has proven particularly receptive to the states' demands. NCLB's effects, meanwhile, have been sufficiently severe to induce some states—New Hampshire, Connecticut, and Utah among them—to contemplate the virtually unheard-of measure of declining federal funds, thus escaping NCLB's burden.

To date, these states have either balked at taking the final step or pursued alternative paths unlikely to yield any significant improvements. The State of Connecticut's suit against the U.S. Department of Education was recently dismissed because of a procedural error.[37] Even if the challenge is successful on appeal, it would yield only minor changes at best, and is more likely to wind up being a waste of time.[38] More serious efforts to "secede" from NCLB may materialize.

The expert consensus on NCLB has continued to sour. Many of those who were originally among the law's biggest boosters have come to recognize its dubious benefits.[39] NCLB has already produced a compliance regime in which states attempt simply to mollify the federal authorities through bureaucratic acrobatics. That will become progressively more common, but also more difficult, as NCLB's restructuring mandates begin to kick in. The mandates to restructure "failing" schools fall principally upon the states. As NCLB supporters have observed, however, states lack the capacity to restructure hundreds of schools. Therefore, they say, Washington should assist the states in establishing an extra layer of experts and administrators.

Prominent education experts Mark S. Tucker and Thomas Toch make the case in a *Washington Monthly* March 2004 article entitled "Hire Ed: The Secret to Making

Bush's School Reform Law Work? More Bureaucrats." The authors contemplate "not a simple matter, but a vast, man-to-the-Moon kind of challenge" of building a base of experts in data management, curriculum development, and taking good teachers on the road to educate their colleagues.[40] Congress may or may not heed Tucker and Toch's call for additional federal funding in the order of $600 million per year. Clearly, however, states—including Arizona—will be confronted with a massive bureaucratic task in years to come, which will require considerable amounts of their own funds.

## V. REFORM OPTIONS

Our discussion of possible reform efforts is limited in scope. To our minds, the central task for would-be reformers is to take account of the political economy and the warped incentives of federal grant programs.

State-level reforms are constrained by the contours of federal programs. Neither Arizona nor any other state can unilaterally change the structure of those programs. However, because the state-level debate often revolves around what Washington should do about those programs, we begin with a brief analysis for federal-level reforms before turning to state politics.

### Federal Reform: Thus Far, Ineffective and Irrelevant

A recurrent reform proposal, dating back as far as the Nixon administration's "New Federalism," has been to give the states more flexibility vis-à-vis the central government. One example of such initiatives is the 1995 Unfunded Mandates Reform Act (UMRA), which purported to impede the imposition of new unfunded mandates on state and local governments. Another example is the 1996 welfare reform law, which replaced individuals' entitlements to welfare with de facto block grants to the states.

In some instances, such devolutionary measures may produce desirable policy consequences. However, it is important to recognize the limitations.

- Federal process reforms have thus far been ineffective in curbing the expansion of federal programs. Scholarly descriptions and analyses of UMRA, for example, range from "modest" to "a hoax."[41] Prominently, the Act's modest requirements do not apply at all to federal grants programs, such as Medicaid or NCLB. Impositions on the states under those programs are not unfunded mandates but grant conditions, which the state can avoid by not accepting the funds in the first place. One could, of course, imagine an expanded UMRA with teeth. However, it would be difficult to force Congress' hand to enact such a statute. For federal legislators, a federal grant that induces state and local expenditures is an opportunity to curry favor with potent constituencies, for less than 100 cents on the dollar. It is the rare legislator who will voluntarily deprive himself of that device.[42]
- A diminished federal capacity to impose potentially onerous grant conditions does nothing to affect the expansionist *budgetary* incentives that drive federal funding programs. If anything, looser conditions make the program more attractive for the states and thereby inflate state demand over and above an already high level. The Reagan

*A recurrent reform proposal has been to give the states more flexibility vis-à-vis the central government.*

administration learned this lesson the hard way: having block-granted several programs in an effort both to return power to the states and to trim federal transfer payments, it recategorized many programs when those two objectives proved contradictory. Experience since has proven the same point. For example, Medicaid growth has been driven by services to constituencies that states need not cover at all under the program. As for required services, the Clinton administration and the Bush administration have been very generous in granting states waivers from Medicaid requirements. Among the states with the fastest Medicaid growth rates are many of those with the most expansive waivers.

*Currently, states can opt out of program participation but not out of the tax payments for those programs.*

**A Real Reform: A Symmetrical Op-Out**

Can one think of a federal reform that *would* make a difference? One idea—with very limited chances of immediate enactment, but with considerable political potential—is to provide states with a genuine opt-out right from some or all federally funded programs. Currently, states can opt out of program participation *but not* out of the tax payments for those programs. This fiscal asymmetry helps to explain the universal state participation in virtually all federal programs. To remedy that problem, Congress could and should provide that the citizens and businesses of nonparticipating states receive their proportionate share of payments as a credit against the next year's income tax.[43] Doing so would lower the tax burden for individuals and businesses—whatever they paid in to support a federal program that the state government of their residence opted out of would be returned to their wallets. This provision need not operate across the board; it could be attached to individual federal funding programs.

**State Government: Truth in Budgeting?**

**An Insufficient Remedy: Legislative Appropriation of Federal Funds**

As noted earlier, the Arizona legislature is severely constrained in its budgetary powers. The erosion of its appropriation authority has been accompanied by recurrent efforts to reverse the trend. The chief proposal to that effect has been to make all federal funds subject to the legislative appropriations process under "truth in budgeting" laws. Such laws came out of Arizona's statehouse in 1979, 1980, 1981, 1982, 1996, and 2003, and in each case met with the governor's veto.

The legislative appropriation of federal funds is believed to be unconstitutional under two decisions by the Arizona Supreme Court.[44] Regardless of that difficulty, however, the appropriation of federal funds is unlikely to affect policy outcomes. Of course, executive agencies seek to expand their own budgets, and they are likely to commit the state to politically popular programs that will be very difficult to cut even when federal funds are scheduled to terminate after some years. It is difficult to see, however, why legislators should have a longer time horizon. In fact, they do not. The 44 states in which legislators do appropriate federal funds are no less locked into federal spending programs, and no more circumspect in accepting federal funds, than is Arizona.

