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# Federal Grants, State Decisions

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## FEDERAL GRANTS, STATE DECISIONS

BRIAN GALLE\*

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### ABSTRACT

*The authority to raise and spend money is one of the most expansive and fundamental of all Congress's enumerated powers, particularly when Congress chooses to impose conditions on those who wish to receive its cash. The consensus modern view of this "conditional spending" is that its*

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*unfettered use threatens the diversity and accountability goals of “our federalism.” As a result, nearly all commentators support either direct or indirect judge-made limits on conditional spending. These claims, I argue, rest on a set of largely unexamined assumptions about the political motivations, budgetary situation, and other incentives of the state officials who must decide whether or not to accept federal offers.*

*Thus, this Article attempts to begin a truly in-depth study of the political economy of state decisions to accept federal funds. In particular, I focus on state officials’ own incentives to preserve diversity and accountability, albeit for self-interested reasons. For example, I document and model the ways in which opportunities to impose hidden taxes, or to export taxes onto outsiders, may encourage officials to turn down federal grants that might diminish state autonomy. I also examine closely the available empirical evidence on the actual fiscal situation of states, concluding there is no evidence states are in such dire financial straits that they are likely ever obliged to accept federal funds. In sum, I argue that the current consensus is mistaken about the need for constraining conditional federal grants. Thus, there is presently little evidence in favor of judicial intervention in freely chosen state decisions to accept grants.*

#### INTRODUCTION

Although it is a familiar point that debates over the most appealing way to read a statute may turn largely on empirical questions,<sup>1</sup> not all statutory debates have yet been subject to careful examination of the underlying empirics. For example, the Supreme Court has held that conditions attached by Congress to federal grants offered to state or local governments should be interpreted strictly against Congress, even where the plaintiff suing to enforce the condition is a third party.<sup>2</sup> I argue here that this position can be justified, if at all, only by a showing that there are defects in the bargaining process between Congress and its grantees, and that those defects threaten values the courts are charged with protecting. Defenders of the Court’s approach have suggested that states bargain from a position of weakness, and that their representatives have strong incentives to ignore the federalism values protected by the Constitution.<sup>3</sup> In this Article, I attempt to subject these assumptions to more rigorous scrutiny, arguing that officials in fact have their own self-serving incentives to preserve federalism values. In addition, I survey recent empirical evidence suggesting that officials typically have access to the resources to pursue their goals contrary to Congress’s entreaties.

Given the scale of so-called “conditional” federal spending, and its place in

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<sup>1</sup> Cass R. Sunstein & Adrian Vermeule, *Interpretation and Institutions*, 101 MICH. L. REV. 885, 889-90 (2003).

<sup>2</sup> *Pennhurst State Sch. & Hosp. v. Halderman*, 451 U.S. 1, 17 (1981).

<sup>3</sup> See *infra* Part I.B.

our constitutional structure, these questions are urgent ones.<sup>4</sup> A vast array of domestic programs depend, in one way or another, on the states' willingness to accept both federal dollars and the terms and conditions that go with them.<sup>5</sup> The question, then, of how or whether the federal judiciary should police these grants is a correspondingly important one.<sup>6</sup>

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<sup>4</sup> Of course, I am not the first to note the importance of spending legislation. See, e.g., David Engdahl, *The Spending Power*, 44 DUKE L.J. 1, 2 (1994); Edward M. Gramlich, *Alternative Federal Policies for Stimulating State and Local Expenditures: A Comparison of Their Effects*, 21 NAT'L TAX J. 119, 119-20 (1968); Lewis B. Kaden, *Politics, Money and State Sovereignty: The Judicial Role*, 79 COLUM. L. REV. 847, 847-49 (1979); Thomas R. McCoy & Barry Friedman, *Conditional Spending: Federalism's Trojan Horse*, 1988 SUP. CT. REV. 85, 86; Albert J. Rosenthal, *Conditional Federal Spending and the Constitution*, 39 STAN. L. REV. 1103, 1105-06 (1987); Peter J. Smith, Pennhurst, Chevron, and the Spending Power, 110 YALE L.J. 1187, 1188 (2001).

<sup>5</sup> These programs include: the Individuals with Disabilities Education Act, 20 U.S.C. § 1407(a)(1) (2006); Title IX of the Education Amendments of 1972, 20 U.S.C. § 1681(a) (2006); No Child Left Behind, 20 U.S.C. § 6311(a)(1) (2006); Medicaid, 42 U.S.C. § 1396c (2006); Title VI of the Civil Rights Act of 1964, 42 U.S.C. § 2000d (2006); Clean Air Act, 42 U.S.C. §§ 7410, 7420 (2006). Lynn Baker and Mitchell Berman also observe the importance of conditional spending doctrine for the Religious Land Use and Institutionalized Persons Act of 2000 ("RLUIPA"), 42 U.S.C. § 2000 (2006), Congress's latest effort to require states to take greater account of the free exercise claims of individuals than the Supreme Court is willing to afford. Lynn A. Baker & Mitchell N. Berman, *Getting Off the Dole: Why the Court Should Abandon its Spending Doctrine, and How a Too-Clever Congress Could Provoke it to Do So*, 78 IND. L.J. 459, 495-97 (2003) [hereinafter Baker & Berman, *Getting Off the Dole*].

For some basic discussions of the origins and structures of cooperative federalism, see MORTON GRODZINS, *THE AMERICAN SYSTEM: A NEW VIEW OF GOVERNMENT IN THE UNITED STATES* 7-10 (Daniel J. Elazar ed., 1966); WILLIAM H. RIKER, *FEDERALISM: ORIGIN, OPERATION, SIGNIFICANCE* 10-11 (1964); Jerry L. Mashaw & Dylan S. Calsyn, *Block Grants, Entitlements, and Federalism: A Conceptual Map of Contested Terrain*, 14 YALE L. & POL'Y REV. 297, 300-24 (1996); Philip J. Weiser, *Towards a Constitutional Architecture for Cooperative Federalism*, 79 N.C. L. REV. 663, 668-73 (2001).

<sup>6</sup> In addition to debates over conditional spending per se, there has also been a fair amount of discussion of the fiscal dimensions of state and federal relations in the context of a related problem: the so-called "unfunded mandate." This scholarship, for the most part, focuses on the possibility that Congress is obligated to provide funds to accompany any regulatory demands it imposes on state or local governments. See Robert W. Adler, *Unfunded Mandates and Fiscal Federalism: A Critique*, 50 VAND. L. REV. 1137, 1231-54 (1997); David A. Dana, *The Case for Unfunded Environmental Mandates*, 69 S. CAL. L. REV. 1, 3-5 (1995); Rena I. Steinzor, *Unfunded Environmental Mandates and the "New (New) Federalism": Devolution, Revolution, or Reform?*, 81 MINN. L. REV. 97, 103-11 (1996); Edward A. Zelinsky, *Unfunded Mandates, Hidden Taxation, and the Tenth Amendment: On Public Choice, Public Interest, and Public Services*, 46 VAND. L. REV. 1355, 1356 (1993). But see Evan H. Caminker, *State Sovereignty and Subordinacy: May Congress Commandeer State Officers to Implement Federal Law?*, 95 COLUM. L. REV. 1001, 1081-87 (1995); Julie A. Roin, *Reconceptualizing Unfunded Mandates and Other*

The Supreme Court's decision in *Arlington Central School District Board of Education v. Murphy* offers an occasion to revisit the question of judicial oversight of conditional federal spending.<sup>7</sup> *Arlington* held, in essence, that the word "costs" in the Individuals with Disabilities Education Act ("IDEA") did not include the cost incurred by prevailing plaintiff parents to hire experts as part of their litigation to secure a free and appropriate education for their child.<sup>8</sup> By the time the dispute reached the Supreme Court, the best reading of the statute was somewhat unclear; there was both clear legislative history pointing one way and a series of judicial interpretations, decided between the enactment of the statute and 2006, pointing in the other direction.<sup>9</sup>

The *Arlington* Court resolved its interpretive problem by reading the IDEA strictly against Congress, a technique sometimes called the "clear statement rule."<sup>10</sup> That rule, dating to the early 1980s but somewhat unevenly enforced since,<sup>11</sup> holds that courts may enforce against states the conditions of a federal grant only if those conditions are stated "unambiguously" in the statute.<sup>12</sup> As scholars have recognized, the rule serves as a sort of second-best constitutional constraint on federal expansion; rather than directly striking down strings attached to federal grants, the Court simply interprets them penuriously.<sup>13</sup>

The clear statement rule seems to depend on an assumption that state decisions are not to be trusted.<sup>14</sup> Rational actors would only accept offers they

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*Regulations*, 93 NW. U. L. REV. 351, 386 (1999). This Article considers, in effect, the reciprocal question: how best should we interpret conditions Congress imposes when it in fact does fund its "mandates"?

<sup>7</sup> *Arlington Cent. Sch. Dist. Bd. of Educ. v. Murphy*, 126 S. Ct. 2455 (2006). For other early commentary on the *Arlington* decision, see Ilya Somin, *A False Dawn for Federalism: Clear Statement Rules After Gonzales v. Raich*, in *CATO SUPREME COURT REVIEW* 2005-2006, at 113, 131-33 (Mark K. Moller ed., 2006) [hereinafter Somin, *False Dawn*].

<sup>8</sup> *Arlington*, 126 S. Ct. at 2457.

<sup>9</sup> *Id.* at 2459-63.

<sup>10</sup> *Id.* at 2459, 2461.

<sup>11</sup> See Baker & Berman, *Getting Off the Dole*, *supra* note 5, at 465; Brian Galle, *Getting Spending: How to Replace Clear Statement Rules with Clear Thinking About Conditional Grants of Federal Funds*, 37 CONN. L. REV. 155, 162-66 (2004) [hereinafter Galle, *Getting Spending*]; Smith, *supra* note 4, at 1189-90.

<sup>12</sup> *Pennhurst State Sch. & Hosp. v. Halderman*, 451 U.S. 1, 17 (1981); *Barnes v. Gorman*, 536 U.S. 181, 186 (2002); *Gregory v. Ashcroft*, 501 U.S. 452, 465-67 (1991).

<sup>13</sup> See Dan T. Coenen, *The Rehnquist Court, Structural Due Process, and Semisubstantive Constitutional Review*, 75 S. CAL. L. REV. 1281, 1303-04 (2002); David Freeman Engstrom, *Drawing Lines Between Chevron and Pennhurst: A Functional Analysis of the Spending Power, Federalism, and the Administrative State*, 82 TEX. L. REV. 1197, 1242-46 (2004); William N. Eskridge, Jr. & Philip P. Frickey, *Quasi-Constitutional Law: Clear Statement Rules as Constitutional Lawmaking*, 45 VAND. L. REV. 593, 624 (1992); Nicholas Quinn Rosenkranz, *Federal Rules of Statutory Interpretation*, 115 HARV. L. REV. 2085, 2097, 2122-23 (2002).

<sup>14</sup> See Eskridge & Frickey, *supra* note 13, at 635; H. Geoffrey Moulton, Jr., *The Quixotic*

perceive as producing a net benefit for themselves (or perhaps their constituents). If state officials were well-advised, and really cared about the structural constraints on federal power some see in the Constitution, then there would be no need for the clear statement rule.<sup>15</sup> The officials would refuse to accept offers that, in the long run, would undermine their own autonomy, diminish the diversity that leads to good national policy-making, or otherwise undercut what we think of as the values of federalism.<sup>16</sup> Or, they would at least decline such offers unless the benefits of cooperation would outweigh those costs.<sup>17</sup>

Of course, public officials at any level are unlikely to be perfectly rational, or to represent perfectly the interests of their constituents.<sup>18</sup> Instead, we have a world of second-bests. Indeed, it is widely understood that the Constitution itself is designed as a tool for channeling the less-than-perfect impulses of public officials into routes that nonetheless lead to acceptable outcomes.<sup>19</sup>

What is not widely understood, or to date much studied, is whether such second-best channels funnel state and local actors when they decide whether to accept federal funds.<sup>20</sup> The Supreme Court has barely nodded at the possibility.<sup>21</sup> The existing academic literature argues almost exclusively that

**Comment [BDG1]:** This would be a tough infra cite to provide, since I view the entire article as the response to this point.

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*Search for a Judicially Enforceable Federalism*, 83 MINN. L. REV. 849, 867, 911 (1999); John C. Yoo, *The Judicial Safeguards of Federalism*, 70 S. CAL. L. REV. 1311, 1319 (1997).

<sup>15</sup> For a more detailed analysis on this point, see *infra* Part I.B.

