

# State-Federal Relations: Defense, Demography, Debt, and Deconstruction as Destiny

By John Kincaid

*Coercive federalism has shown great continuity since the late 1960s, as characterized by a shift of federal aid from places to persons, policy conditions and earmarks attached to federal aid, preemptions, federal encroachments on state taxation, federalization of state criminal law, defunct intergovernmental institutions, reduced federal-state cooperation within major intergovernmental programs, and federal court litigation. However, unfunded federal mandates and federal court orders mandating major state institutional change have become less prevalent. State policy activism remains vigorous, but the U.S. Supreme Court's state-friendly federalism jurisprudence has stalled since 2002.*

State-federal relations reflect both long-term trends initiated in the late 1960s and shorter term trends triggered by the current president and by the terrorist attacks of September 11, 2001. The long-term trends are those of coercive or regulatory federalism. These trends continue largely unabated because Congress and the president feel politically and constitutionally uninhibited about displacing state powers.<sup>1</sup> The U.S. Supreme Court, which became more state-friendly in the 1990s, has again become less willing to restrain federal power. The shorter term trends are ones of fiscal constraint induced by the economic downturn of 2001-2003 but now being prolonged by the costs of national defense and homeland security, social welfare for senior citizens and long-term federal deficits.<sup>2</sup> Although state revenue collections have improved significantly since FY 2003, states face rising costs for major programs such as Medicaid, as well as a need to replenish rainy-day funds. Caught between increasing social welfare costs, reduced federal domestic spending, and voter resistance to tax increases, the watchwords for state officials are budget constraints and fiscal discipline.

A federalism bell that did not ring in 2004 was Electoral College reform. George W. Bush's victory in the popular and Electoral College votes quelled revival of this issue. Another federalism bell that stopped ringing is voting reform. Although implementation of the Help America Vote Act continues, the absence of a major voting scandal in the 2004 presidential election pushed voting reform off center stage.

## 4-D Destiny

The fiscal lifeblood of federalism will be defined for the foreseeable future by compelling costs asso-

ciated with national defense, the demography of aging, long-term deficits, and deconstruction of federal fiscal roles in many domestic programs.

## Defense and Homeland Security

The end of the Cold War in 1989 delivered a peace dividend, which, combined with a booming economy during much of the 1990s, enhanced domestic spending. This dividend expired with President Bush's declaration of a war on terrorism following the terrorist attacks of 2001. High and rising costs for defense, homeland security, veterans' benefits and international relations—all of which will consume nearly a quarter of federal spending in FY 2006—will be a long-term feature of the federal budget. Consequently, fewer federal dollars will be available for state and local governments. Furthermore, if all discretionary defense, domestic and international spending is capped, there will be tough defense-versus-domestic competition for money. Overall, reductions in federal domestic discretionary-spending (about a third of which is for grants-in-aid) are likely for the foreseeable future.

At the same time, the heavy reliance placed on National Guard units to prosecute the wars in Afghanistan and Iraq has left many states short-handed for responding to domestic emergencies. If recruitment for the National Guard declines as well, many states will lack sufficient military personnel to manage sizable emergencies. Additionally, there are likely to be reductions in federal aid for police and fire services. In an era marked by increased devastation from natural disasters, plus threats of catastrophic terrorism, state and local preparedness is crucial, but that preparedness will require more state and local own-source funding.

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Generally, the Department of Homeland Security has established cooperative relationships with state and local agencies, and complaints about the slow flow of funds to states, and especially to cities, became less prevalent by late 2004, particularly when money for the country's 50 largest cities began to flow directly to them rather than through the governors' offices. Instead, concerns are now being expressed about secrecy surrounding how states are spending counterterrorism money. Nevertheless, the flow of federal money for homeland security will not be commensurate with the costs of state and local security responsibilities; hence, homeland security will be a long-running competitor for state and local tax dollars.