In short, the perverse incentive effects of federal funds operate on all state officials, including legislators. In any state legislature, a federally co-financed program

will beat a wholly self-financed program any day of the week, and large majorities of legislators will accept "free" federal money without much concern for the long-term consequences. The same Arizona legislature that has insisted so strenuously on its appropriation authority also included in the FY 2006 budget a $25 million "savings" from "revenue maximization" efforts—that is, as-yet unidentified *federal* funds to be obtained through bureaucratic effort.[45] That gimmick, while small, illustrates that the potent incentive effects of federal funds will dominate legislative as well as executive decisions at the state level.

**Homogeneous Federal Solutions for Diverse Local Problems**

Increased federal mandates offer homogeneous, national policy solutions for diverse, local problems. While uniform solutions might be fitting in limited instances, attention must be brought to the fact that unique communities require policy solutions fitted to their unique circumstances. Otherwise, one-size-fits-all solutions undercut the very foundation of federalism—that states should be on the forefront as laboratories of reform. States and local communities know best when it comes to managing their resources and deciding what works best. Carefully designed local programs specifically tailored to solve local problems should not be displaced in favor of one-size-fits-all federal formulas. Imposing identical solutions nationwide removes incentives for states to compete and experiment in designing the most optimal policy solutions.

Ten years ago, Congressman Paul Gillmor and legislative assistant Fred Eames argued that it is "contrary to federalist purposes for Congress to *require* a local government to implement and pay for national policy, regardless of cost, regardless of reimbursement, regardless of local need, regardless of local support for the program, and regardless of the effect on essential local services."[46] When local governments are, in essence, forced to participate in a federal program, they are no longer partners but servants.

**Courts Have Given Congress Seemingly Unlimited Powers to Tax and Spend**

The Taxing Clause of the U.S. Constitution provides the federal government with the powers of taxation and, by implication, spending. The U.S. Supreme Court has interpreted the Taxing Clause to mean that it is a taxing and spending clause and that Congress may offer federal funds to the states with conditions.[47] Pursuant to the Clause, courts have routinely held that, even though the federal government is supposed to be one of limited and enumerated powers, Congress may achieve policy objectives beyond its limited and enumerated powers through conditional grant programs to the states. Thus, in areas where Congress lacks authority to achieve its desired result, it uses money to accomplish indirectly that which it has no authority to command directly.[48] This was not always the case.

*One-size-fits-all solutions undercut the very foundation of federalism—that states should be on the forefront as laboratories of reform.*

Many great minds have debated the exact scope of this power. The interpretation favored by most today is that the power is plenary in nature and permits Congress to spend for the common defense and general welfare.[49] This interpretation was first pronounced by Alexander Hamilton, but not during pre-ratification debates.[50] Rather, it was invented later and some suggest for political purposes.[51] In contrast, James Madison favored a much more limited reading of the Clause, suggesting

that "the grant of power to tax and spend for the general national welfare must be confined to the enumerated legislative fields committed to the Congress."[52]

In *United States v. Butler,* the Supreme Court adopted what has come to be known as the Hamiltonian view by noting that it would "*not review* the writings of public men and commentators or discuss the legislative practice."[53] Instead, it just quipped that the "power of Congress to authorize expenditure of public moneys for public purposes is not limited by the direct grants of legislative power found in the Constitution."[54] Money talks where the Constitution is otherwise silent.

*In 1976, the Supreme Court expressed some commitment to a defined sanctuary of state powers where federal authorities could not approach.*

The Supreme Court expanded this reasoning in *Pennhurst State School and Hospital v. Halderman* to detail the situations in which Congress could use the Spending Clause to impose conditions on grant recipients.[55] The Court reasoned:

> Turning to Congress' power to legislate pursuant to the spending power, our cases have long recognized that Congress may fix the terms on which it shall disburse federal money to the states ... legislation enacted pursuant to the spending power is much in the nature of a contract. In return for federal funds, the states agree to comply with federally imposed conditions.

Going further still, the Supreme Court upheld a congressional plan to condition federal highway funds on states' compliance with a minimum drinking age in 1987 in the case of *South Dakota v. Dole*.[56] In upholding the conditional grant, the Court explained that there were at least four restrictions of Congress' power under the Spending Clause. First, use of the spending power must always be connected with the "general welfare."[57] That test, like so many others, comes with a heavy judicial assumption—the courts will "defer substantially" to the judgment of the legislature. Second, Congress must condition the receipt of federal funds unambiguously, so that states may knowingly choose, "cognizant of the consequences of their participation." Third, any conditions placed on federal grants must be related to the federal interest in the project at hand. Fourth, other existing constitutional bases may provide a bar for certain federal grant programs.

*South Dakota v. Dole* demonstrated the weakness of the Court's modern four-part test in determining whether the spending power of the Congress was valid. In her dissenting opinion, Justice Sandra Day O'Connor explained that the establishment of a minimum drinking age was not reasonably related to the conditional grant of highway funds to the states. The advent of a reasonable relation test only brings to mind the question: Reasonable by what objective measurement?

Legal challenges to unfunded federal mandates have largely proven unsuccessful in remedying the problem. In 1976, the Supreme Court expressed some commitment to a defined sanctuary of state powers where federal authorities could not approach, in *National League of Cities v. Usery*. Justice William Rehnquist explained that if Congress' laws "directly displace the States' freedom to structure integral operations in areas of traditional [state] governmental functions, they are not within the authority granted Congress by Article 1, Section 8, clause 3."[58]

*Usery* concerned Congress' enactment of minimum wage standards that were

applicable to state employees and deemed invalid because they would "impair the States' 'ability to function effectively within a federal system.'" This, in turn, would eliminate states' "separate and independent existence." In other words, the Supreme Court recognized that unchecked conditional federal grants would eviscerate the role of the state in a federalist system.

The slightest hint that the Supreme Court might preserve state autonomy under *Usery* would not last. In *Garcia v. San Antonio Metropolitan Transit Authority,* the Court explained that states themselves were the best deciders of determining when federal authority went too far.[59] It reasoned that "the principal means chosen by the Framers to ensure the role of the States in the federal system lies in the structure of the Federal Government itself."[60] Rather than rely on discrete limits of federal authority, the Court left the determination of how much federal intervention is too much to the states. By accepting or rejecting federal programs and their reciprocal grant money, states define the appropriate level of federal intervention.

As a result of the Court's holding in *Garcia,* judicial redress under traditional precedent proves largely unlikely as a means of a viable solution to the problem. Other remedial options exist.