<sup>16</sup> See Roderick M. Hills, Jr., *The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and “Dual Sovereignty” Doesn’t*, 96 MICH. L. REV. 813, 862 (1998) [hereinafter Hills, *Cooperative Federalism*]; Ilya Somin, *Closing the Pandora’s Box of Federalism: The Case for Judicial Restriction of Federal Subsidies to State Governments*, 90 GEO. L.J. 461, 465 (2002) [hereinafter Somin, *Closing the Pandora’s Box*].

<sup>17</sup> See Hills, *Cooperative Federalism*, *supra* note 16, at 874.

<sup>18</sup> See, e.g., John Ferejohn, *Accountability and Authority: Toward a Theory of Political Accountability*, in DEMOCRACY, ACCOUNTABILITY, AND REPRESENTATION 131, 137-38 (Adam Przeworski et al. eds., 1999); Joseph P. Kalt & Mark A. Zupan, *The Apparent Ideological Behavior of Legislators: Testing for Principal-Agent Slack in Political Institutions*, 33 J.L. & ECON. 103, 103-06, 128 (1990).

<sup>19</sup> See, e.g., Frank H. Easterbrook, *The State of Madison’s Vision of the State: A Public Choice Perspective*, 107 HARV. L. REV. 1328, 1332-33 (1994); Daryl J. Levinson, *Empire-Building Government in Constitutional Law*, 118 HARV. L. REV. 915, 921-22 (2005); Jonathan R. Macey, *Transaction Costs and the Normative Elements of the Public Choice Model: An Application to Constitutional Theory*, 74 VA. L. REV. 471, 480-87 (1988).

<sup>20</sup> For an exception, see John O. McGinnis & Ilya Somin, *Federalism vs. States’ Rights: A Defense of Judicial Review in a Federal System*, 99 NW. U. L. REV. 89, 121 (2004) [hereinafter McGinnis & Somin, *Federalism vs. States’ Rights*] (arguing that state institutional structures in fact are insufficient to preserve federalism values). I take issue with this point herein. [ES: Can you provide an infra cite to where this is?]

<sup>21</sup> See *New York v. United States*, 505 U.S. 144, 182 (1992) (contending that “powerful incentives might lead both federal and state officials to view departures from the federal structure to be in their personal interests”).

the public cannot expect state officials to act in ways that preserve federalism values.<sup>22</sup> States, in these accounts, are strapped for cash on account of competition for mobile capital and federal siphoning of scarce tax dollars, or otherwise in need of some central-government resolution to their collective-action dilemmas.<sup>23</sup> State officials must grab whatever funds or other nationalized solutions are available in order to provide the services their constituents demand.<sup>24</sup> [ES: This sentence seems a little awkward. I tried to change it, but am open to other suggestions.] Since the costs that flow from these acceptances arise down the road, or are difficult for constituents to notice, the officials pay them little heed relative to the value of the offered dollars or services.<sup>25</sup> As a result, voters later inappropriately blame state officials for decisions that Congress putatively imposed.<sup>26</sup>

In other words, courts and scholars generally believe that state officials will not turn down federal grants on their own in order to preserve a diverse national market for legal rules. Indeed, even scholars who generally are not sympathetic to arguments for judicial enforcement of federalism values appear to accept this claim. These other scholars, most prominently Professor Tribe, support the clear statement rule.<sup>27</sup> They argue that binding states by the terms

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<sup>22</sup> See Lynn A. Baker, *Conditional Federal Spending After Lopez*, 95 COLUM. L. REV. 1911, 1933 (1995) [hereinafter Baker, *Conditional Spending*]; McCoy & Friedman, *supra* note 4, at 124; McGinnis & Somin, *Federalism vs. States' Rights*, *supra* note 20, at 90; Somin, *Closing the Pandora's Box*, *supra* note 16, at 462-63, 484, 496; Somin, *False Dawn*, *supra* note 7, at 137; Richard B. Stewart, *Federalism and Rights*, 19 GA. L. REV. 917, 958 (1985); Ernest A. Young, *Two Cheers for Process Federalism*, 46 VILL. L. REV. 1349, 1385-92 (2001) [hereinafter Young, *Two Cheers*].

<sup>23</sup> See Baker, *Conditional Spending*, *supra* note 22, at 1936 (describing how there is “no competitor to the federal government” to whom states could turn for alternative revenue); McCoy & Friedman, *supra* note 4, at 86 (explaining how the federal tax burden has increased, making it harder to raise state revenue and increasing state reliance on federal funds); Somin, *Closing the Pandora's Box*, *supra* note 16, at 468 (describing the horizontal competition between states because dissatisfied residents can move to another state); Stewart, *supra* note 22, at 971 (explaining that states are subject to “nearly irresistible” internal pressures from taxpayers and external pressures from competing states to accept federal funds).

<sup>24</sup> Baker, *Conditional Spending*, *supra* note 22, at 1936-39; McCoy & Friedman, *supra* note 4, at 86, 124; Somin, *Closing the Pandora's Box*, *supra* note 16, at 484; Stewart, *supra* note 22, at 971.

<sup>25</sup> See McCoy & Friedman, *supra* note 4, at 124; cf. McGinnis & Somin, *Federalism vs. States' Rights*, *supra* note 20, at 94-100 (arguing that because of “rational ignorance” among constituents, government officials undervalue costs of burdens associated with acceding to federal objectives).

<sup>26</sup> See McCoy & Friedman, *supra* note 4, at 125 (exemplifying the problem by the fact that voters perceive the minimum drinking age law to be imposed by state government); Stewart, *supra* note 22, at 958.

<sup>27</sup> STEPHEN BREYER, *ACTIVE LIBERTY: INTERPRETING OUR DEMOCRATIC CONSTITUTION* 64-65 (2005); LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 6-25, at 479-81 (2d

of grant conditions arguably unclear at the time of acceptance will make it more difficult for voters to police offers and acceptances. Further, granting final say over grant terms to courts is said to diminish states' continuing political influence over those terms. As I attempt to show, these claims assume defects in the process of state decisions. The voter activism story presumes that officials imperfectly protect federalism concerns absent close monitoring by the public. And, absent some story about procedural flaws in state decision-making, it is hard to see how the state-political-influence account explains why states should in effect be forbidden to assume the risk that in the future they will enjoy diminished influence over federal law.

My central argument here is that the available economic data belie, or at best do not support the claims that state officials will fail to preserve diversity, or that federal grants wrongly obscure official accountability. As a result, I maintain that decisions applying the clear statement rule, as well as more direct limits on conditional spending, are hard to defend. I examine the public finance literature on state and local fiscal health, and state and local official responses to grants from higher-level governments. I find, among other significant information, that critics of unconstrained conditional spending seem to greatly underestimate the capacity of state and local governments to raise their own revenues. In many cases the perceived political cost to officials of raising money locally will be less than the perceived cost of federal grant conditions, even if officials heavily discount those conditions. In those situations, the officials will refuse the grant unless there is an increase in its perceived benefits. In effect, state own-revenue capacity is an independent check on federal expansion by means of conditional spending. Relatedly, critics overlook the indirect fiscal supports (and, therefore, indirect constraints on Congress's power to utilize conditional spending) that flow to states through the federal tax system.

If local revenues are to be the prime check against federal expansion, it is important to know whether those revenues are large enough to matter. Therefore, I also examine available data on state fiscal capacity – that is, the ability of the States to raise enough money to provide the services demanded by their citizens. For a variety of reasons, direct measures of fiscal capacity are difficult or controversial.<sup>28</sup> However, I examine one possible indirect measure, the existence of the “flypaper effect.” The “flypaper effect” is the

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ed. 1988); LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 6-28, at 1175-76 (3d ed. 2000); Engdahl, *supra* note 4, at 71; William P. Marshall & Jason S. Cowart, *State Immunity, Political Accountability, and Alden v. Maine*, 75 NOTRE DAME L. REV. 1069, 1078-79 (2000); Thomas W. Merrill, *Rescuing Federalism After Raich: The Case for Clear Statement Rules*, 9 LEWIS & CLARK L. REV. 823, 826, 833 (2005); Smith, *supra* note 4, at 1203-04; Somin, *False Dawn*, *supra* note 7, at 115; Stewart, *supra* note 22, at 966-69; Cass R. Sunstein, *Nondelegation Canons*, 67 U. CHI. L. REV. 315, 339 (2000); Young, *Two Cheers*, *supra* note 22, at 1354-55.

<sup>28</sup> See *infra* note 232.



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economic term for grant-recipient expenditures exceeding what classic economic theory would predict to be the amount spent as a result of the grant – money “sticks where it hits” instead of being diverted back to tax cuts.<sup>29</sup> This might be evidence of the inability of states to raise all the money they need to provide services, or at least an indication that federal revenue-raising is more efficient than state taxation. However, after canvassing the existing literature, I find no real support for those explanations, although I acknowledge that they remain at least theoretical possibilities.

In short, I do not expect to refute for certain the claims and implicit assumptions of the proponents of judge-made limits on federal conditional spending. However, I do establish that no convincing evidence presently exists to demonstrate that the reasonably rational decisions of self-serving officials in fact undermine federalism. As I explain, the burden is on proponents of judicial intervention to explain why judges should set aside the freely-made decisions of uncoerced public officials. And so far I see no signs that such a burden can be met.

Part I of this Article sets out the *Arlington* holding as well as the general judicial and academic dispute over the proper scope and interpretation of spending legislation. Part I.B. elaborates on my claim that all of the arguments in favor of limiting spending legislation, including Professor Tribe’s defense of the clear statement rule, rely on an underlying assumption that state officials cannot be trusted to protect federalism values when deciding whether to accept a conditional grant. Part II subjects this assumption to close examination, noting that existing accounts of state official behavior are incomplete in a number of respects, including their failure to consider the possibility that officials can replace costly federal grants with local taxes that at least appear less costly to their constituents. Thus, Part III introduces a simple economic model of the substitutability of local taxes for federal grants. Part IV suggests other theoretical reasons to believe official decisions to accept grants tend to preserve core federalism values. Part V goes a step further, contrasting prevailing assumptions about voter confusion and state influence with the available empirical evidence. Synthesizing a number of studies of state fiscal behavior, I show there is no evidence that state officials are in any meaningful sense constrained to accept federal grants.

#### I. CONDITIONAL SPENDING: A BRIEF BACKGROUND

When Congress distributes money to other persons or entities, it typically does so subject to conditions.<sup>30</sup> This conditional spending is a major avenue

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<sup>29</sup> James R. Hines, Jr. & Richard H. Thaler, *Anomalies: The Flypaper Effect*, J. ECON. PERSP., Autumn 1995, at 217, 218 (attributing the phrase to economist Arthur Okun).

<sup>30</sup> See Laura S. Jensen, *Federalism, Individual Rights, and the Conditional Spending Conundrum*, 33 POLITY 259, 277 (2000). For an overview of the structure of conditional spending (albeit not an especially sympathetic one), see DAVID B. WALKER, TOWARD A FUNCTIONING FEDERALISM 144-51 (1981).

for federal regulation of state, local, and private actors.<sup>31</sup> Congress's authority to attach these conditions to its largesse is usually said to derive from Article I, Section 8 of the Constitution, commonly called the Spending Clause, which grants Congress "Power To lay and collect Taxes . . . to pay the Debts and provide for the common Defence and general Welfare."<sup>32</sup>

For the most part, courts have not directly limited the scope of Congress's power to enact legislation in the form of conditional spending.<sup>33</sup> In the seminal case, *South Dakota v. Dole*, the Supreme Court set out some loose restrictions on conditional grants but acknowledged they were largely aspirational.<sup>34</sup>

The issue instead lies in how courts should interpret the terms of conditional grants. In a series of decisions starting in 1981 with the *Pennhurst* case, the Supreme Court has declared it will not hold states to the conditions attached to a statute rooted in the Spending Clause unless those conditions are stated "unambiguously."<sup>35</sup>

The scope of this doctrine remains, after twenty-five years, still rather confused.<sup>36</sup> The Court has not decided whether or not "unambiguous" conditions can be stated in regulations enacted in furtherance of a statute.<sup>37</sup> It has given conflicting signals over whether courts should consider legislative history in determining the clarity of a statute.<sup>38</sup> And, crucially, its decisions reveal an ongoing and unresolved tension in the underlying rationale for the *Pennhurst* rule.<sup>39</sup>

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<sup>31</sup> See THOMAS R. DYE, *AMERICAN FEDERALISM: COMPETITION AMONG GOVERNMENTS* 99-115 (1990); DAVID B. WALKER, *THE REBIRTH OF FEDERALISM: SLOUCHING TOWARD WASHINGTON* 182, 189-91 (1995).

<sup>32</sup> U.S. CONST. art. I, § 8.