### *Demography*

Social Security, Medicare and other health spending will consume about 46 percent of the FY 2006 federal budget. This can be compared to the categories of agriculture, commerce, community development, education, energy, environment, housing, job training, natural resources, social services, and transportation, which together, will consume only about 10 percent of the FY 2006 federal budget, and to interest payments on the national debt, which will absorb some 8 percent. The new Medicare prescription-drug benefit, which might cost \$700 billion over the next 10 years, will add another huge component to federal social welfare spending.

The aging of the U.S. population is the states' single largest and most refractory fiscal challenge, one that will soon become a relentless feature of state budgeting and other policy-making. Federal aid will be constrained because the federal budget will face the same challenge. At the same time, senior citizens, living mostly on fixed and time-limited incomes, are likely to resist tax increases.

### *Debt*

Increased defense and entitlement spending, along with tax reductions, which produced a \$413 billion deficit in FY 2004, will put increasing downward pressure on federal spending on discretionary domestic programs, especially grants for states and local governments. For example, Congress failed to reauthorize surface transportation—the Safe, Accountable, Flexible, and Efficient Transportation Equity Act (SAFETEA)—in 2004 because President Bush insisted on a less costly bill of \$256 billion compared to the House's \$275 billion bill and Senate's \$318 billion bill.

The projected federal deficit for FY 2005 is \$427 billion, with the deficit still running at about \$207

billion in 2010. Reductions in federal spending are expected, for example, for K-12 education, Medicaid, Community Development Block Grants, Section 8 housing rental assistance, low-income housing tax credit, low-income home-energy assistance, food stamps, some child-care assistance, Clean Water State Revolving Fund, public health, and bioterrorism, as well as the elimination of such programs as HOPE VI (public housing), the Community Services Block Grant and AMTRAK subsidies.

### *Deconstruction*

Federal fiscal reductions and withdrawals from a variety of domestic programs have been evident in recent years and will become more so. Yet federal officials are reluctant to relinquish regulations. Consequently, state and local governments will be expected to pick up more of the costs of domestic services while also, in many instances, being expected to comply with federal regulations.

In response to this trend, the National Conference of State Legislatures recently revived its *Mandate Monitor*, estimating that the costs to states of carrying out federally mandated programs will be more than \$29 billion in FY 2004 and over \$35 billion in FY 2005. Strictly speaking, few if any of these costs stem from mandates. Instead, the costs stem from such things as conditions attached to federal aid, federal failures to release funds, substantive changes to entitlement programs, reduced funding for administration, unfunded increases in administrative rules, increased sanctions, and changes in federal tax policies.

### *Onward Coercive Federalism*

Although the federal system remains cooperative in many respects, especially in most intergovernmental-administration arenas, the predominant political, fiscal, statutory, regulatory, and judicial trends have entailed impositions of federal dictates on state and local governments.

### *Grants-in-Aid*

Although President Bush proposed a modest increase to \$435.7 billion in federal aid for states and localities in FY 2006 (about 17 percent of the budget), federal aid has taken on three significant characteristics in this era of coercive federalism. First, aid has shifted substantially from places to persons; that is, almost two-thirds of federal aid is now dedicated for payments to individuals (i.e., social welfare).<sup>3</sup> Among the long-term consequences of this shift is that place-oriented aid for such functions as infrastructure, economic development and education has declined

steeply, and the increased aid for social welfare has locked state budgets into programs ripe for escalating federal regulation and matching state costs.

Medicaid, which alone accounts for almost 45 percent of all federal aid and serves nearly 52 million people, is the leading example of this shift. Combined federal and state spending on Medicaid has increased 63 percent during the last five years. The federal government provides 57 percent of the nearly \$300 billion of total Medicaid funding. President Bush has proposed \$45 billion in Medicaid reductions over 10 years, a proposal strongly resisted by the governors. In turn, Bush wants to give states more flexibility and to reduce or eliminate the current process by which states must apply for waivers from federal rules. However, even with state cutbacks in services, Medicaid continues to display a voracious appetite for state dollars.