**Remedy #1: Amend the U.S. Constitution to Prohibit Federal Mandates of Non-Federal Funds**

A remedy of first resort would act to eliminate federal mandates before they occur. As proposed, in part, by Congressman Gillmor in the early 1990s, a suitable constitutional amendment would stop the federal government from forcing state governments to pay for federal programs. Specifically:

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

This proposal rests on a simple foundation: "When a local government is forced to pay for national policy, the local government becomes a servant of the national government, rather than a partner in federalism."[61] The underlying policy question is whether one government body should be able to propose an objective and demand that another government body pay for it. In a system of unchecked federal mandates, the federal government does exactly this.

*The underlying policy question is whether one government body should be able to propose an objective and demand that another government body pay for it.*

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

Congressman Gillmor's proposed reform would have eliminated Congress' ability to pass off costs onto third parties—states, and ultimately taxpayers—without consequence. In turn, this would force Congress to make rational, difficult funding choices. Instead of discounting costs, Congress would have to budget—cutting programs or raising revenues to

support new endeavors. It would also have removed a perverse incentive structure for Congress—an incentive to hide the costs of legislation as they will primarily be borne by the states. But when the burden of payment rests squarely on the federal government, this creates an incentive to fully disclose costs up-front for accurate budgeting purposes.

Under this amendment, Congress would be required to be more cooperative in establishing federal spending programs:

> Conceivably, since Congress might be without sufficient funds to serve every goal, there could be a renewed shift toward more flexible 'block grants,' which are directed chiefly to general purpose governmental units in accordance with a statutory formula for use in a variety of activities with a broad functional area largely at the recipient's discretion. Congress could also pass laws in other forms that would create a more cooperative partnership between federal and non-federal governments.[62]

*Enabling states to block objectionable national legislation would diminish some of Congress' blatant disregard for state and local interests.*

Block grants and adaptable grants would permit Congress and the states some flexibility in reaching mutually agreed-upon policy objectives. This helps eliminate the one-size-fits-all problem inherent in federal mandates.

Another proposal to cure unfunded mandates includes a "states' veto" amendment to the U.S. Constitution.[63] Under this reform alternative, if Congress imposed an unfunded mandate on the states, state legislators could begin an amendment drive to rescind such burden. In short, a simple majority, or super-majority, of the state legislatures could intervene and block unwanted federal mandates looming on the horizon. Enabling states to block objectionable national legislation would diminish some of Congress' blatant disregard for state and local interests. Moreover, this option offers the hope to wipe the slate clean—permitting states to decide whether to keep existing mandates in place or start anew. Such competitive interaction between the states and the federal government is precisely the kind of healthy competition of give and take expected and envisioned by the Framers under a system of competitive federalism.

**Remedy #2: Expand the Reach of the Unfunded Mandates Reform Act**

In 1995, Republican governors, strengthened after the results of the 1994 elections, moved to address the problem of unfunded mandates in the states. As a result, the Unfunded Mandates Reform Act passed Congress in 1995 and was signed into law by President Clinton.

UMRA included important reform provisions tending to lessen the probability that unfunded mandates would be passed onto the states. The Act requires, for example, that the Congressional Budget Office prepare informational statements for certain mandates that assess costs and consequences—the underlying assumption being that a well-informed Congress will mandate and pass on costs less.

There are serious exemption problems contained in UMRA, leaving its capacity for reform largely undermined. Laws that are deemed "emergency legislation" or that affect "constitutional rights" automatically exempt them from the reach of UMRA. Notably missing is the definition of a

valid "emergency," permitting laws to be classified as emergency according to the whim of Congress.

There are further procedural problems with the UMRA. As one commentator noted:

> The Senate retained the right to waive any point-of-order objection to a proposed unfunded mandate and thus proceed to consider the proposal. While the House of Representatives is nominally forbidden to waive a point-of-order objection to a new unfunded mandate, the House retains the unilateral right to free itself of that procedural constraint any time it wants. Hence, the procedural provisions of the Mandates Act will bind the houses of Congress only for so long as Congress desires and will be overridden when Congress wants to grant a new unfunded mandate.[64]

Under existing congressional rules, the promises offered under UMRA may simply be disregarded through procedural maneuvering, leaving little protection against advancing federal mandates.

Meaningful reform efforts could turn their eyes toward strengthening UMRA to afford real protection against mandates. Some critics have argued that UMRA lacks strength because it only requires a simple majority to overcome the procedural hurdle to pass an unfunded mandate. Senator Phil Gramm and others have suggested strengthening the Act to require a three-fifths majority to pass such mandates. That modest reform measure would demand greater unanimity in creating a mandate but would ultimately not address the roots of the problem.

In fact, since UMRA's enactment, local governments have pointed to the Clean Air Act, Clean Water Act, Homeland Security Act, and NCLB as federal laws that local governments have ended up paying for. And the federal government interprets "duties imposed as a condition of federal assistance or duties that arise from participating in voluntary federal programs" as not counting as federal mandates under the law. In short, UMRA has failed to reach many of its intended reform goals.

An UMRA with teeth would apply broadly, making it a true burden for the federal government to pass along hidden costs to the states. First, it should reach both existing and new mandates. A revised UMRA would bring past mandates into account, appropriately revising them to account for any associated mandates imposed by them. Second, legislation that involves constitutional rights or prohibits discrimination should be covered as well. Even the pursuit of noble goals carries a price tag. Lastly, "emergency legislation" should not be an excuse to pass mandates onto the states. Fiscal responsibility is a virtue in times of both calm and crisis. Eliminating these spending loopholes would help stop the regular flow of mandates out of them, bringing some sense of fiscal candor back to Washington.

*Local governments have pointed to the Clean Air Act, Clean Water Act, Homeland Security Act, and NCLB as federal laws that local governments have ended up paying for.*

**Remedy #3: Seek Judicial Redress**

A final pathway of reform involves judicial redress. Each of three approaches presents some ray of light in challenging overbearing federal mandates in the courts. The U.S. Constitution promises to the citizens a republican form of government in the states.[65] Unless states can retain their own independence and autonomy, they cannot enjoy republican

forms of government as promised under the Constitution. These promises are contained in the Guarantee Clause and the 10th Amendment. Likewise, the Taxing and Spending Clause of the Constitution, under current precedent, permits Congress to condition the acceptance of federal grants on compliance with requirements, provided that the conditions are set forth unambiguously.[66] Lastly, some federal statutes contain assurances that the law in question will not require states to spend or incur funds in administering the federal program.