<sup>33</sup> See *Kansas v. United States*, 214 F.3d 1196, 1200 (10th Cir. 2000) (stating that "Kansas bears a very heavy burden in seeking to have the PRWORA declared unconstitutional" and discussing the lack of recent cases where conditions have been invalidated); Baker & Berman, *Getting Off the Dole*, *supra* note 5, at 466, 524; Smith, *supra* note 4, at 1196-97.

<sup>34</sup> *United States v. Dole*, 483 U.S. 203, 207 (1987); see Baker & Berman, *Getting Off the Dole*, *supra* note 5, at 466-69; Richard W. Garnett, *The New Federalism, the Spending Power, and Federal Criminal Law*, 89 CORNELL L. REV. 1, 32-33 (2003). I have argued in an earlier work that this is a sensible conclusion. Galle, *Getting Spending*, *supra* note 11, at 229-30. It is true that on its face the Spending Clause might allow Congress to enact legislation that would go beyond the limits on its other main sources of authority, such as the Commerce Clause. But this fact is not troubling, given that Congress must literally pay a price, both in treasury dollars and political capital, for such expansions. *Id.* at 169-70, 187-91, 230. Thus, some of Congress's limits, as under the Commerce Clause, are textual, while others, as in the case of the Spending Clause, are structural or fiscal. *Id.* at 170.

<sup>35</sup> *Pennhurst State Sch. & Hosp. v. Halderman*, 451 U.S. 1, 17 (1981).

<sup>36</sup> See *supra* note 11.

<sup>37</sup> See Smith, *supra* note 4, at 1188-89.

<sup>38</sup> See Galle, *Getting Spending*, *supra* note 11, at 165.

<sup>39</sup> See *id.* at 162-66.

### A. *Understanding Arlington*

The Court's decision in *Arlington Central School District v. Murphy* is typical in these regards.<sup>40</sup> *Arlington* dealt with whether the word "costs" in the IDEA included the costs incurred by plaintiff parents for services rendered by experts.<sup>41</sup> The structure of the IDEA is that Congress allocates money to state and local education agencies in exchange for those entities' agreement to comply with the IDEA's requirements.<sup>42</sup> The IDEA's primary requirement is that the agencies assure students with disabilities receive a "free [and] appropriate" education.<sup>43</sup> Parents can challenge an alleged failure to comply with the IDEA, and, if they prevail, can recover their "costs," such as attorney's fees.<sup>44</sup>

The holding of *Arlington* was that the word "costs" does not "unambiguously" include the costs of expert services rendered to prevailing plaintiffs.<sup>45</sup> On its face, this determination was less strange than it seems at first. There had been a series of earlier Supreme Court interpretations of the term "costs" in similar statutes, in each of which the Court found that "costs" was a term of art whose special statutory meaning was meant to exclude expert fees.<sup>46</sup> On the other hand, in the case of the IDEA there was a Conference Committee Report – that is, a report by the committee of the House and Senate whose job it was to reconcile any differences between the two Houses' versions of the bill – stating that the Committee understood "costs" to include expert fees in this context.<sup>47</sup>

The Court resolved this conflict by invoking the *Pennhurst* rule. The Court explained:

"[L]egislation enacted pursuant to the spending power is much in the nature of a contract," and therefore, to be bound by "federally imposed conditions," recipients of federal funds must accept them "voluntarily and knowingly." States cannot knowingly accept conditions of which they are "unaware" or which they are "unable to ascertain." Thus, in the present case, we must view the IDEA from the perspective of a state official who is engaged in the process of deciding whether the State

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<sup>40</sup> *Arlington Cent. Sch. Dist. Bd. of Educ. v. Murphy*, 126 S. Ct. 2455 (2006).

<sup>41</sup> *See id.* at 2457.

<sup>42</sup> *See id.* at 2458-59. Congress appears not to have depended entirely on its spending power in enacting the IDEA, however. *See id.* at 2464 (Ginsburg, J., concurring) (stating that the IDEA was also enacted under the authority of Section 5 of the Fourteenth Amendment).

<sup>43</sup> 20 U.S.C. § 1400(d)(1)(A) (2000).

<sup>44</sup> 20 U.S.C. § 1415(i)(3)(B) (2000).

<sup>45</sup> *Arlington*, 126 S. Ct. at 2463.

<sup>46</sup> *See id.* at 2461-63.

<sup>47</sup> H.R. REP. NO. 99-687, at 5 (1986) (Conf. Rep.). For a more detailed discussion of how conference reports may be utilized in statutory interpretation, see ROBERT A. KATZMANN, *COURTS AND CONGRESS* 46-68 (1997).

should accept IDEA funds and the obligations that go with those funds. We must ask whether such a state official would clearly understand that one of the obligations of the Act is the obligation to compensate prevailing parents for expert fees. In other words, we must ask whether the IDEA furnishes clear notice regarding the liability at issue . . . .<sup>48</sup>

The Court later added, “[i]n a Spending Clause case, the key is not what a majority of the Members of both Houses intend but what the States are clearly told regarding the conditions . . . .”<sup>49</sup> Thus, the Court reasoned that since it was unclear whether the Conference Committee report could overcome other indications that “costs” did not include expert fees, *Pennhurst* meant the State had to prevail.<sup>50</sup>

The puzzle here is that there is every reason to think that state officials in fact did clearly understand their obligations under the statute. State representatives were intimately involved in the bargaining process that led to the enactment of the “costs” provision.<sup>51</sup> The IDEA would have been pointless if the states would not accept its terms, and accordingly state negotiators had a prominent place at the table during its drafting.<sup>52</sup> Therefore, the states’ representatives were perhaps in a better position than the Court to understand the product of those negotiations.<sup>53</sup> Indeed, the States lobbied against the

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<sup>48</sup> *Arlington*, 126 S. Ct. at 2459 (citation omitted).

<sup>49</sup> *Id.* at 2463.

<sup>50</sup> *Id.*

<sup>51</sup> See *Handicapped Children’s Protection Act: Hearing on H.R. 1523 Before the Subcomm. on Select Education of the H. Comm. on Education and Labor*, 99th Cong. 23-28 (1985) (statements of National School Boards Association) [hereinafter NSBA House Statement]; *id.* at 10, 13, 17 (statement of Linus Wright, General Superintendent of Schools, Dallas, TX, representing the American Association of School Administrators); *Handicapped Children’s Protection Act of 1985: Hearing on S. 415 Before the Subcomm. on the Handicapped of the Comm. on Labor and Human Resources*, 99th Cong. 61-79 (1985) (statement of National School Boards Association).

<sup>52</sup> Cf. NANCY LEE JONES, CONG. RESEARCH SERV., *THE INDIVIDUALS WITH DISABILITIES EDUCATION ACT: CONGRESSIONAL INTENT* 5-6 (1995) (stating that the decision to structure the predecessor to the IDEA as a federal spending statute came in response to state advocate arguments that states could not themselves bear the costs).

<sup>53</sup> Cf. Robin Kundis Craig, *The Stevens/Scalia Principle and Why It Matters: Statutory Conversations and a Cultural Critical Critique of the Strict Plain Meaning Approach*, 79 TUL. L. REV. 955, 967-70 (2005) (claiming that statutes may be intended for interpretation by an audience with already-developed understandings of the statute and its context that exceed the courts’ own understandings); Jerry L. Mashaw, *Norms, Practices, and the Paradox of Deference: A Preliminary Inquiry into Agency Statutory Interpretation*, 57 ADMIN. L. REV. 501, 511 (2005) (arguing that agencies may have superior information about the meaning of a statute because they were involved in its drafting, and therefore should be encouraged to use that information in the interpretive process); Peter L. Strauss, *When the Judge Is Not the Primary Official with Responsibility to Read: Agency Interpretation and the Problem of Legislative History*, 66 CHI.-KENT L. REV. 321, 329-31 (1990) (discussing

inclusion of the expert fees language.<sup>54</sup> Having failed to keep that language out, they nonetheless accepted Congress's money. At a minimum, when they began accepting money under the IDEA, New York officials had to know they did so at a substantial risk that they would have to pay expert fees.<sup>55</sup> They certainly were not "unaware" of the condition or "unable to ascertain" it. What they were unaware of was the exact likelihood that the condition would be upheld by a court.

To put this point a different way, consider the claim that uncertainty about legal outcomes is indistinguishable from other forms of risk. This is a common point in, for example, scholarship on the law of takings, and in debates about the proper transitional rules when laws change.<sup>56</sup> A regulatory decision can wipe out a home's value as surely as a hurricane. When individuals make decisions about when to invest or enter into contracts, if rational, they will attempt to account for potential disasters both legal and natural.<sup>57</sup> In a properly functioning market, these risks are capitalized into the value of property.<sup>58</sup> Alternatively, the seller can insure the buyer against

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how agencies have particularized knowledge about legislative history because they are "almost wholly the creature[s] of [their] statutes").

<sup>54</sup> See NSBA House Statement, *supra* note 51, at 25 ("[R]egarding the definition of fees and other expenses . . . we would prefer to see the committee adopt similar language to that used in other pieces of civil rights legislation, for instance, section 1988 . . . that says the court, in its discretion, may allow the prevailing party a reasonable *attorney's* fee . . ." (emphasis added)).

<sup>55</sup> See Galle, *Getting Spending*, *supra* note 11, at 176; *cf.* *Bell v. New Jersey*, 461 U.S. 773, 790-91 (1983) (holding that the conditional spending statute need not provide "notice" to the State of particular remedies that will be available against it under the statute). The notice explanation is particularly puzzling in light of the fact that New York's IDEA-tied funding was re-authorized annually by Congress. So, regardless of whether the obligations of the statute were clear at the time the IDEA was enacted, they were overwhelmingly clear more than a decade later in 2000, when New York accepted its yearly appropriation and the Murphys prevailed in court. See *Murphy v. Arlington Cent. Sch. Bd. of Educ.*, 86 F. Supp. 2d 354, 368 (S.D.N.Y. 2000) (ordering Arlington School District to pay for the cost of private schooling for the Murphys' child), *aff'd*, 297 F.3d 195 (2d Cir. 2002); Brief for Respondents at 30-34, *Arlington Cent. Sch. Dist. Bd. of Educ. v. Murphy*, 126 S. Ct. 2455 (2006) (No. 05-18) (arguing that, through 2002, numerous court decisions and administrative and legislative documents had interpreted the IDEA to impose expert costs on losing government party). For more extensive discussion of the notice argument, see Samuel R. Bagenstos, *Spending Clause Litigation in the Roberts Court*, 58 DUKE L.J. (forthcoming 2008).

<sup>56</sup> For the early definitive work, see Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967).

<sup>57</sup> See Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509, 522-27 (1986) (suggesting that private actors should recognize legal changes may affect their investments).

<sup>58</sup> *Cf.* Avishai Shachar, *From Income to Consumption Tax: Criteria for Rules of*

losses, such as by selling her a warranty.<sup>59</sup> In that case, the purchase price is higher. Therefore, buying risky property without insurance is simply a wager: the property comes at a bargain price, and, if the risk never materializes, the purchaser has won her bet.<sup>60</sup>

The challenge for *Arlington* and its advocates lies in articulating why states should be denied the opportunity to make these kinds of bargain purchases.<sup>61</sup> Just as a property buyer might elect to forego buying a warranty, states may choose to accept a federal grant subject to the risk of legal change that will reduce the value of their bargain.<sup>62</sup> In Kathleen Sullivan's classic formulation, restraints of this kind convert the right not to accept an offer into a duty not to

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*Transition*, 97 HARV. L. REV. 1581, 1596 (1984). That is, the value of property should increase or decrease to reflect the risk of gains or losses.

<sup>59</sup> See Kaplow, *supra* note 57, at 527-28.

<sup>60</sup> See Ronald Dworkin, *What is Equality? Part 2: Equality of Resources*, 10 PHIL. & PUB. AFF. 283, 294 (1981). There is considerable nuance to this claim. Barbara H. Fried, *Ex Ante/Ex Post*, 13 J. CONTEMP. LEGAL ISSUES 123, 129-31 & n.11 (2003).

<sup>61</sup> Cf. *Pennhurst State Sch. & Hosp. v. Halderman*, 451 U.S. 1, 17 (1981) (describing conditional grants as outcome of bargain between states and Congress); Craig Volden, *Intergovernmental Grants: A Formal Model of Interrelated National and Subnational Political Decision*, 37 PUBLIUS: J. FEDERALISM 209, 228 (2007) (describing bargaining between Congress and state governors over conditions of AFDC grants).