A second characteristic has been increased use of conditions of aid to achieve federal objectives that lie beyond Congress's constitutionally enumerated powers and to extract higher levels of spending on federal objectives from state and local governments. Conditions of aid, which are now often mistakenly called "mandates," are a powerful tool for federal policy-makers.<sup>4</sup> The 670-page No Child Left Behind Act (NCLB) of 2002 is the states' current *cause célèbre* because of the costly testing and performance requirements established by the NCLB. Even the governor and legislature of Utah, the state that voted the most strongly for Bush in 2004, have demanded more freedom from the NCLB's "mandates."<sup>5</sup> Recent research seems to confirm state officials' complaints that the NCLB's compliance costs substantially exceed the law's grant-in-aid funding.<sup>6</sup> Although the U.S. Department of Education has recently taken a more flexible approach to enforcing the NCLB, President Bush wants to extend the NCLB's requirements beyond the eighth grade to all public high schools.

After a two-year battle, Congress reauthorized the Individuals with Disabilities Education Act (IDEA) and even authorized the federal government to pay by 2011 nearly 40 percent of the states' annual excess costs of educating the nation's 6.5 million children with disabilities. This 40 percent had been promised when IDEA was enacted in 1975, but it never exceeded 19 percent. However, IDEA funding remains discretionary, and the reauthorized IDEA imposes new regulations on the states while also providing relief from some previous rules.

Several other education programs, including Head Start, the Higher Education Act and the Workforce

Investment Act, were not reauthorized by the 108<sup>th</sup> Congress. For the second time, Congress also failed to reauthorize the 1996 welfare reform law, which expired in 2002. Congress did revive the E-Rate program that provides grants to schools and libraries to connect to the Internet. The law also authorizes \$250 million a year in grants to states over five years to improve the ability of 911 systems to track the location of cell phone callers.

Congress passed the Innocence Protection Act, which, among other things, provides grants to states to help expedite the processing of biological crime-scene evidence, preserve DNA evidence, defray the costs of post-conviction DNA testing, and represent defendants as well as victims in state capital cases. Congress also authorized the U.S. Department of Health and Human Services to give preference for its asthma-prevention grants to states that allow students with asthma or other life-endangering allergies to medicate themselves at school.

The third notable change affecting the delivery of aid to places has been a significant increase in congressional earmarking (i.e., pork-barreling). The number of earmarks increased from under 2,000 in 1998 to 9,362 by 2003. For example, the 2004 SAFETEA bill contained some 2,881 earmarks compared to 538 in the 1991 act and 1,800 in the 1998 law.<sup>7</sup> The Fund for the Improvement of Postsecondary Education even cancelled its FY 2005 competition for grants because 89 percent of the appropriation was already consumed by 419 earmarked grants (compared to two earmarks accounting for 18 percent of the appropriation in FY 1998). Earmarking advocates argue that members of Congress, as elected officials, are better qualified than "bureaucrats" to make funding allocations.

### **Mandates**

Mandates have been another characteristic of coercive federalism; however, mandating plateaued with enactment of the Unfunded Mandates Reform Act (UMRA) of 1995. UMRA cut new mandate enactments sharply, but did not eliminate standing mandates. Currently, one sizable mandate looms on the horizon—a bill to standardize drivers' licenses, the Real ID Act, which could cost states hundreds of millions. States could opt out, but then their licenses would not be accepted for any federal-government purpose, including boarding an airplane, purchasing a firearm, and entering a federal building. The bill calls for a year and a half of implementation consultation among state and federal officials and others.