*The U.S. Constitution's Promise of State Autonomy*

*The U.S. Supreme Court has recognized the importance of protecting the independent and autonomous nature of states.*

The U.S. Supreme Court has recognized the importance of protecting the independent and autonomous nature of states. In 1869, it explained that "the preservation of the States, and the maintenance of their governments, are as much within the design and care of the Constitution as the preservation of the Union and the maintenance of the National Government."[67] The Constitution envisions an indestructible Union, "composed of indestructible states." Unfortunately, most of the litigation challenges connected with states rights have failed to preserve the sanctity of these sovereign states.[68]

The Guarantee Clause of the Constitution assures citizens that states will provide a republican form of government. It provides, in relevant part, that the "United States shall guarantee to every State in this Union a Republican Form of Government…."[69] A republic, according to James Madison, is "a government which derives all its powers directly or indirectly from the great body of the people."[70] As one scholar has explained:

> The guarantee clause, therefore, promises each state a government based on popular control. This promise plainly restricts the freedom of the states. No state may establish a monarchy, a dictatorship, or any other form of government inconsistent with popular representation. At the same time, however, the words of the guarantee clause suggest a limit on the power of the federal government to infringe state autonomy: the citizens of a state cannot operate a republican government, "choos[ing] their own officials" and "enact[ing] their own laws," if their government is beholden to Washington.[71]

A variety of federal courts have relied on the Guarantee Clause to confine federal action. In *United States v. Downey,* the Southern District of Illinois held that the Guarantee Clause prohibits the federal government from establishing rules of criminal procedure applicable to the states.[72] Even the Ninth Circuit, in *Brown v. EPA,* construed the Clean Air Act narrowly to prevent the federal government from commanding state governments to implement federal policies.[73] In short, the court's concern was that state citizens could lose control over how their state-generated tax funds would be spent, eliminating popular accountability.

Constitutional history also suggests that the Guarantee Clause should be taken seriously. One Federalist, identifying himself a "Jerseyman," described the Clause as a protection against "the danger of our state governments being annihilated."[74] Both Federalists and anti-Federalists recognized the Guarantee Clause as an "attempt to mark the boundary between federal power and state sovereignty."[75]

Today, when the federal government intrudes regularly into the affairs of state government, the promise of a republican form of government diminishes.

The Guarantee Clause acts as a bulwark against federal intervention in the internal affairs and government processes selected by a state's citizens. However, when federal grant money has been involved, courts have been reluctant to strike such programs down due to their apparent voluntary nature. For example, in *Florida v. Mathews,* the Fifth Circuit Court of Appeals upheld a federal regulation restricting membership in state nursing home licensing boards based on voluntary participation in a federally funded program.[76] Likewise, in *Florida Department of Health & Rehabilitative Services v. Califano,* a district court upheld federal regulations changing the structure of state agencies that provided vocational rehabilitation services.[77] It did so to "insure the proper functioning of federally funded programs." Importantly, "any state which object[ed] to the 'strings' attached to receipt of the federal funds ha[d] the option to refuse both the grants-in-aid and the objectionable conditions."[78]

Renewed litigation tying the Guarantee Clause to the effects of federal mandates may well reinvigorate its strength. Strictly upholding the Clause would do much to reinforce state autonomy. When Congress tries to condition the receipt of federal funds on a modification of state government, courts should apply exacting scrutiny to such programs, striking them down to preserve state republican government. To permit wholly republican forms of government, the courts must be willing to leave the states free to determine how they structure their own government programs, even if there is federal money involved.[79]

Federal mandates are a particularly appropriate area in which to test new Guarantee Clause litigation claims. As the federal government becomes bolder in its mandate programs and intrudes further into the operation of state government, the Guarantee Clause (coupled with the Spending Clause and the Tenth Amendment) may prove a powerful tool in the arsenal of pro-freedom litigators. As noted earlier, the discretionary spending power of the Arizona legislature is greatly diminished by the presence of overreaching federal programs. Currently, about one-fourth of the funds available are appropriated, or under the control of the legislature. As time moves forward, these programs will continue to eat up much of the discretionary authority enjoyed by the state legislature, leaving it immobilized. As that deterioration occurs, it cannot be said that Arizonans have meaningfully retained their sovereignty. At such point, but hopefully before, litigation based on the Guarantee Clause may help eliminate the infective grip these programs have in Arizona.

*These programs will continue to eat up much of the discretionary authority enjoyed by the state legislature, leaving it immobilized.*

*The Taxing and Spending Clause*

Another less optimistic prospective is litigation based on the Taxing and Spending Clause. Unlike the Guarantee Clause, many litigants have tried, and failed, to bring challenges to federal spending programs under this clause.[80] As explained earlier, the Court has "long recognized that Congress may fix the terms on which it shall disburse federal money to the states ... legislation enacted pursuant to the spending power is much in the nature of a contract. In return for federal funds, the states agree to comply with federally imposed conditions. The legitimacy of Congress' power to legislate under the spending power thus rests on

whether the state voluntarily and knowingly accepts the terms of the 'contract.'"

As stated most recently by Justice Samuel Alito, Taxing and Spending Clause challenges involve a determination of "whether … a state official would clearly understand ... the obligations of the Act" and whether it "furnishes clear notice regarding the liability at issue."[81] So long as the obligations and liabilities assumed under the federal program are unambiguous, no challenge under the Spending Clause will be viable. Typically, courts will analyze these claims like contract disputes; so long as the government can point to a clear understanding that the state would incur obligations and liabilities, the challenge will not be successful.

*It is very hard to convey to American citizens outside the Beltway how hopeless and cynical the Medicaid debate has become.*

*Assurances within Federal Laws*

Finally, some federal statutes include their own specific language protecting states against unfunded mandates. For example, NCLB provides:

> GENERAL PROHIBITION. Nothing in this chapter shall be construed to authorize an officer or employee of the Federal Government to mandate, direct, or control a State, local educational agency, or school's curriculum, program of instruction, or allocation of State or local resources, or mandate a State or any subdivision thereof to spend any funds or incur any costs not paid for under this chapter.[82]

Several school districts have relied on this language, in conjunction with the Spending Clause, to file suit against the federal government.[83] Their suits have asked the courts to declare that the states are not required to spend money to comply with the law and to prohibit the federal government from allocating state resources. Where specific statutory language permits it, challenges may be brought based upon that language itself.