I assume here that it is reasonably evident that a state, unlike an individual, will be fully informed about the relevant legal context of its decision to accept an offer. Cf. Craig, *supra* note 53, at 1011-12, 1038 (observing that statutes governing a technically sophisticated audience need not be read according only to plain language because the audience is already familiar with the policy nuance of potential meanings).

<sup>62</sup> Cf. Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309, 346-47 (arguing that bargainers should be free to exchange constitutional privileges for other consideration).

For example, in the lawmaking process that spawned the *Arlington* litigation, the States and Congress apparently agreed to leave the wording of the statute somewhat ambiguous as to expert fees, but to include a clear directive about fees in the Conference Report. See *Arlington Cent. Sch. Dist. Bd. of Educ. v. Murphy*, 126 S. Ct. 2455, 2462 (2006) (claiming that the conference report, in its interpretation of the statute's fee language, was attempting to "depart from ordinary meaning" (citing *W. Va. Univ. Hosp., Inc. v. Casey*, 499 U.S. 83, 92 n.5 (1991))). But see Brief for Respondents at 33-42, *Arlington Cent. Sch. Dist. Bd. of Educ. v. Murphy*, 126 S. Ct. 2455 (2006) (No. 05-18) (arguing that there was strong reason to believe at the time of enactment that the language of the statute itself was not especially ambiguous, but rather that it was relatively clear to the authors that it included fees). One plausible interpretation of this sequence of events is that Congress and the states in effect agreed to disagree, or at a minimum, to take the chance that courts would decide how best to read the language of the statute. Yet *Arlington* rejects the very possibility of political agreements by the states to be governed by later interpretations, even where that seems to have been the intent of their negotiators. That is, the *Arlington* Court is willing to enforce only "what the States are clearly told," rather than what they are arguably or likely told. *Arlington*, 126 S. Ct. at 2463.

accept an offer.<sup>63</sup> In effect, we have limited state sovereignty in the name of state sovereignty.

*Arlington* therefore raises more questions than it answers. We may think states should largely be free to arrange their own affairs free of judicial control. However, that seems untrue of state decisions to take risks about the meaning of federal grants. What is there about state decisions to accept legal uncertainty that is different from, and more suspect than, state decisions to accept any other form of uncertainty?

B. *The Defective-Bargaining Theories of the Clear Statement Rule*

*Arlington* and *Pennhurst*, as we have just seen, beg the question why we should prohibit states from entering into bargains subject to some legal uncertainty. The Supreme Court and commentators, however, have elsewhere offered four distinct, if related, justifications. The four defenses draw on Kathleen Sullivan's architecture for thinking about waivers of constitutional rights. Professor Sullivan suggests that we can justify setting aside bargains for constitutionally-protected rights where there are failures in the political or bargaining process,<sup>64</sup> where there are third-party effects,<sup>65</sup> or where individual

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<sup>63</sup> Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 HARV. L. REV. 1413, 1419-21, 1486-87 (1989); see also Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentalism*, 98 COLUM. L. REV. 267, 426 (1998).

<sup>64</sup> Sullivan, *supra* note 63, at 1480-83, 1495. That, of course, is the classic account of the basic justification for judicial review formulated by John Hart Ely, among others. See generally JOHN HART ELY, *DEMOCRACY AND DISTRUST* (1980); Bruce Ackerman, *Beyond Carolene Products*, 98 HARV. L. REV. 713 (1985) (describing how judicial review defines "the ultimate limits imposed on pluralist bargaining by the American constitutional system"); Frank I. Michelman, *Welfare Rights in a Constitutional Democracy*, 1979 WASH. U. L.Q. 659 (1979) (adopting an "interpretivist" view of judicial review put forth by Ely and arguing that the judiciary supports a constitutional right to welfare through its review of statutes). That is not to say that the theory is without its own problems. See, e.g., Paul Brest, *The Substance of Process*, 42 OHIO ST. L.J. 131, 134-37 (1981) (arguing against Ely's view that "courts are more competent to engage in representation-reinforcing judicial review" as opposed to "fundamental values review"); Laurence H. Tribe, *The Puzzling Persistence of Process-Based Constitutional Theories*, 89 YALE L.J. 1063, 1072-77 (1980) (questioning the ability to ascertain which groups are prejudiced, a point central to Ely's argument that "governmental action that burdens groups effectively excluded from the political process is constitutionally suspect").

<sup>65</sup> See Sullivan, *supra* note 63, at 1478-79, 1482, 1491. For other claims that third-party effects may justify unsettling bargains over rights, see Richard A. Epstein, *The Supreme Court, 1987 Term – Forward: Unconstitutional Conditions, State Power, and the Limits of Consent*, 102 HARV. L. REV. 4, 26-28 (1988); Daniel A. Farber, *Another View of the Quagmire: Unconstitutional Conditions and Contract Theory*, 33 FLA. ST. U. L. REV. 913, 916, 920 (2006); John Ferejohn & Barry Friedman, *Toward a Political Theory of Constitutional Default Rules*, 33 FLA. ST. U. L. REV. 825, 829-30 (2006); Tamar Frankel, *What Default Rules Teach Us About Corporations; What Understanding Corporations Teaches Us About Default Rules*, 33 FLA. ST. U. L. REV. 697, 703-13 (2006); Seth F.

free transfers collectively result in unacceptable distributive consequences.<sup>66</sup> I argue that all four defenses of the clear statement rule rest primarily on the first and second of Sullivan's scenarios. Each assumes, either explicitly or implicitly, that state decisions to accept grants produce serious third-party harms that will not be taken into account by the bargaining parties because of imperfections in the way in which public officials represent the public interest. More specifically, defenders of the clear statement rule presume that state decisions to accept federal funds will fail to account for the nationwide harms to our system of federalism that putatively will flow from many such decisions. Some defenders also claim that, as a result of political process failures, state officials' decisions will fail to reflect some harms internal to the state. Correcting for these externalities may justify judicial intervention.

Before I detail these arguments in more depth, note first that in order to justify judicial intervention one would likely have to identify failures on both the "supply" and "demand" sides of the grant. If federal officials perfectly represent the nation as a whole, they will never offer grants to states where those grants would reduce the national welfare. In the absence of any externality, state officials' decisions to accept the proffered grants, similarly, should always maximize the wellbeing of the nation's citizens.<sup>67</sup> If the political process on *either* side is functioning properly, then welfare-reducing grants will fail: either Congress will never offer them or states will never accept them.

Thus, although the first set of defenders of the clear statement rule focus on Congress's behavior in extending grants, these defenders in effect also presume a defect in state process. The Supreme Court, following Professor Tribe, has said it wants to assure the rules governing state behavior are crafted in a place where the political safeguards of federalism can operate – that is, a venue open to state lobbying efforts.<sup>68</sup> By limiting statutes affecting states to

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Kreimer, *Allocational Sanctions: The Problem of Negative Rights in a Positive State*, 132 U. PA. L. REV. 1293, 1378-93 (1984).

<sup>66</sup> See Sullivan, *supra* note 63, at 1496-99.

<sup>67</sup> See Hills, *Cooperative Federalism*, *supra* note 16, at 862-63 (suggesting that states will readily accept federal grants where "Congress has made a correct estimate of the nonfederal governments' opportunity costs of providing the requested services"); Somin, *Closing the Pandora's Box*, *supra* note 16, at 465.

<sup>68</sup> *Gregory v. Ashcroft*, 501 U.S. 452, 464 (1991) ("[T]o give the state-displacing weight of federal law to mere congressional *ambiguity* would evade the very procedure for lawmaking on which *Garcia* relied to protect states' interests.") (quoting LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 6-25, at 480 (2d ed. 1988)); see also *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 197 (1824) (describing how "the wisdom and the discretion of Congress, their identity with the people, and the influence which their constituents possess at elections" are controls on Congress's power over the States); LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 6-28, at 1175-76 (3d ed. 2000). Richard Stewart also offered a similar argument, roughly contemporaneous with Tribe's account. See Stewart, *supra* note 22, at 963. For other, later commentators agreeing with this approach, see *supra*



their “clear” language, the Court suggests it will reduce the degree to which judges alone can bind the States.<sup>69</sup> Even assuming this is an accurate description of the judicial process, it leaves unresolved the demand-side of our equation. The states may well lack power to control all the terms of the grants offered to them. But that does not explain whether one should expect the states to accept such grants where their nationwide or local expected value is negative. In claiming that state control is the whole story, Professor Tribe and the Court have simply assumed the states would accept pernicious grants.

There is a similar lacuna in the claims by a second group of scholars who have argued the clear statement rule can be justified because, historically, courts have inadequately defended federalism values, and Congress is unlikely to give full consideration to the virtues of state power.<sup>70</sup> This “underenforced norm” critique, too, seems to assume that states will not fully vindicate their own rights.

A third set of commentators, including some who have urged the underenforced norm view, have given more direct attention to the question of state officials’ behavior. One version of this argument suggests that state officials may have incentives to set aside or discount the potential harms of federal grants in favor of their own political interests.<sup>71</sup> The typical story here

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note 27.

The political safeguards theory has proven highly controversial. For more extensive discussions on either side, see JESSE H. CHOPER, *JUDICIAL REVIEW AND THE NATIONAL POLITICAL PROCESS* 175-84 (1980); Lynn A. Baker & Ernest A. Young, *Federalism and the Double Standard of Judicial Review*, 51 *DUKE L.J.* 75, 107-12 (2001); Baker & Berman, *Getting Off the Dole*, *supra* note 5, at 475-77; Elizabeth Garrett, *Enhancing the Political Safeguards of Federalism? The Unfunded Mandates Reform Act of 1995*, 45 *U. KAN. L. REV.* 1113, 1121-27 (1997); Larry D. Kramer, *Putting the Politics Back into the Political Safeguards of Federalism*, 100 *COLUM. L. REV.* 215, 278-87 (2000); McGinnis & Somin, *Federalism vs. States’ Rights*, *supra* note 20, at 103-04; Saikrishna B. Prakash & John C. Yoo, *The Puzzling Persistence of Process-Based Federalism Theories*, 79 *TEX. L. REV.* 1459, 1483-89 (2001); Herbert Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 *COLUM. L. REV.* 543, 559-60 (1954).

<sup>69</sup> See Gregory, 501 U.S. at 464.

<sup>70</sup> See *supra* note 13.

<sup>71</sup> See Baker, *Conditional Spending*, *supra* note 22, at 1942, 1946 (hypothesizing that legislators may seek to “‘entice’ outlier states into amending or adopting some provision(s) of state constitutional or statutory law”); Hills, *Cooperative Federalism*, *supra* note 16, at 886-87 (stating that politicians may face different agency costs at the federal or state level based on the strength of constituents); McCoy & Friedman, *supra* note 4, at 124-25; McGinnis & Somin, *Federalism vs. States’ Rights*, *supra* note 20, at 118; Somin, *Closing the Pandora’s Box*, *supra* note 16, at 465-66 (explaining how state politicians may have incentives to “yield to the preferences of national political majorities”); Stewart, *supra* note 22, at 958-59; see also Steven G. Calabresi, “A Government of Limited and Enumerated Powers”: *In Defense of United States v. Lopez*, 94 *MICH. L. REV.* 752, 797 (1995) (describing how state officials can politically act in a self-interested manner); Levinson,

is one of a political market failure, in which local officials distort the preferences of their constituencies. The central claim is that officials will fully value the proffered cash grant while discounting in their calculus the cost of any attached conditions.<sup>72</sup> The cash the official has brought home to her district is easy to measure and highly salient in the eyes of her voters, while the costs of the accompanying strings may be hard to measure and be buried in the budgets of many different local entities.<sup>73</sup> [ES: This sentence seems awkward. I tried to improve on it, but maybe you can do better than I did.] The official also might calculate that voters will have trouble associating these costs with her decision to accept the grant.<sup>74</sup>

These critics could raise a similar criticism based on the possibility of time discounting, but thus far have not. An official offered the chance to accept a grant today may well discount the true effect of future costs.<sup>75</sup> Grants allow for immediate political rewards, but costs may not come until much later.<sup>76</sup> The official may irrationally discount future costs, or rationally calculate that by the time angry voters notice the red ink, she will be safely retired or her vote long forgotten.<sup>77</sup> At a minimum, the official has achieved some of her

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*supra* note 19, at 941 (asserting that state officials may favor increased federal power if it leads to more federal spending on states).

<sup>72</sup> See Hills, *Cooperative Federalism*, *supra* note 16, at 886-87. Professors McGinnis and Somin also emphasize that the states discount the costs to themselves of the federal tax dollars that pay for the grants they receive. See McGinnis & Somin, *Federalism vs. States' Rights*, *supra* note 20, at 118 (explaining the incentive for politicians to "acquire funds that are mostly paid for by taxpayers in other states"). While I disagree with this account, for my purposes here I accept it. In my analysis I assume that states treat the costs to themselves of federal grants as essentially \$0.