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### *Preemptions*

The historically unprecedented level of federal preemption of state powers characteristic of coercive federalism was well symbolized by enactment of the Class Action Fairness Act of 2005, which prohibits state courts from hearing most class-action suits that involve more than 100 plaintiffs and \$5 million in potential damages. Such suits must be heard by federal courts. This is a major change in tort law and, thus, a major derogation of an historic state power. The act, however, is only the first of what President Bush and many members of Congress foresee as much broader preempting of state tort powers.

In March 2004, the U.S. Office of the Comptroller of the Currency issued a final rule preempting a range of state laws previously applicable to national banks. Federal preemption is not a new idea," said Comptroller John D. Hawke, "Its roots lie in the Supremacy Clause of the Constitution, and the courts have repeatedly held that the states cannot restrict the federally authorized activities of national banks."<sup>8</sup> Insurance regulation, long a state responsibility, will likely come under increased congressional scrutiny, especially with insurance companies pressing for federal intervention. As U.S. Sen. Richard C. Shelby's office put it, "If the state regulators are not up to the task of regulating the insurance industry, we may have to look at alternatives."<sup>9</sup>

Preemption is frequently upheld by the U.S. Supreme Court. In fact, the "Federalism Five" justices who ordinarily vote for the states in federalism cases often vote against the states in preemption cases. In a pair of 2004 cases, for example, the Court unanimously held that patients' rights laws in 10 states that allowed patients to sue their health plans over decisions to withhold coverage were preempted by the 1974 Employee Retirement Income Security Act.<sup>10</sup>

### *Taxation*

Another characteristic of coercive federalism has been federal constraints on state taxation and borrowing, beginning especially with the enactment of limits on tax-exempt private-activity bonds in 1984. Federal judicial and statutory prohibitions of state taxation of Internet services and sales are among the most prominent, current constraints. In November 2004, Congress extended its Internet tax ban (i.e., the Internet Tax Non-Discrimination Act) to November 2007. Congress did revive the federal income-tax deduction for state and local sales taxes (which had been eliminated in 1986) for 2004 and 2005, pri-

marily to benefit taxpayers who live in states lacking an income tax (e.g., Florida, South Dakota, Texas and Washington). However, itemizing taxpayers can only deduct their state and local income taxes or sales taxes, not both.

Talk in Congress and the White House about possibly repealing the estate tax permanently, limiting or eliminating the deductibility of all state and local taxes, providing new federal-tax deductions, and offering new tax incentives for saving and charitable giving could lead, directly and indirectly, to reductions in state and local revenues. Even more ominous for state-local revenue systems is the quietly growing discussion of enacting a federal sales tax or value added tax.

A potential time bomb for state and local economic-development efforts is a 2004 ruling by a three-judge panel of the U.S. Court of Appeals for the Sixth Circuit that a 1998 tax break awarded to DaimlerChrysler AG by Toledo and Ohio violated the U.S. Constitution's commerce clause. Business organizations, such as the Council on State Taxation, have joined with state and local officials in a vigorous effort to overturn this ruling and preserve states' rights.

### *Federalization of State Criminal Law*

Another feature of coercive federalism has been the federalization of state criminal law, to the point where there are now some 3,500 federal criminal offenses, nearly half of which have been enacted since the mid-1960s. The number of federal prisoners has increased from about 20,000 in 1981 to nearly 175,000 today, and the number of federal prosecutors jumped from 1,500 in 1981 to more than 7,000 now. Generally, federal criminal laws are tougher than comparable state laws and make prosecutions and convictions easier than under state laws.

### *Demise of Intergovernmental Institutions*

Coercive federalism has been marked, as well, by the demise of executive and congressional intergovernmental institutions established during the era of cooperative federalism to enhance cooperation. Most notable was the death of the U.S. Advisory Commission on Intergovernmental Relations in 1996 after 37 years of operation.

### *Decline of Political Cooperation*

There also has been a decline in federal-state cooperation in major grant programs such as Medicaid and surface transportation, with Congress earmarking and altering programs more in response to national and regional interest groups than to elected state

and local officials, who themselves are viewed as little more than interest groups.