Besides these structural reform options, it is worth looking at the two federal programs that account for 90 percent of federal spending in Arizona and examining the feasibility of withdrawal from each.

**Medicaid: Impossible to Opt Out; Mandatory to Rein In**

It is very hard to convey to American citizens outside the Beltway how hopeless and cynical the Medicaid debate has become. Policymakers and experts on all sides agree that Medicaid's funding formula guarantees the expansion of the program, and of the states' expenditures. The program inexorably pushes toward some version of a single-payer system. Massachusetts has already taken that step, and California and other states are poised to follow. Opponents of such a system, meanwhile, are in a very poor position. Any and all proposals to change the funding formula or to cap Medicaid funding—the only realistic means of arresting continued program expansion—face the united opposition of all states, "red" and "blue" alike. Medicaid study or reform commissions are often barred from even considering them. For the foreseeable future, then, states will continue to operate under the existing regime.

Fiscal reality makes withdrawal impractical. As mentioned, in FY 2005, AHCCCS received about $4 billion of its $5.9 billion budget from the federal government. To pass up this money would be a difficult choice, representing a 68 percent cut. Few legislators would be

willing to contemplate, let alone vote for, such mammoth cuts.

Even our hypothetical refund option would not materially affect this situation. Medicaid accounted for about 7.4 percent of the federal government's outlays in 2005, and Arizona's citizens paid $25.8 billion in individual income and payroll taxes that year.[84] If that amount were refunded in exchange for release from Medicaid, Arizonans would receive back approximately $1.9 billion. (Including corporate taxes, the figure would grow to $2.16 billion.) As things stand, however, Arizona received about $4 billion in federal funds for AHCCCS in 2005—roughly *twice* the hypothetical refund. Thus, even if Arizona could opt out of Medicaid with a refund, it would still choose to do so only if smaller government, healthy federalism, and preservation of liberty were so important to it as to pass up a massive subsidy.

In that light, any state-level reform will have to occur within the existing framework. As noted, a full examination of the options is beyond the scope of this paper. Our general recommendations are as follows:

- Repeal Proposition 204. We understand that the political will for such a campaign may be lacking. The fact remains, however, that Proposition 204 effectively put the ever-escalating demands of a potent, deeply entrenched constituency beyond the reach of the ordinary political process and debate.
- Resist any and all proposal for further expansions of AHCCCS.
- Emulate and expand on state initiatives, such as Florida's and South Carolina's, that introduce meaningful consumer incentives into state-administered Medicaid plans.[85] Such incentives are the only available means of counteracting the built-in expansionary dynamics.
- Repeal the 1998 Arizona Voter Protection Act. By requiring a three-fourths supermajority of legislators to alter spending on programs, the Arizona legislature is crippled in being able to mend the aftereffects of poorly designed initiatives, especially those that foster increased federal spending.

**Leave the Feds Behind**

A withdrawal from NCLB is a viable option from a fiscal and budgetary perspective. In the long term, it might actually have positive fiscal effects. Arizona's K-12 schools had total revenues of $8.8 billion in the 2005-2006 school year. About $1.15 billion, or 13.0 percent of the total, was derived from the federal government.[86] Only about half of those federal dollars, however, fall under NCLB.[87]

*A withdrawal from NCLB is a viable option from a fiscal and budgetary perspective.*

Utah's flirtation with withdrawal in 2004 gave some indications that funding for many education programs would continue should a state withdraw from NCLB. According to a U.S. Department of Education letter by Acting Deputy Secretary Eugene Hickok, a state's refusal to participate in NCLB would *not* affect its funds from the Individuals with Disabilities Education Act, its school lunch funding, or its schools' ability to apply for discretionary grant funds.[88] And while at present some programs' funding levels are calculated as a function of Title I funding, there is some question as to whether Congress intended to make the receipt of these funds contingent on participation in NCLB. A reasonable estimate is that Arizona might lose approximately half of its federal education dollars, likely on the order of 4 to 6 percent of its total K-12 education spending.[89]

In contrast to Medicaid, our rebate proposal would have a major effect on the prospect of withdrawing from NCLB. If Arizona were allowed to make a clean break from NCLB and get its money back, that decision would be quite attractive. Federal spending on primary and secondary education in 2005 made up approximately 1.5 percent of total federal outlays that year. If that proportion of the income taxes paid by Arizona's citizens were to be rebated to the state, it would receive about $400 million. Including Arizona's corporate income taxes would raise the total to around $450 million.

As noted, a reasonable estimate of Arizona's federal education funds is somewhat higher than these totals—$578 million. (Arizona is subsidized here as it is in general.) If Arizona could merely give up its roughly $135 million subsidy from the federal government, or slightly more than 1 percent of the state's total education spending, in exchange for casting aside the onerous and perverse NCLB, doing so would be a steal.

*Federal funds do not simply represent "cash in." They are accompanied by budgetary and compliance costs.*

The calculation just sketched illustrates why our refund option is not a part of any federal funding program. The entire point of those programs is to inflate the demand for services far beyond the level of any sentient voter's preferences, and politicians at all levels—federal, state, and local—agree on that objective. Barring a miracle, then, NCLB withdrawal would entail Arizona's "loss" of some $578 million.

A "cut" of that magnitude would undoubtedly be decried as an intolerable hit. "Intolerable," however, depends largely on one's assessment of the underlying merits. If NCLB participation has predominantly bad effects, even a few hundred million dollars might be a price worth paying.

- Federal education programs do not fund education; they fund education bureaucrats—compliance officers at all levels of the bureaucracy, grant writers, testing services and professionals, and liaison officers. Once the costs of maintaining this (largely unionized) workforce have been subtracted from federal funds, not much money is left to reach a local school, let alone a classroom. This "flypaper effect"—the money sticks where it hits—is particularly pronounced, and clearly intended, under NCLB.
- The price of obtaining Senator Ted Kennedy's crucial support for NCLB was to cut teachers' unions in on "reform." Hence, many of the most prescriptive—and, for the states, expensive—NCLB provisions govern teacher training, paraprofessionals' certification, and other pay-boosting and leisure-enhancing policies.
- While federal funding programs always have a centralizing, bureaucracy-building effect at the state level, that effect is especially pronounced under NCLB because of its focus on holding educational institutions up and down the line "accountable" to the federal bureaucracy. That will become increasingly clear in coming years, as NCLB's mandate to "restructure" consistently failing schools becomes operative.