<sup>73</sup> See Baker, *Conditional Spending*, *supra* note 22, at 1942-46 (discussing public choice dynamics of grants); *cf.* Hills, *Cooperative Federalism*, *supra* note 16, at 886-88 (describing how Congress may require public participation in accepting federal grants because of the view that "some constituents are over or underrepresented in the local political process").

<sup>74</sup> See McCoy & Friedman, *supra* note 4, at 124 (stating that voters tend to view grants as gifts without considering the attached strings); Young, *Two Cheers*, *supra* note 22, at 1360-61 (describing how in a nontransparent political system "people cannot assign blame for an unpopular federal policy"); *cf.* McGinnis & Somin, *Federalism vs. States' Rights*, *supra* note 20, at 94-99 (describing sources of rational voter ignorance of federalism issues).

<sup>75</sup> *Cf.* Edward J. McCaffery & Joel Slemrod, *Toward an Agenda for Behavioral Public Finance*, in *BEHAVIORAL PUBLIC FINANCE* 12-13 (Edward J. McCaffery & Joel Slemrod eds., 2006) (describing the effect on public officials of "present-tense bias").

<sup>76</sup> *Cf.* Peter H. Aranson et al., *A Theory of Legislative Delegation*, 68 *CORNELL L. REV.* 1, 31 (1982) (suggesting that political "issues of immediate impact" will predominate over issues "carr[ying] a long-term impact").

<sup>77</sup> See Daniel A. Farber, *From Here to Eternity: Environmental Law and Future Generations*, 2003 *U. ILL. L. REV.* 289, 294-301; Clayton P. Gillette & James E. Krier, *Risk, Courts, and Agencies*, 138 *U. PA. L. REV.* 1027, 1039-41 (1990); Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 *ECONOMETRICA* 263, 265-66 (1979).

policy goals in the time between the reward of the grant and the pain of the costs.<sup>78</sup> Even if the official genuinely wants to balance costs and benefits, many costs can be purely subjective, making them difficult for the official alone to measure.<sup>79</sup>

Finally, there is a fourth strand of support for the clear statement rule that seems to focus on both the supply and demand sides of the grant process. In this view, which I have elsewhere termed “notice as deliberation,”<sup>80</sup> the clear statement rule activates citizens who otherwise would be inattentive to the legislative process.<sup>81</sup> The notice-as-deliberation approach, like the underenforced norms critique, begins with a public choice story about general voter inattention. The theory here appears to be that, if not for the vagueness of the terms attached to conditional federal grants, voters would be more engaged in both federal and state legislative processes.<sup>82</sup> That engagement, in turn, would make it more likely that offers and acceptances alike would enhance national welfare, rather than heeding small groups of special interests.

In sum, all of the defenses of the clear statement rule depend on a common premise, sometimes explicit and sometimes assumed, of failures in the state political process. More specifically, they rely on the likelihood that, when state officials elect to accept federal grants, they will discount to some degree potential harms to their constituents or outsiders that arise from their decisions to accept the grant. As I will argue, because states are usually free to make bad policy for themselves, it is this latter externality – harms to outsiders – that is of greatest concern to constitutional law. Meanwhile, the question remains the broader one: do state officials maximize national welfare in their decisions to accept funds?

Thus, the remainder of this Article attempts to shed more light on the behavior of state officials. Despite the centrality of this question, scholars have subjected it to little, if any, rigorous scrutiny. In the succeeding Parts, I attempt to assemble the available social science evidence on whether voters can rely upon state officials to preserve the values of federalism.

## II. DISCOUNTING, PUBLIC CHOICE, AND THE THEORY OF GRANTS

As Part I demonstrated, the question of how judges should interpret the

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<sup>78</sup> See Brian Galle, *Designing Interstate Institutions: The Example of the Streamlined Sales and Use Tax Agreement (“SSUTA”)*, 40 U.C. DAVIS L. REV. 1381, 1425 n.224 (2007) [hereinafter Galle, *SSUTA*].

<sup>79</sup> See Aranson et al., *supra* note 76, at 38-39.

<sup>80</sup> Galle, *Getting Spending*, *supra* note 11, at 177-81.

<sup>81</sup> Merrill, *supra* note 27, at 833; see Roderick M. Hills, Jr., *Against Preemption: How Federalism Can Improve the National Legislative Process*, 82 N.Y.U. L. REV. 1, 16-39 (2007) (making this argument in the context of congressional decisions to preempt state law); Sunstein, *supra* note 27, at 317, 335 (making this argument in the context of delegations to agencies that would approach limits of federal power over states).

<sup>82</sup> See Sunstein, *supra* note 27, at 317.

terms of federal grants turns on underlying questions about the performance of state officials. If state officials internalize whatever social cost may accompany a decision to accept a federal grant, the case for close judicial oversight weakens.<sup>83</sup> This Part begins the analysis at the level of the general theory of official behavior in response to grants. Is it true, as proponents of the clear statement rule suggest, that state officials largely discount any negative effects of the grants? The analysis that critics of conditional spending offer for the political economy of state decisions to accept funds remains significantly incomplete. Indeed, given the wide variety of different combinations of grants and conditions, any broad generalizations about the politics behind them probably cannot prove accurate in all cases.

#### A. *Public Choice Theory*

The critical analysis, as outlined in the last section, relies mainly on straightforward public choice theory.<sup>84</sup> The small, heavily affected group, the argument goes, will be the potential recipients of federal grants, while the costs of complying with the federal strings will be buried in the state's budget and spread thinly among all taxpayers.<sup>85</sup> Even if no grantees have organized at the time of an initial grant offer, over time, a constituency might develop that depends on the grant revenues and form a powerful lobbying coalition to retain them.<sup>86</sup> That scenario plausibly describes some federal programs, such as the

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<sup>83</sup> For purposes of this Part, I accept, for the sake of argument, the possibility that externalities of any kind might justify federal judicial intervention. In later Parts, I will argue that courts should be concerned only with certain kinds of third-party effects – that is, that state officials should be free to make bad decisions, except to the extent that their decisions infringe on federally-protected values. [\[ES: Can you add an infra cite here?\]](#)

<sup>84</sup> Rationally self-serving public officials, this claim goes, will tend to favor the interests of their most intensely motivated group of constituents (or other interests involved in the legislative process). See McGinnis & Somin, *Federalism vs. States' Rights*, *supra* note 20, at 103, 118. The effect is the result of collective action problems among constituents, many of whom would prefer to free ride on the work of similarly situated others. Thus, the most intensely active groups will be those that are small and have much at stake in the legislation. For some basic summaries of public choice theory, see MANCUR OLSON, JR., *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* 11-16, 21-22, 31, 35, 46-48 (1965); TODD SANDLER, *COLLECTIVE ACTION: THEORY AND APPLICATIONS* 19-62 (1992) (outlining several economic tools that aid in the study of collective action problems).

<sup>85</sup> Hills, *Cooperative Federalism*, *supra* note 16, at 887 (arguing that well-organized opposition could stop a cost-effective initiative that would benefit people with “muted voices”); Somin, *Closing the Pandora's Box*, *supra* note 16, at 465-66; Stewart, *supra* note 22, at 958.

<sup>86</sup> See Somin, *Closing the Pandora's Box*, *supra* note 16, at 499; see also STEPHEN J. BAILEY, *LOCAL GOVERNMENT ECONOMICS: PRINCIPLES AND PRACTICE* 97 (1999); cf. Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism*, 76 VA. L. REV. 265, 278-79 (1990) (explaining how interest groups develop stakes in the legal status quo by favoring

IDEA, which offer specific entitlements to discretely identified groups (e.g., a free and appropriate public education for children with disabilities), while distributing the cost of the entitlement broadly across a wide swath of state budget lines.<sup>87</sup> As a result, this theory predicts that state officials will accept federal grants too readily, undercutting structural constitutional protections for a diverse set of legal regimes.<sup>88</sup>

However, one can just as easily think of any number of examples in which a superficial public choice analysis cuts in the opposite direction. To return to the IDEA example, the bureaucracy of each state agency is itself a constituency of the legislature, and will likely resist threats to its budget – indeed, that is the point of public choice theory.<sup>89</sup> Thus, efforts to tap other state budget items in order to pay for grant-compliance costs may stir up very active resistance both from the ultimate beneficiaries of those budget items as well as the government actors who administer them.<sup>90</sup> The critics' IDEA story remains plausible where the resulting budgetary burden is spread evenly across the entire state budget. In that scenario, the impact on the recipients of each other state budget line may be small enough, and the number of the affected large enough, that collective action problems will tend to mitigate political opposition. In actuality, however, state-level IDEA expenses typically fall rather heavily on a few budgets such as Departments of Education and other state-level service providers obliged to provide services (such as transportation for individuals with disabilities or residential care for the mentally ill) free of charge.<sup>91</sup> Thus, a decision to accept a grant subject to the IDEA's restrictions may well prompt a strong response from the affected agencies, as few others will produce lobbying efforts upon which each agency could free ride.

Many other federal grant regimes look even less like the public choice backdrop painted by critics. For instance, until 1975, Congress required states to enact laws obliging motorcyclists to wear helmets as a condition of federal highway funding.<sup>92</sup> Beginning in the early 1970's, however, a coalition of

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the jurisdiction in which they are expert).

<sup>87</sup> For example, the IDEA appears to require contributions not only from state education departments but also from other agencies that might provide services to the disabled students. See 20 U.S.C. § 1412(a)(12)(B) (2006).

<sup>88</sup> Baker, *Conditional Spending*, *supra* note 22, at 1950; Hills, *Cooperative Federalism*, *supra* note 16, at 887; Stewart, *supra* note 22, at 958, 971; see also Dorf & Sabel, *supra* note 63, at 430-31 (arguing that conditional spending, like commandeering, essentially obliges states to accept funds and attached conditions).

<sup>89</sup> See Hills, *Cooperative Federalism*, *supra* note 16, at 887 (recognizing that “nonfederal officials are themselves a powerful interest group with interests that can be inconsistent with the well-being of their constituents”).

<sup>90</sup> Theory predicts that bureaucrats should prove highly effective in influencing legislative decisions. See, e.g., Terry M. Moe, *The New Economics of Organization*, 28 AM. J. POL. SCI. 739, 769 (1984).

<sup>91</sup> See 20 U.S.C. § 1412(a)(12)(B) (2000).

<sup>92</sup> Highway Safety Act of 1966, Pub. L. No. 89-564, 80 Stat. 731 (1966); 23 C.F.R. §

cyclists and motorcycle manufacturers banded together to undermine the laws.<sup>93</sup> Although the cyclists did not succeed in convincing any state to refuse federal funding, they went one better: they prodded many state officials into joining their federal lobbying efforts, resulting in the ultimate repeal of the helmet restriction.<sup>94</sup> Medical costs rose sharply afterwards and fell largely on the general public.<sup>95</sup> This was the opposite of the story told by critics of conditional spending. Here, a small, concentrated group shifted costs to the public at large by *resisting* a conditional grant.

If that example proves unconvincing, consider the Clean Air Act (“CAA”).<sup>96</sup> States accept funds subject to CAA conditions despite the large, concentrated costs that the polluters in their jurisdiction bear as a result.<sup>97</sup> Of course, scholars sometimes hold up the environmental movement as a rare example of public interest in small, diffuse costs occasionally triumphing over the concentrated interests of polluters.<sup>98</sup> That triumph, though, only further emphasizes the difficulty of forecasting matters of political economy.

### B. *Things Get Sticky: Grant Theory*

With that caution, again, about the dangers of generalization, there is also an argument that under classic public finance theory almost every non-matching conditional grant scenario should raise no public choice concerns. Because money is fungible, even an earmarked federal grant should do no more than slightly reduce the price for all of a state’s expenditures, in effect re-

204.4 (1969).

<sup>93</sup> See Clay P. Graham, *Helmetless Motorcyclists – Easy Riders Facing Hard Facts: The Rise of the “Motorcycle Helmet Defense,”* 41 OHIO ST. L.J. 233, 238 (1980).

<sup>94</sup> Federal-Aid Highway Act of 1976, Pub. L. No. 94-280, § 208(a), 90 Stat. 454 (1976) (codified as amended at 23 U.S.C. § 402(c) (2000)); U.S. DEP’T OF TRANSP., NAT’L HIGHWAY SAFETY ADMIN., A REPORT TO CONGRESS ON THE EFFECT OF MOTORCYCLE HELMET USE LAW REPEAL – A CASE FOR HELMET USE (1980); Graham, *supra* note 93, at 238.