**Federal Court Litigation**

Coercive federalism also has been marked by unprecedented numbers of federal court orders and a quantum leap in the number of times state and local governments are sued in federal courts. Although federal court orders dictating major and costly changes in such institutions as schools, prisons and mental health facilities have declined since the early 1990s, state and local governments are subject to high levels of litigation in federal courts, with various interests often trying to block major state policy initiatives through litigation. The U.S. Supreme Court resurrected the 11th Amendment in the 1990s to restrain some types of such litigation, but the reach of the Court's decisions has been quite limited.

**U.S. Supreme Court's Stalled Federalism Revolution**

Indeed, since 2002, the Supreme Court has exhibited a reluctance to continue its state-friendly federalism rulings initiated in 1991. In fact, in the major federalism case of 2003-2004, the Court, voting 5-4, held that states have no 11th Amendment immunity under Title II of the Americans with Disabilities Act against citizen lawsuits over gaining physical access to courts.<sup>11</sup> The justices also upheld unanimously a 1984 federal law that makes it a federal crime to bribe a state or local official whose agency receives more than \$10,000 in federal grants or contracts.<sup>12</sup> The Court then generated turmoil in about a dozen state criminal-justice systems, plus the federal justice system, by overturning a Washington law that allowed judges to independently increase a convicted defendant's sentence beyond the usual length for the crime.<sup>13</sup>

The Court even sustained one of the key structural supports for coercive federalism, namely, partisan gerrymandering, which creates so many safe U.S. House seats and fosters ideological polarization in Congress. By a 5-4 vote, the Court rejected a Democrat challenge to post-2000 census partisan gerrymandering in Pennsylvania.<sup>14</sup>

**Federalism and the Culture Wars**

For the general public, federalism became salient in 2004 because of debates associated with the so-called culture wars of recent decades. Rulings by the Massachusetts Supreme Judicial Court in 2003 and 2004 upholding gay marriage triggered intense national controversy. President Bush endorsed a fed-

eral constitutional amendment to ban gay marriage nationwide; Democratic presidential candidate John Kerry wanted to leave gay marriage to the states. Bush also asked the federal courts to strike down Oregon's Death With Dignity Act, which permits physician-assisted suicide. Meanwhile, the U.S. Court of Appeals for the Ninth Circuit rejected again an administration effort to neuter California's medicinal marijuana law. As a result of such Bush initiatives, many liberals, historically hostile to states' rights, are now warming to states' rights.<sup>15</sup>

However, there also is growing pressure to allow more state regulation of abortion and for the Supreme Court to set aside its 1973 abortion ruling so as to restore state authority over abortion. Here, the tables are turned, with conservatives supporting states' rights and liberals opposing states' rights.

**State Activism**

Another, seemingly contradictory characteristic of coercive federalism has been state policy activism, especially since the early 1980s. However, this activism has been both a response to coercive federalism as states have bucked federal policies and filled federal policy voids and a stimulant of coercive federalism as interest groups have sought federal intervention to tranquilize hyperactive states.

State attorneys general, treasurers, pension-fund heads and others have pursued aggressive litigation and regulation in many policy areas. For example, eight states have joined in a federal lawsuit against utilities to reduce carbon dioxide emissions. The California Air Resources Board (CARB) shocked the automobile industry in 2004 by adopting regulations to reduce automobile and light-truck emissions of carbon dioxide and other greenhouse gases by 30 percent within 11 years. A leading justification for such state activism was expressed by CARB's chairman: "Absent federal leadership, it's important for California to demonstrate that there is a way to address global warming."<sup>16</sup> Nine automakers filed suit to overturn the regulation, but Republican Gov. Arnold Schwarzenegger vowed "to fight the expected court challenges."<sup>17</sup>

Highly publicized in 2004 were efforts by nearly half the states to explore mechanisms, such as state Web sites listing prescreened foreign pharmacies, to help citizens import cheaper pharmaceuticals from Canada in defiance of the U.S. Food and Drug Administration. Several states have approved and supported stem-cell research in defiance of President Bush's policy. Consequently, state activism has brought some intergovernmental policy competition into the federal system.