Our point is simple: Federal funds do not simply represent "cash in." They are accompanied by budgetary and compliance costs, which would not accrue if the state refused the money. Withdrawing from NCLB would mean reduced costs as well as foregone federal transfers.

Admittedly, it is hard to estimate the size of the available savings. (No credible study has done so, either in Arizona or elsewhere.) Once a state has participated for a number of years, the federally induced costs become intermingled with the bureaucratic and political apparatus as a whole. It becomes very hard to unscramble the omelet and to realize budget savings, all the more so since the bureaucracy and its clientele will vehemently resist the attempt. That consideration, though, confirms our general warning that states should pay far more attention to the long-term impact of accepting federal funds. To a large extent, the case for withdrawing from NCLB is prospective: Arizona should take that step *now,* before NCLB's expanding mandates generate wholly irreversible pressures for further centralization.

## CONCLUSION

It is well-nigh impossible to counteract the destructive effects of federal funding programs. Procedural reforms, either at the federal or the state level, are difficult to achieve in the short term. The principal constraint is political in nature. One way or the other, state legislators are called upon to deliver public services, build and maintain roads, provide police protection, and respond to emergencies. These crucial functions are often subsidized by the federal government, but transfer programs are being subsidized far more generously.

Increasingly, in Arizona as elsewhere, federal funds have driven legislators to expand payments for Medicaid and education, at considerable cost to other programs and constituencies. Legislators, in Arizona as elsewhere, will need and want a way out. In the short term, an exit from the No Child Left Behind Act would be a start. In the long term, focusing attention on procedural and structural reforms, such as strengthening the Unfunded Mandates Reform Act, proposing a federal constitutional amendment to end mandates, or devoting funds to litigation challenges may just free Arizona from the grip of its federal masters perpetually.

*States should pay far more attention to the long-term impact of accepting federal funds.*

**ENDNOTES**

1 Benjamin Barr is a senior fellow in constitutional studies with the Goldwater Institute. The author wishes to thank Professor Robert G. Natelson, Davin Mason Scholar of Law at the University of Montana School of Law, and Tim Keller, the Executive Director of the Institute for Justice, Arizona Chapter, for their scholarly assistance with this project.

2 Martin H. Redish, *Constitutionalizing Federalism: A Foundational Analysis*, 23 Ohio N.U. L. Rev. 1237, 1240 (1997).

3 USASpending.gov, "Assistance Spent in Arizona (FY 2007)," http://www.usaspending.gov/faads/faads.php?reptype=p&database=faads&datype=T&fiscal_year=2007&sortby=f&detail=1&principal_place_state_code=04.

4 The Federal Funding and Transparency Act of 2006 provides federal-state spending data at http://www.usaspending.gov/faads/faads.php?reptype=p&database=faads&datype=T&fiscal_year=2007&sortby=f&detail=-1&principal_place_state_code=04.

5 Office of Management and Budget, *FY 2007 Budget,* Historical Table 15.1.

6 See, for example, Aaron Wildavsky, "Fruitcake Federalism or Birthday Cake Federalism," in David Schleicher and Brendon Swedlow, eds., *Federalism and Political Culture,* New Brunswick, N.J.: Transaction Publishers, 1998, p. 55, and Edward M. Gramlich, "Intergovernmental Grants: A Review of the Empirical Literature," in Wallace Oates, ed., *The Political Economy of Fiscal Federalism,* Lexington, Mass.: Lexington-Heath, 1977, p. 219.

7 Federal Register, Vol. 72, No. 228, November 28, 2007, http://aspe.hhs.gov/health/fmap09.pdf.

8 The program, dubbed Community Oriented Policing Services (COPS), was a part of the 1994 Violent Crime Control and Law Enforcement Act and authorized $8.8 billion to hire 100,000 new police officers by 2000.

9 See Dan Eggen, "Hiring Under COPS Appears Set to End," *Washington Post,* September 29, 2004, p. A25. As indicated in the article, it was actually considered a misfortune under the program whenever the cessation of federal money failed to be made up for by new state and local spending.

10 Copious empirical evidence shows that state and local demand for services will rise in response to federal grants but fail to decrease proportionately to a grant decrease. Most economists attribute the asymmetry to interest group dynamics at the state level. See, for example, Edward M. Gramlich, "Federalism and Federal Deficit Reduction," *National Tax Journal,* No. 40, 1987, p. 299. For a sophisticated discussion and review of the literature, see Shama Gamkhar, *Federal Intergovernmental Grants and the States,* Northampton, Mass.: Edward Elgar, 2002.

11 Tax Foundation, "Federal Spending Received per Dollar of Taxes Paid by State, 1981-2004," March 16, 2006, http://www.taxfoundation.org/research/show/347.html.

12 Governor's Office of Strategic Planning and Budgeting, *Statement of Federal Funds, Fiscal Years 2005-2007,* August 2006, http://www.ospb.state.az.us/documents/2005-07FederalFunds.pdf.

13 Arizona Joint Legislative Budget Committee Summary of the FY 2008 Budget, released January 2007.

14 David R. Berman, "Restrictions, Mandates, and the Arizona Budget," Morrison Institute for Public Policy, Arizona State University, April 2004, p. 9.

15 See, e.g., the New School Facilities Fund, A.R.S. § 15-2041, the Deficiencies Correction Fund, A.R.S. § 15-2021, and the Building Renewal Fund, A.R.S. § 15-2031.

16 William Tucker, "Tax Rebels Battle State Spending Through the Ballot - How Initiatives Have Fared in Efforts to Control State Budgets," *Insight on the News,* August 8, 1994, http://findarticles.com/p/articles/mi_m1571/is_n32_v10/ai_15716052.

17 Robert Natelson, *A Reminder: The Constitutional Values of Sympathy and Independence,* 91 Ky. L. J. 353 (2003).

18 Ibid.

19 National Association of State Budget Officers, *State Expenditure Report,* Washington, D.C., 1995 and 2005, Table 3, pp. 16 and 8, respectively.