<sup>95</sup> See Andreas Muller, *Evaluation of the Costs and Benefits of Motorcycle Helmet Laws,* 70 AM. J. PUB. HEALTH 586, 586 (1980).

<sup>96</sup> 42 U.S.C. §§ 7401-7671q (2006).

<sup>97</sup> Daniel C. Esty, *Revitalizing Environmental Federalism,* 95 MICH. L. REV. 570, 597-98 (1996) (explaining that states accept environmental regulation despite concentrated costs to particular industries and intangible benefits); Richard B. Stewart, *Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy,* 86 YALE L.J. 1196, 1213 (1977) (explaining the improved position of environmentalist groups when the federal government, rather than the states, sets policy).

<sup>98</sup> See Cary Coglianese, *Social Movements, Law, and Society: The Institutionalization of the Environmental Movement,* 150 U. PA. L. REV. 85, 94-99, 110-12 (2001); Richard L. Revesz, *Federalism and Environmental Regulation: A Public Choice Analysis,* 115 HARV. L. REV. 553, 564-65 (2001); Christopher H. Schroeder, *Rational Choice Versus Republican Moment – Explanations for Environmental Laws, 1969-73,* 9 DUKE ENVTL. L. & POL’Y F. 29, 50-59 (1998).

**Deleted:** (stating that States must create a motorcycle safety program ensuring that “protective safety equipment for drivers and passengers will be worn”)

**Deleted:** (describing the dissipated interests and the beginning successes of environmental regulation)

**Deleted:** (explaining how large groups mobilize for public goods issues like the environmental movement as long as one member of the collective group is willing to contribute to the collective good)

**Deleted:** (explaining the success of the environmental movement through rational choice theory)

distributing the grant evenly to every beneficiary of state spending.<sup>99</sup> For example, suppose a state chooses to spend \$100 million of its \$1 billion budget on highways. The federal government gives the state \$50 million earmarked for highway spending. The state still prefers to tax its citizens and allocate its resources in such a way that it spends \$100 million on roads.<sup>100</sup> The effect should be that the state reduces its own spending on highways by \$50 million and either cuts taxes by \$50 million, distributes the \$50 million proportionately among all its other spending priorities, or, more likely, a mix of the two.<sup>101</sup> If this theory accurately represented how state governments behaved, then nearly all non-matching<sup>102</sup> conditional federal grants would have thin, widely-spread benefits, but many of them would have narrow, heavy costs. Public choice analysis predicts that in those situations states will simply refuse welfare-diminishing grants because there is no disproportionately strong lobbying group pressing for acceptance of the grant.

The catch here is that most empirical studies show that state and local jurisdictions do not behave this way, at least not to the extent that the classic theory predicts.<sup>103</sup> Instead, targeted grants often increase recipient-jurisdiction

<sup>99</sup> David F. Bradford & Wallace E. Oates, *The Analysis of Revenue Sharing in a New Approach to Collective Fiscal Decisions*, 85 Q.J. ECON. 416, 420-23, 434 (1971) (explaining how a lump sum distributed to a group may have diffuse economic benefit to all individuals through revenue sharing); David F. Bradford & Wallace E. Oates, *Towards a Predictive Theory of Intergovernmental Grants*, 61 AM. ECON. REV. 440, 443 (1971) (suggesting that given certain conditions, a system that gave grants to individuals could “lead[] via the political process to precisely the same equilibrium state of the community as does the grant to the collectivity”); Ronald C. Fisher, *Income and Grant Effects on Local Expenditure: The Flypaper Effect and Other Difficulties*, 12 J. URB. ECON. 324, 325-26 (1982). That is, the grant shifts the state’s demand curve for government services outward without changing its shape.

<sup>100</sup> See Hines & Thaler, *supra* note 29, at 218. To be completely accurate, the state would likely make a small upward adjustment in highway spending as a result of the additional wealth represented by the grant. But one would expect this additional spending to be a fraction of the grant that resembles the percentage of the state’s overall wealth devoted to highway spending prior to the grant. If citizens spent \$.01 per dollar of income on highways, and the grant does not alter their preferences, they should spend \$.01 of each grant dollar on highways.

<sup>101</sup> Fisher, *supra* note 99, at 328; see Wallace E. Oates, *An Essay on Fiscal Federalism*, 37 J. ECON. LITERATURE 1120, 1129 (1999).

<sup>102</sup> This analysis does not work perfectly for matching grants, which for obvious reasons tend to encourage the state to spend more than it would otherwise prefer on the matched expenditure. ROBERT D. COOTER, *THE STRATEGIC CONSTITUTION* 116-19 (2000); Stephen J. Bailey & Stephen Connolly, *The Flypaper Effect: Identifying Areas for Further Research*, 95 PUB. CHOICE 335, 336 (1998) (“[O]pen-ended matching grants have a greater stimulatory effect on grantee spending than equivalent lump-sum grants because they have both income and substitution effects.”).

<sup>103</sup> See Katherine Baicker, *Government Decision-Making and the Incidence of Federal Mandates*, 82 J. PUB. ECON. 147, 177-78 (2001); Rebecca J. Campbell, *Leviathan and Fiscal*

**Deleted:** (describing how a lump-sum grants affect both public expenditure and private consumptions)

spending in the targeted category, sometimes by nearly as much as the grant amount.<sup>104</sup> For instance, in the highway example, the state might spend \$130 million on roads after receiving the \$50 million grant, and cut taxes or increase other spending by only \$20 million. Economists call this the “flypaper effect,” because, as one economist colorfully put it, the money “sticks where it hits.”<sup>105</sup> Importantly, recent studies suggest that flypaper effects tend to be short-lived, such that grants increase targeted spending for a year or two, but states then begin to decrease their own contribution and offset the grant with tax cuts and spending increases in other areas, as theory predicts.<sup>106</sup> Economists have offered a variety of possible explanations for the flypaper phenomenon, but no single theory has won out, and it seems possible that all of the hypothesized processes contribute in some measure to the observed results.<sup>107</sup>

The underlying causes of the flypaper effect may well be significant to the public choice analysis. Some of the theories tend to support the conclusion that state officials would undervalue the costs of accepting a grant or, equivalently, overvalue the benefit of accepting. For example, one common account claims that the flypaper effect results from officials’ manipulation of state spending in order to develop constituencies favorable to them, or from

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*Illusion in Local Government Overlapping Jurisdictions*, 120 PUB. CHOICE 301, 324 (2004); Radu Filimon et al., *Asymmetric Information and Agenda Control: The Bases of Monopoly Power in Public Spending*, 17 J. PUB. ECON. 51, 60-61 (1982); Nora Gordon, *Do Federal Grants Boost School Spending? Evidence from Title I*, 88 J. PUB. ECON. 1771, 1773 (2004); Peter M. Mitias & Geoffrey K. Turnbull, *Grant Illusion, Tax Illusion, and Local Government Spending*, 29 PUB. FIN. REV. 347, 361 (2001); Geoffrey K. Turnbull, *The Overspending and Flypaper Effects of Fiscal Illusion: Theory and Empirical Evidence*, 44 J. URB. ECON. 1, 15-232 (1998); Byron F. Lutz, *Taxation with Representation: Intergovernmental Grants in a Plebiscite Democracy* 24 (Fin. & Econ. Discussion Series, Working Paper No. 2006-06, 2006), available at <https://www.federalreserve.gov/Pubs/FEDS/2006/200606/200606pap.pdf>. But see Brian Knight, *Endogenous Federal Grants and Crowd-out of State Government Spending: Theory and Evidence from the Federal Highway Aid Program*, 92 AM. ECON. REV. 71, 88 (2002) (“[F]ederal highway grants crowd out state highway spending, leading to little or no increase in net spending.”).

<sup>104</sup> Bailey & Connolly, *supra* note 102, at 337-38, 339 tbl.1; G. Brennan & J.J. Pincus, *A Minimalist Model of Federal Grants and Flypaper Effects*, 61 J. PUB. ECON. 229, 230 (1996); Fisher, *supra* note 99, at 329-30 & tbl.1; Hines & Thaler, *supra* note 29, at 219-20; Oates, *supra* note 101, at 1129; Monica Singhal, *Special Interest Groups and the Allocation of Public Funds*, 92 J. Pub. Econ. 548, 554-56 (2008) (finding increases in state expenditures on tobacco control programs despite large tobacco industry lobby); Volden, *supra* note 61, at 225.

<sup>105</sup> See *supra* note 29.

<sup>106</sup> Gordon, *supra* note 103, at 1785-88; Lutz, *supra* note 103, at 19.

<sup>107</sup> See Sang-Seok Bae & Richard C. Feiock, *The Flypaper Effect Revisited: Intergovernmental Grants and Local Governance*, 27 INT’L J. PUB. ADMIN. 577, 583-85 (2004); Bailey & Connolly, *supra* note 102, at 336, 347; Fisher, *supra* note 99, at 324; Hines & Thaler, *supra* note 29, at 220-22.



whom they can extract rents.<sup>108</sup> That is, officials take what would be an even distribution of benefits and make it lumpy, precisely in order to generate extra engagement from the community benefited. In that scenario, one might plausibly predict that the relevant officials see more political value in creating a beholden set of grant recipients than the value of the grant warrants. Thus, although the officials do not underestimate costs of compliance, they may overvalue the gains of the grant. This prediction assumes, however, that the officials with authority to accept conditional grants also have the authority to allocate the resulting funds, or at least that they have a large degree of influence over the allocating officials. That is not necessarily a good assumption, particularly if budget-setting authority rests mainly with the executive and acceptance rests with the legislature or vice versa.<sup>109</sup>

A number of other theories of the flypaper effect might suggest little or no additional political pressure to accept federal grants. One might, for instance, question whether the rent-extraction theory can be squared with the categorical stickiness of grants – that is, the fact that grant dollars are spent on the activity they target. If politicians are developing or catering to interest groups, why do politicians in many different states and local jurisdictions all happen to cater to the same interest groups as those targeted by the federal grant? One economist, Monica Singhal, theorizes instead that the flypaper effect is a form of commission payment to groups that generated extra money for the state through successful lobbying at the federal level.<sup>110</sup> In order to motivate these groups to continue to exert effort in the future, state officials must offer them some reward.<sup>111</sup> However, the group receives only a fraction of the value of the grant, and the state offsets later payments as theory predicts. Although Singhal does not consider our particular question, under this view, no evident reason exists for state officials to either overvalue grant awards or undervalue the cost of grant conditions.

In short, absent some new resolution of these disputes, it is unclear what results public choice theory should predict for state decisions to accept grants.<sup>112</sup> Grants from higher to lower tiers of government may or may not

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<sup>108</sup> See Bae & Feiock, *supra* note 107, at 581; Filimon et al., *supra* note 103, at 52.

<sup>109</sup> Cf. Bae & Feiock, *supra* note 107, at 584-85, 591 (arguing that the flypaper effect may depend on the degree of accepters' control over the budget and finding a larger effect where control of the budget and acceptance of the grant is integrated).

<sup>110</sup> Singhal, *supra* note 104, at 549.

<sup>111</sup> *Id.* at 551.

<sup>112</sup> Later in this Article, I argue that the best explanation for the observed flypaper data is a combination of official responses to incomplete voter understanding of fiscal information, together with the need to appease grantors. See *infra* text accompanying notes 245-255. This result, even if right, remains ambiguous as to the likely political economy results. Officials who respond to voter ignorance may be acting either self-interestedly or in the public welfare. Only the first set may reduce overall welfare by their choices, and available data to date do not allow us to distinguish between the two.

result in widely shared benefits, confounding our ability to predict how political actors will respond.