## FEDERAL-STATE RELATIONS

### Conclusion

Although state activism will generate a kind of competitive state-federal federalism, coercive federalism will be the system's dominant motif and will be exacerbated by the fiscal pressures generated by defense, demography, debt, and deconstruction.

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### Notes

<sup>1</sup> See, John Kincaid, "Trend in Federalism: Continuity, Change and Polarization," *The Book of the States 2004*, (Lexington, KY: The Council of State Governments, 2004), 21-7; John Kincaid, "State-Federal Relations: Continuing Regulatory Federalism," *The Book of the States 2002*, (Lexington, KY: The Council of State Governments, 2002) 25-32; John Kincaid, "From Cooperation to Coercion in American Federalism: Housing, Fragmentation, and Preemption, 1780-1992," *Journal of Law and Politics* 9 (Winter 1993): 333-433.

<sup>2</sup> See, John Kincaid, "Trends in Federalism: Is Fiscal Federalism Fizzling?" *The Book of the States 2003*, (Lexington, KY: The Council of State Governments, 2003), 26-31.

<sup>3</sup> For explication, see John Kincaid, "The State of U.S. Federalism, 2000-2001," *Publius: The Journal of Federalism* 31 (Summer 2001): 1-69.

<sup>4</sup> See, for example, Karl Kronebusch, "Matching Rates and Mandates: Federalism and Children's Medicaid Enrollment," *Policy Studies Journal* 32:3 (2004): 317-37.

<sup>5</sup> Sam Dillon, "Strongly G.O.P. Utah House Challenges Bush's Signature Education Law," *New York Times*, February 16, 2005, A14; Associated Press, "States rebelling over new rules on education," *Express-Times* (Easton), February 18, 2004, A-8.

<sup>6</sup> Jennifer Imazeki and Andrew Reschovsky, "Is No Child Left Behind an Un (or Under) funded Federal Mandate?

Evidence from Texas," *National Tax Journal* 57 (September 2004): 571-79.

<sup>7</sup> Brian Friel, "Defending Pork," *National Journal* 36 (May 8, 2004): 1405.

<sup>8</sup> Statement of the Comptroller of the Currency at <http://www.occ.treas.gov/2004-3aComptrollersstatement.pdf>, accessed March 30, 2004.

<sup>9</sup> Quoted in Joseph B. Treaster, "States vs. U.S.: Who Will Police Insurance Firms?" *New York Times*, December 31, 2004, C3.

<sup>10</sup> *Aetna Health Care Inc. v. Davila and Cigna HealthCare of Texas Inc. v. Calad*, 124 S. Ct. 2488 (2004).

<sup>11</sup> *Tennessee v. Lane*, 124 S. Ct. 1978 (2004).

<sup>12</sup> *Sabri v. United States*, 124 S. Ct. 1941 (2004).

<sup>13</sup> *Blakely v. Washington*, 124 S. Ct. 2531 (2004).

<sup>14</sup> *Vieth v. Jubelirer*, 541 U.S. 267 (2004).

<sup>15</sup> See, for example, Jim Holt, "A States' Rights Left?" *New York Times Magazine*, November 21, 2004, 27-28; Jonah Goldberg, "Federalism vs. states' rights," *Express-Times* (Easton), December 2, 2004, A-10.

<sup>16</sup> Quoted in Stuart F. Brown, "California rocks the auto industry," *Fortune* 150 (November 1, 2004): 154.

<sup>17</sup> Quoted in Dan Hakim, "Automakers Sue to Block Emissions Law In California," *New York Times*, December 8, 2004, C1.

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