20 See Michael S. Greve with Jinney Smith, "What Goes Up May Not Go Down: State Medicaid Decisions in Times of Plenty," American Enterprise Institute working paper, August 5, 2003, http://www.aei.org/publications/pubID.17115/pub_detail.asp.

21 Master Settlement Agreement, Exhibit A. The National Association of Attorneys General makes the document available at http://www.naag.org/backpages/naag/tobacco/msa/msa-pdf/1109185724_1032468605_cigmsa.pdf.

22 Pub. L. No. 106-31, 113 Stat. 57 (1999) (amending 1903(d)(3) of the Social Security Act, 42 U.S.C. 1396b(d)(3) (2000)).

23 Proposition 204 significantly loosened eligibility requirements for several AHCCCS programs, including Temporary Assistance for Needy Families (TANF), Supplemental Security Income (SSI), and Medical Expense Deduction (MED), allowing those who have incomes above the poverty line to spend down their income on medical bills to meet the requirements.

24 Data from FY 2007 JLBC Summary, prepared January 2006, and from National Association of State Budget Officers reports; calculations by author.

25 For a similar discussion of these issues, see Arizona Center for Public Policy, "Limitations and Constraints on Arizona's State Budgeting Process," October 2003, p. 4.

26 Arizona State Senate, "State Lawmakers Address Budget Shortfall," news release, January 4, 2008, http://www.azleg.gov/FormatDocument.

asp?inDoc=/press/Senate/48leg/2R/BUDGET+RELEASE.DOC.htm

27 Berman, "Restrictions, Mandates, and the Arizona Budget," pp. 5 and 9.

28 Arizona Monthly Budget Highlights, June 2005, prepared for the Arizona Legislature by the Joint Legislative Budget Committee Staff, July 29, 2005, http://www.azleg.state.az.us/jlbc/mfh-jun-05.pdf.

29 Arizona Department of Education, *Superintendent's Annual Report 2005-2006,* Volume 1, Table 1, p. 6, http://www.ade.state.az.us/AnnualReport/AnnualReport2006/.

30 U.S. Department of Education, "Funds for State Formula-Allocated and Selected Student Aid Programs," http://www.ed.gov/about/overview/budget/statetables/09stbystate.pdf

31 Frederick M. Hess and Michael J. Petrilli, *No Child Left Behind,* New York: Peter Lang Publishing Group, 2006, p. 35.

32 Paul E. Peterson and Frederick M. Hess, "Keeping an Eye on State Standards: A Race to the Bottom?" *Education Next,* Summer 2006, pp. 28-29.

33 Arizona Department of Education, *Arizona State Report Card 2005-2006,* http://www.ade.az.gov/srcs/statereportcards/StateReportCard05-06.pdf.

34 Sara Mead, "Easy Way Out: 'Restructured' Usually Means Little Has Changed," *Education Next,* Winter 2007, pp. 52-56.

35 David J. Hoff, "Colorado Town Raises Taxes to Finance NCLB Withdrawal," *Education Week,* January 4, 2006.

36 Hess and Petrilli, *No Child Left Behind,* p. 124.

37 *Connecticut et al. v. Spellings,* No. 3:05CV1330(MRK) (D.D.C. April 28, 2008) (Memorandum Decision granting the state's cross-motion for Judgment on the Record and entering a final order in favor of the Secretary of Education and the National Association for the Advancement of Colored People), http://www.nysd.uscourts.gov/courtweb/pdf/D02CTXC/08-01591.PDF.

38 Most of the case, *Connecticut et al. vs. Spellings,* U.S. District Court, District of Connecticut, 3:05CV1330, was previously dismissed by Judge Mark R. Kravitz, who basically concluded that unless Connecticut actually incurred some harm by withdrawing from the program or was getting penalized for noncompliance, it had no standing to sue for relief (memorandum of decision, September 27, 2006).

39 American Enterprise Institute Conference, "Fixing Failing Schools: Is the NCLB Toolkit Working?" November 30, 2006 (transcript available at http://www.aei.org/events/filter.all,eventID.1351/transcript.asp).

40 Mark S. Tucker and Thomas Toch, "Hire Ed: The Secret to Making Bush's School Reform Law Work? More Bureaucrats," *Washington Monthly,* March 2004, http://www.washingtonmonthly.com/features/2004/0403.toch.html.

41 Elizabeth Garrett, *Enhancing the Political Safeguards of Federalism? The Unfunded Mandate Reform Act of 1995,* 45 U. Kan. L. Rev 1113, 1168 (1997).

42 Edward Zelinsky, *Unfunded Mandates, Hidden Taxation, and the Tenth Amendment: On Public Choice, Public Interest, and Public Services,* 46 Vand. L. Rev. 1355 (November 1993).

43 The seemingly simpler option of remitting the funds to nonparticipating state *governments* would only exacerbate problems. To those governments, the rebate will look like the proceeds of an income tax they never had to levy, and they will rarely be prepared to pass them along. In fact, those governments will emerge as the strongest proponents of expanding a federal program in which they do not participate: the bigger the program, the bigger the windfall.

44 The two cases are *Navajo Tribe v. Arizona Department of Administration* (1975) and *Cochise County v. Dandoy* (1977). When Governor Fife Symington used his veto in 1996, he cited constitutional concerns, as did Governor Napolitano in March 2003. The legislature attempted to overcome Governor Babbitt's vetoes in 1984 through a constitutional amendment, which was rejected by voters.

45 See Joint Legislative Budget Committee, FY 2006 Budget, http://www.azleg.gov/jlbc/06summ/pg1.pdf ("The JLBC FY 2006 budget would increase total permanent spending by $783 million, or 10.7%, to a level of $8.09 billion. This amount continues the prior year assumption that the Executive will generate $25 million in savings to existing programs by maximizing the state's draw down of federal funds").

46 Paul Gillmor and Fred Eames, *Reconstruction of Federalism: A Constitutional Amendment to Prohibit Unfunded Mandates,* 31 Harv. J. on Legis. 395 (1993).

47 U.S. Const. art. I, § 8.

48 See, e.g., *Fullilove v. Klutznick,* 448 U.S. 448, 474, (1980) (citing *California Bankers Assn. v. Shultz,* 416 U.S. 21 (1974); *Lau v. Nichols,* 414 U.S. 563 (1974); *Oklahoma v. CSC,* 330 U.S. 127 (1947); *Helvering v. Davis,* 301 U.S. 619 (1937); and *Steward Machine Co. v. Davis,* 301 U.S. 548 (1937).