C. *Discounting “Good” Grants*

A final point of uncertainty about the public choice critique of federal grants is that some grants may enhance national welfare. For example, grants and their accompanying conditions may operate as tools of interstate coordination, through which the federal government can encourage states to reduce negative spillovers or increase their production of goods with positive externalities.<sup>113</sup>

Just as local officials may neglect the negative nationwide effects of accepting a grant, so too might they ignore the positive nationwide effects. By definition, local voters do not take externalities into account in their preferences.<sup>114</sup> Moreover, if the public choice/discounting story proves persuasive, it should also persuade us about “good” grants. The increased national welfare that follows from more efficient local behavior will benefit all citizens roughly equally and will arise mostly at some future time. Again, the public choice story predicts that the political process will generally neglect these forms of goods.<sup>115</sup>

Thus, the discounting of both nationwide costs and benefits may put grants in a kind of equipoise. The fact that grants might be too tempting, in some sense, potentially can offset the fact that in another sense they are not tempting enough.<sup>116</sup> Which effect predominates remains an empirical question that will vary from grant to grant.<sup>117</sup>

Accordingly, I am skeptical that public choice analysis offers any coherent set of guidelines on which to base judicial intervention. Even instances in which federal funds appear to flow narrowly and deeply to one interest group,

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<sup>113</sup> Caminker, *supra* note 6, at 1012-13 (using the Radioactive Waste Act as an example to discuss ways in which Congress can empower the states); Oates, *supra* note 101, at 1127; Ernest A. Young, *The Rehnquist Court’s Two Federalisms*, 83 TEX. L. REV. 1, 113 (2004). That is, rather than designing their own institutions for bargaining, writing their own sets of rules for agenda setting and agreement, and consenting to a mutually satisfactory enforcement system, states wishing to agree amongst themselves simply take their issues to their congressmen. They can then write a proposed bill offering money in exchange for compliance and rely on federal regulators and courts to oversee the whole exchange. See Bruce H. Kobayashi & Larry E. Ribstein, *Introduction* to ECONOMICS OF FEDERALISM, at viv-xv (Bruce H. Kobayashi & Larry E. Ribstein eds., 2007); Somin, *Closing the Pandora’s Box*, *supra* note 16, at 469-70.

<sup>114</sup> JONATHAN GRUBER, PUBLIC FINANCE AND PUBLIC POLICY 120-28 (2d ed. 2007).

<sup>115</sup> See Nina A. Mendelson, *Chevron and Preemption*, 102 MICH. L. REV. 737, 767-68 (2004).

<sup>116</sup> I am grateful to Rick Hills for suggesting a version of this point.

<sup>117</sup> For purposes of this Article, though, I place relatively little weight on this possibility. My focus here is on whether state officials, on their own, will reject welfare-diminishing grants. I therefore presume, for the sake of argument, that essentially all federal grants are at best welfare-neutral.

with costs spread thinly across a state's population, may prove relatively innocuous on close inspection. Our political science simply is not good enough to say for certain.<sup>118</sup>

### III. A SIMPLE MODEL OF TAX AS A CONSTRAINT ON DECISIONS TO ACCEPT GRANTS

This Article has argued so far that the theoretical argument supporting the assumption that state officials will discount the costs of grants remains incomplete to the extent that it overlooks the possible implications of public finance economists' theory of grants. Another major hole in the critics' assumptions lies in the fact that they neglect not only a complete treatment of grants but also any treatment of state and local taxation. To illustrate the size of that hole, I offer a simple model of how local taxes could affect the attractiveness of federal grants to local officials. In essence, one cannot make meaningful predictions about the political economy of a local decision to accept a grant by considering only the grant; a full analysis must include the politics of the state's tax system as well.

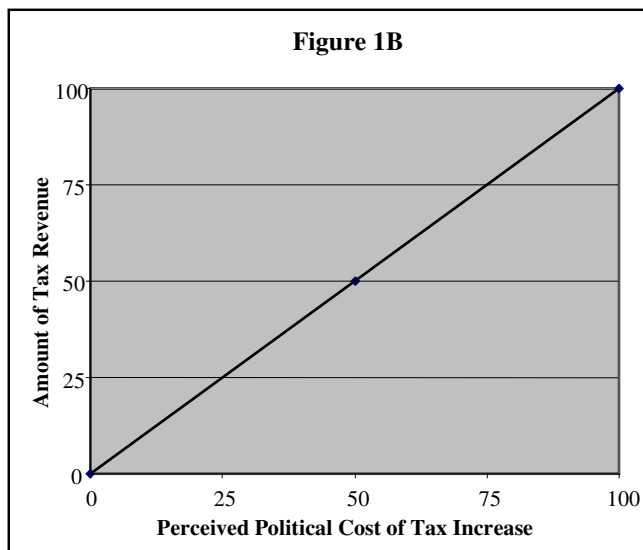
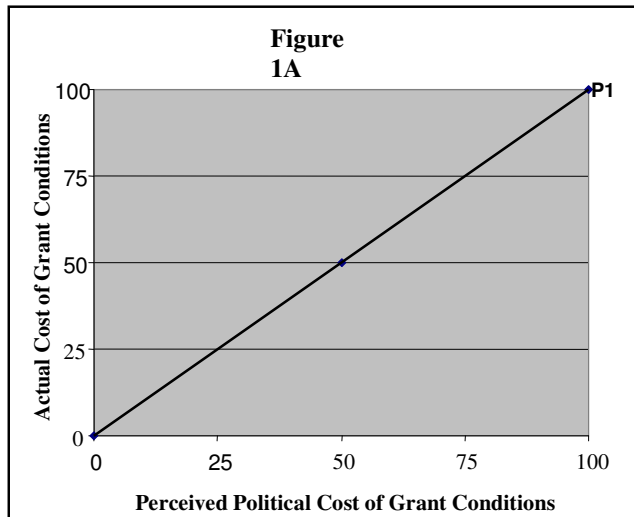
The model proceeds from the intuition that officials will choose the least politically costly alternative for obtaining a set benefit. Even if officials discount the actual welfare cost to their constituents in determining whether to accept grants, grants still have political costs. Depending on the degree of discounting, it may prove politically cheaper for the official to substitute a local tax increase for the federal grant. Put another way, officials should only accept a conditional grant where the attached conditions are less odious than a comparable tax increase would be. Thus, local political taste for increased taxes may represent a kind of floor for the amount of perceived costs a locality is willing to accept in exchange for federal funds.

A series of stylized graphs illustrate this point.<sup>119</sup> Figures 1A and 1B chart the politician's perceived political cost of raising money, X, against Y, the actual cost of accepting a federal grant (in Fig. 1A) or raising taxes (in Fig. 1B).

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<sup>118</sup> Cf. Merrill, *supra* note 27, at 834 (arguing that the efficacy of political safeguards of federalism is an elusive, empirical question).

<sup>119</sup> For a more mathematically rigorous model based on a similar premise, see Volden, *supra* note 61, at 215-23.



These figures represent the ideal case: both of these graphs show identical straight lines, indicating that the politician fully internalizes the welfare effects either of an unfortunate condition (Fig. 1A) or imposing taxes (Fig. 1B). In other words, in both Figures 1A and 1B the politician is just as reluctant to

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force his constituents to suffer \$100 in costs as the constituents would be themselves.<sup>120</sup> In the world represented by Figure 1A, all decisions to accept grants will increase constituent welfare, because the politician will obviously reject grant offers in amounts below the line and accept those above it. For instance, at point P1, where the actual and perceived costs of a condition are both \$100, a grant amount would have to be \$101 or more to convince the politician to accept.<sup>121</sup> Tax is not a meaningful limit in Figure 1, since the political costs either of taxing a certain amount or accepting a condition with a given cost are always identical. Thus, at point P1, any offer that exceeds the costs of accepting the grant condition could be matched only by a tax in which the political cost of raising \$101 will exceed the cost of accepting the grant.

There is a similar situation if, as critics of conditional spending seem largely to assume, politicians discount the costs of accepting grants but not the costs of raising taxes.<sup>122</sup> [Figures 2A and 2B model these assumptions.](#)

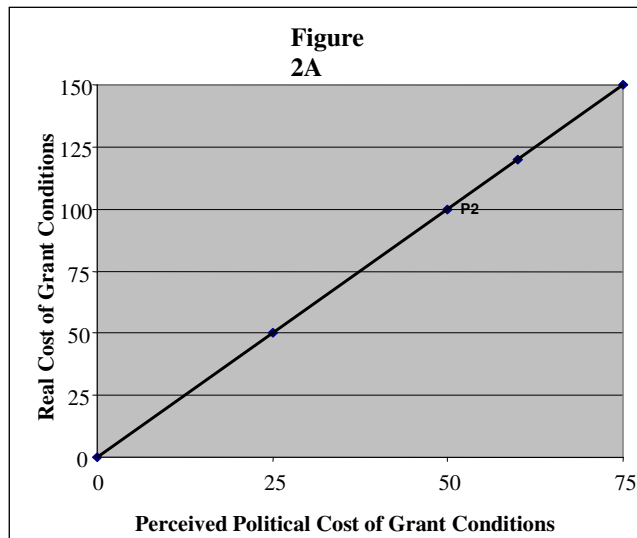
[\[ES: We should introduce figures 2A & 2B here. Can you add a sentence doing this?\]](#)

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<sup>120</sup> My results here do not depend on whether we conceive of costs to voters as average costs, costs to the median voter, or overall social welfare adjusted by some distributional preference.

<sup>121</sup> I assume for simplicity that the official fully realizes the political benefit of having money to spend. Of course, exaggerated, discounted or diminishing political returns on spending as well as on revenue-raising also seem possible. See, e.g., JOHN KENNETH GALBRAITH, *THE AFFLUENT SOCIETY* (4th ed. 1984); Wallace E. Oates, *On the Nature and Measurement of Fiscal Illusion: A Survey*, in *TAXATION AND FISCAL FEDERALISM: ESSAYS IN HONOUR OF RUSSELL MATHEWS* 65, 67 (Geoffrey Brennan et al. eds., 1988) (raising the possibility of exaggerated returns due to “a *systematic misperception* of fiscal parameters – a recurring propensity, for example, to underestimate one’s tax liability associated with certain public programs”). I set aside those cases here.

<sup>122</sup> I am not aware of any prior analysis in the legal literature of the possibility of local-source tax discounting.



[FIGURE 2B]

Figure 2A illustrates a world in which officials discount the costs to their constituents of accepting a grant. At point P2 in this graph, the actual costs to the official's constituents of accepting a federal grant are \$100, but the official perceives the costs only to be \$50. At the same time, in Figure 2B, the perceived political cost of raising \$51 in taxes is \$51. In this world, all grants reduce constituent welfare, and taxes again are no constraint. At point P2, the official is willing to accept a grant of \$51 with an actual cost of \$100 because the perceived political cost of accepting the grant is only \$50, and the political cost of substituting a tax would be \$51.

Figure 3 is where things start to get interesting.

[FIGURE 3]

In Figure 3, the political price of taxes, too, is discounted. Thus, at P3, the political cost of raising \$51 in funds from tax is approximately \$40.80. In this world, we should expect the official to refuse a \$51 grant with a perceived cost of \$50, because she can get the same money, at lower political cost, simply by raising taxes. This observation leads us to the inequality,

$$D_t * G > D_c * C$$

This inequality expresses the relationship between Figures 2A and 3. The left side represents the official's discount rate for raising taxes (Dt) multiplied

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by the grant amount (G). The right side represents the official's discount rate for accepting grant conditions (Dc) multiplied by the cost of accepting the grant (C). [ES: I think we should define these variables before beginning the discussion of the equation. This is my understanding of the variables, but feel free to change my wording.] Put simply, the inequality indicates that we should expect a rational official to accept a conditional federal grant only where the discounted political costs of raising an equivalent amount of money through taxation would exceed the discounted costs of accepting the grant. For example, at a grant amount of \$61.60, the perceived political costs either of accepting the grant or raising taxes are equal. At any amount less than \$61.60, the official rejects the grant. At amounts in excess of \$61.60, she accepts it. Assuming the conditions of the grant remain fixed, the official's opportunity to substitute taxes for the federal grant increases the price of the grant.

A bit more elementary algebra shows us the broad implications of these simple deductions. Solving the inequality for the term "G," the grant amount, yields a second relationship:

$$G > (Dc / Dt) * C$$

The term on the right represents the ratio of the official's discount rate for accepting grant conditions over the discount rate for raising taxes. In this model in which the rates are fixed and linear, the relationship between these two discount rates tells us whether grant amounts must be greater or less than the total cost of compliance. Wherever officials discount the costs of accepting federal conditions by a greater percentage than they discount the cost of raising taxes, then C, the cost to taxpayers, will be multiplied by a number less than one (in my example, .5 / .8, or .625).<sup>123</sup> That is, if officials discount the burden of federal conditions more than they discount the burden of taxation, then they will accept grants that do not pay fully for the burden on their constituents. In this scenario, constituent welfare decreases.<sup>124</sup> [ES: I think this paragraph is a little confusing to a lay reader. Do you think you can rephrase it somewhat?]

But – and this is the key point – there is another scenario, in which officials discount the costs of raising taxes by a larger percentage than they discount the costs of grant compliance. In those situations, C will be multiplied by a number larger than one, and the grant that the federal government would have to offer a state to accept its conditions must actually exceed the costs of

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<sup>123</sup> That is, in the examples I have given, officials perceive only half of the costs of federal grant conditions, but perceive 80% of the costs of raising taxes. So the discount on grant conditions is larger, at 50%, as compared with 20% for the discount on tax increases.