49 Robert G. Natelson, *The General Welfare Clause and the Public Trust: An Essay in Original Understanding,* 52 Univ. Kan. L.Rev. 1, 8 (2003-2004).

50 Ibid., 45.

51 Ibid.

52 *United States v. Butler,* 297 U.S. 1, 65-66 (1936).

53 *United States v. Butler,* 297 U.S. 1, 65-66 (1936).

54 Ibid.

55 451 U.S. 1, 17 (1981).

56 483 U.S. 203 (1987).

57 Ibid., 207

58 426 U.S. 833, 852 (1976).

59 469 U.S. 528 (1985).

60 Ibid., 550.

61 Paul Gillmor and Fred Eames, Reconstruction of Federalism.

62 Ibid., 411.

63 Elizabeth Garrett, *Enhancing the Political Safeguards of Federalism?* 45 U. Kan. L. Rev. 1113, 1169 n.245 (1997).

64 Edward Zelinsky, *Unfunded Mandates, Hidden Taxation, and the Tenth Amendment: On Public Choice, Public Interest, and Public Services,* 46 Vand. L. Rev. 1355.

65 U.S. Const. art. IV, § 4.

66 U.S. Const. art. I, § 8.

67 *Texas v. White,* 74 U.S. (7 Wall.) 700, 725 (1869).

68 See, e.g., *National League of Cities v. Usery,* 426 U.S. 833 (1976), and *Garcia v. San Antonio Metropolitan Transit Authority,* 469 U.S. 528 (1985).

69 U.S. Const. art. IV, § 4.

70 The Federalist No. 37, at 234 (J. Madison) (J. Cooke ed. 1961) ("The genius of Republican liberty, seems to demand on one side, not only that all power should be derived from the people; but, that those entrusted with it should be kept in dependence on the people . . . . ").

71 Deborah Jones Merritt, *The Guarantee Clause and State Autonomy: Federalism for a Third Century,* 88 Colum. L. Rev. 1, 26 (1988).

72 195 F.Supp. 581 (S.D. Ill. 1961).

73 521 F.2d 827 (9th Cir. 1975), vacated and remanded for consideration of mootness at 431 U.S. 99 (1977).

74 Deborah Jones Merritt, *The Guarantee Clause and State Autonomy: Federalism for a Third Century,* 88 Colum. L. Rev. 1, 33 (1988).

75 Ibid., 35.

76 526 F.2d 319 (5th Cir. 1976).

77 449 F.Supp. 274 (N.D. Fla.), aff'd., 585 F.2d 150 (5th Cir. 1978), cert. denied, 441 U.S. 931 (1979).

78 Ibid.

79 Guarantee Clause litigation also faces the difficulty of justiciability. See *Baker v. Carr,* 369 U.S. 186 (1962). While justiciability may be difficult in Guarantee Clause claims, it is not impossible as suggested by the U.S. Supreme Court in *Reynolds v. Sims,* 377 U.S. 533 (1964).

80 *California Bankers Assn. v. Shultz,* 416 U.S. 21, (1974); *Lau v. Nichols,* 414 U.S. 563 (1974); *Oklahoma v. CSC,* 330 U.S. 127 (1947); *Helvering v. Davis,* 301 U.S. 619 (1937); *Steward Machine Co. v. Davis,* 301 U.S. 548 (1937).

81 *Arlington Central School District v. Murphy,* 126 S.Ct. 2455 (2006).

82 20 U.S.C. § 7907(a) (2002).

83 See, e.g., P*ontiac School District v. Spellings,* 05-2708 (6th Cir. 2006).

84 Author's calculation from Office of Management and Budget, *FY 2007 Budget of the United States Government: Historical Tables,* http://www.whitehouse.gov/omb/budget/fy2007/pdf/hist.pdf; IRS data available at http://www.irs.gov/pub/irs-soi/05db06co.xls.

85 See South Carolina Department of Health and Human Services, "South Carolina Medicaid Choice: Bringing a Consumer-Directed, M Market-Based Environment to Medicaid," July 15, 2006, http://www.dhhs.state.sc.us/Internet/pdf/SCMC.pdf.

86 Arizona Department of Education, *Superintendent's Annual Report for Fiscal Year 2005-2006, Volume 1,* Table 1, p. 6, http://www.ade.state.az.us/AnnualReport/AnnualReport2006/.

87 U.S. Department of Education, "Funds for State Formula-Allocated and Selected Student Aid Programs."

88 Letter to Dr. Steven O. Laing, Superintendent of Public Instruction, Utah State Office of Education, February 6, 2004, http://www.ccsso.org/content/pdfs/USDEdLettertoUtah.pdf.

89 Consistent with this estimate, Krista Kafer estimates that opting out of NCLB could cost Arizona $584 million, in "No Child Left Behind and Arizona: Making State and Federal K-12 Accountability Systems Work," Goldwater Institute Policy Report No. 212, October 17, 2006, pp. 13-14. The discrepancy between her number and ours represents an updating of the data from Arizona's 2005 report to its 2006 report.

## The Goldwater Institute

*The Goldwater Institute was established in 1988 as an independent, non-partisan policy research organization. Through policy studies and community outreach, the Goldwater Institute broadens public policy discussions to allow consideration of policies consistent with the founding principles Senator Barry Goldwater championed–limited government, economic freedom, and individual responsibility. The Goldwater Institute does not retain lobbyists, engage in partisan political activity, or support or oppose specific legislation, but adheres to its educational mission to help policymakers and citizens better understand the consequences of government policies. Consistent with a belief in limited government, the Goldwater Institute is supported entirely by the generosity of its members.*

## Guaranteed Research

*The Goldwater Institute is committed to accurate research. The Institute guarantees that all original factual data are true and correct to the best of our knowledge and that information attributed to other sources is accurately represented. If the accuracy of any material fact or reference to an independent source is questioned and brought to the Institute's attention with supporting evidence, the Institute will respond in writing. If an error exists, it will be noted on the Goldwater Institute website and in all subsequent distribution of the publication, which constitutes the complete and final remedy under this guarantee.*

GOLDWATER
INSTITUTE
*in defense of liberty*

500 East Coronado Rd., Phoenix, AZ 85004 | Phone (602) 462-5000 | Fax (602) 256-7045 | www.goldwaterinstitute.org