<sup>124</sup> Although net utility is negative in this example, note that the fact of tax discounting alongside grant-cost discounting has reduced the amount of negative utility incurred by the officials' constituents. If own-sources taxes were not an available option, the utility loss would have been the full discount rate, 50%, of the costs of complying with the grant conditions. However, because of the tax consideration the loss is only 37.5%.

acceptance.

In other words, even if local officials discount the costs to their constituents of accepting federal conditions, the decision to accept the grant may still increase constituent welfare.<sup>125</sup> If the cost of raising revenue from local taxes is discounted even more than the cost of accepting federal conditions, then the grant price demanded by the locality's officials may be larger than the actual cost to their citizens of the conditions. Thus, the political optics of grant conditions demonstrate only half the story; we also need to know how officials view tax increases.

Two important objections to this line of thought spring immediately to mind. First, given traditional taxpayer hostility to taxes, it may seem highly unlikely that officials would discount the costs of raising money through taxes.<sup>126</sup> Additionally, one might wonder why, if local officials actually could generate further benefits for their constituents at a net gain in political capital, they have not done so already. Arguably, the point at which local officials stopped raising taxes by definition is the equilibrium point between taxing and spending.

Our intuition about taxpayer hostility to tax increases is probably right for the federal income tax, but perhaps rather less so when state and localities raise revenue through their other potential avenues. For one thing, as I discuss later, local jurisdictions may "export" their tax costs to outsiders.<sup>127</sup> For instance, Alaska and Montana impose "extraction" taxes on their mineral resources, which generally are shipped out of state.<sup>128</sup> These efforts are not always successful. An extraction tax may in fact hurt state residents more than it affects the out-of-state extractors, depending on whether the tax shifts mineral production elsewhere or drives down the price that the state's producers

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<sup>125</sup> Admittedly, however, the possibility of tax constraints on discounting may reduce overall welfare in some situations. For example, I noted earlier that state officials may discount positive as well as negative spillovers. If a given grant would generate a net positive externality, then the opportunity for local revenue will induce officials to refuse the grant, reducing welfare.

<sup>126</sup> See Edward J. McCaffery & Jonathan Baron, *Heuristics and Biases in Thinking About Tax* 6-9 (Univ. of S. Cal. Law Sch., Law & Econ. Research Paper Series, Research Paper No. 03-22, 2003), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=467440](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=467440) (measuring "tax aversion" – that is, a person's attitude toward calling something a "tax").

<sup>127</sup> Cf. Gilbert E. Metcalf, *Deductibility and Optimal State and Local Fiscal Policy*, 39 ECON. LETTERS 217, 221 (1992) (suggesting that opportunities for tax exporting may have made retaining sales tax cheaper than other alternatives); Stephen H. Pollock, *Mechanisms for Exporting the State Sales Tax Burden in the Absence of Federal Deductibility*, 44 NAT'L TAX J. 297, 299 (1991) (stating that the increase in state reliance on sales tax may be explained by the fact that "[t]he state sales tax is subject to a significant amount of exporting"). On the concept of tax exporting generally, see Robert Tannenwald, *Fiscal Disparity Among the States Revisited*, NEW ENG. ECON. REV., July/Aug. 1999, at 4; *infra* text accompanying notes 166-173.

<sup>128</sup> See Tannenwald, *supra* note 127, at 7.



charge.<sup>129</sup> But measuring these complex chains of economic effects is at best challenging.<sup>130</sup>

The actual effectiveness of tax exporting probably does not matter for our purposes. The point is that it may appear to any but the most expert analyst that the state successfully exports its tax burden.<sup>131</sup> If voters believe that someone else is paying for a tax, it seems likely they will be less hostile to it. Thus, as Daniel Shaviro has argued, states may tend to favor taxes that look as though they are exported even if they are not.<sup>132</sup> Tax scholars offer a similar argument for the persistence of the corporate income tax: since no one really knows who bears the “incidence,” or economic burden, of the corporate tax, individual voters tend to prefer it to other options.<sup>133</sup>

The political science and psychological literatures suggest other ways in which “hidden” taxes may reduce voter ire. For instance, voters tend not to notice the full impact of small fees and sales taxes on their financial situation, because these taxes arrive bit by bit, and often hidden inside other prices (quick: how much of the price of your gallon of gas is tax?).<sup>134</sup> Voters also tend not to take the time or mental effort to add up these costs, even if they notice them.<sup>135</sup> Thus, there is strong evidence that political opposition to

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<sup>129</sup> Charles E. McClure, Jr., *Tax Exporting and the Commerce Clause*, in *FISCAL FEDERALISM AND THE TAXATION OF NATURAL RESOURCES* 169, 171-83 (Charles E. McClure, Jr. & Peter Mieszkowski eds., 1983) [hereinafter McClure, *Tax Exporting*] (explaining, in a classic analysis, that the likely outcome of a tax levied on natural resources by a producing state will depend on “the conditions under which it is levied,” including “the degree of geographic concentration and the mobility of resources or industry, cartelization by taxing states, international competition or price umbrella effects, natural substitutability, government regulation, the prevalence of long-term contracts, the importance of transportation costs and the way in which such costs are determined, unionization, and market structure”); see also Charles E. McClure, Jr., *Incidence Analysis and the Supreme Court: An Examination of Four Cases from the 1980 Term*, 1 *SUP. CT. ECON. REV.* 69, 87-89 (1982) (concluding that coal sold under existing contracts would probably export the severance tax to non-resident consumers, but that this would not be the case for those sold under contracts negotiated after the passage of the tax); cf. Pollock, *supra* note 127, at 300 (commenting that states are constrained in their use of exporting by the danger that such use may drive up costs of doing business, which may in turn reduce investment and jobs).

<sup>130</sup> McClure, *Tax Exporting*, *supra* note 129, at 169-70, 186-87.

<sup>131</sup> See Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 *MICH. L. REV.* 895, 956 (1992) [hereinafter Shaviro, *Federalism in Taxation*] (explaining that a severance tax may be directly borne by out-of-state consumers, but its real economic burden, even in the short term, cannot be determined without analyzing a multitude of factors).

<sup>132</sup> *Id.* at 957.

<sup>133</sup> See Charles E. McClure, Jr., *Rethinking State and Local Reliance on the Retail Sales Tax: Should We Fix the Sales Tax or Discard It?*, 2000 *BYU L. REV.* 77, 91-92.

<sup>134</sup> See JAMES M. BUCHANAN & RICHARD E. WAGNER, *DEMOCRACY IN DEFICIT: THE POLITICAL LEGACY OF LORD KEYNES* 129 (1977); Campbell, *supra* note 103, at 305-06.

<sup>135</sup> Aradhna Krishna & Joel Slemrod, *Behavioral Public Finance: Tax Design as Price*

“hidden” taxes of these forms is rather low compared to, for example, the individual income tax.<sup>136</sup> Of course, it is possible that both hidden and more salient taxes still generate exaggerated voter ire, rather than being “discounted.” But we at least have a plausible story for how local officials can create discounts by their choice of tax instruments.

Let us turn back then to the second objection: the “equilibrium” argument. Again, the claim is that we might be able to presume that local officials, prior to the offer of a federal grant, have already imposed all the taxes they believe they can without incurring more political loss than gain. Assuming that fiscal *benefits* are not discounted, the implication is that we have reached a point on the tax curve at which additional taxes will no longer be at a discount.

There are a number of ways in which the equilibrium can change. Local economic conditions can change, or new tax “instruments” can develop to permit less objectionable tax increases.<sup>137</sup> The lobbying efforts that produce a political impetus for the federal grant project might also change local taxpayer preferences, increasing the returns to officials for enacting the policy with local funds.<sup>138</sup> Some evidence suggests that taxpayers evaluate their tax situation relative to those of their neighbors, such that tax increases nearby make local tax increases more politically palatable.<sup>139</sup>

The most convincing response, however, is probably that there often is no stable tax/benefit equilibrium.<sup>140</sup> As observed by the economist Kenneth Arrow, voter preferences are not perfectly linear.<sup>141</sup> Social choice theory

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*Presentation*, 10 INT’L TAX & PUB. FIN. 189, 190-95 (2003); Edward J. McCaffery & Jonathan Baron, *The Humpty Dumpty Blues: Disaggregation Bias in the Evaluation of Tax Systems*, 91 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 230, 231-32 (2003).

<sup>136</sup> Krishna & Slemrod, *supra* note 135, at 192.

<sup>137</sup> That is, choices about how to structure a tax, and how to allocate its economic burden on various individuals and activities, might change public preferences for more or less tax. See, e.g., Daniel Shaviro, *Beyond Public Choice And Public Interest: A Study Of The Legislative Process As Illustrated By Tax Legislation in the 1980s*, 139 U. PA. L. REV. 1, 53, 57-63 (1990). For instance, one might think that a tax on an activity that is unlikely to change in response to taxation will reduce the amount of economic distortion that accompanies the tax, so although the total tax might remain the same, the societal costs of taxing decrease.

<sup>138</sup> Cf. Singhal, *supra* note 104, at 560 (emphasizing the possibility that lawsuits brought by interest groups may have a public-educative function that changes popular preferences for services related to the lawsuit).

<sup>139</sup> See Timothy Besley & Anne Case, *Incumbent Behavior: Vote-Seeking, Tax-Setting, and Yardstick Competition*, 85 AM. ECON. REV. 25, 30 (1995).

<sup>140</sup> See John E. Roemer, *Distribution and Politics: A Brief History and Prospect*, 25 SOC. CHOICE & WELFARE 507, 510-13, 523-24 (2005).

<sup>141</sup> KENNETH J. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES 97-100 (2d ed. 1963) (proving that the no social welfare function can satisfy all four conditions of social choice theory); see also AMARTYA K. SEN, COLLECTIVE CHOICE AND SOCIAL WELFARE 35-51 (1970). For cogent explanations of Arrow’s theorem in laymen’s terms, see KENNETH A.

**Deleted:** (arguing that public sentiment plays a clear political role, but public opinion about taxation suffers from a number of serious misunderstandings, and thus the form and incidence of tax affect its political prospects)

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elaborates that an individual may prefer A to B and B to C, yet also prefer C to A.<sup>142</sup> Thus, which outcome an individual settles on may depend on how he frames the alternatives and the order in which he considers them.<sup>143</sup> In actual studies of legislative behavior, officials who initially chose A over B would sometimes switch to B upon the introduction of a third policy option, C.<sup>144</sup> Accordingly, the fact that a local legislature settled on a particular package of taxes and benefits is not necessarily evidence that voters would be unwilling to accept more taxes in exchange for more benefits.<sup>145</sup>

In sum, my main point in this section is that predicting the welfare effects of state decisions to accept conditional grants is much more complicated than the existing literature would suggest. It is not enough to forecast whether state officials will discount the costs of accepting grants. To make good predictions, we also would have to forecast the relative discount rates of both the costs of accepting grants and the cost of raising taxes from local sources.<sup>146</sup>

#### IV. OTHER SECOND-BEST INTERNALIZATION STORIES

To this point I have attempted to show that it is uncertain whether officials offered federal grants will act as good agents for the electorate and make decisions that maximize welfare. Notwithstanding these arguments, in this Part, I assume that officials act as poor agents. Even under that assumption, it

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SHEPSLE & MARK S. BONCHEK, *ANALYZING POLITICS: RATIONALITY, BEHAVIOR, AND INSTITUTIONS* 63-81 (1997); Hebert Hovenkamp, *Rationality in Law & Economics*, 60 *GEO. WASH. L. REV.* 293, 318-28 (1992).

<sup>142</sup> See Bernard Grofman, *Some Notes on Voting Schemes and the Will of the Majority*, 7 *PUB. CHOICE* 65, 75 n.4 (1969); Richard D. McKelvey, *Intransitivities in Multidimensional Voting Models and Some Implications for Agenda Control*, 12 *J. ECON. THEORY* 472, 472 (1976) (“[I]t is theoretically possible to design voting procedures which, starting from any given point, will end up at any other point in the space of alternatives . . . .”); Steven Slutsky, *Equilibrium Under  $\alpha$ -Majority Voting*, 47 *ECONOMETRICA* 1113, 1119 (1979).

<sup>143</sup> See Saul Levmore, *Voting Paradoxes and Interest Groups*, 28 *J. LEGAL STUD.* 259, 260 (1999); McKelvey, *supra* note 142, at 480-81.

<sup>144</sup> See WILLIAM H. RIKER, *LIBERALISM AGAINST POPULISM: A CONFRONTATION BETWEEN THE THEORY OF DEMOCRACY AND THE THEORY OF SOCIAL CHOICE* 214-32 (1982).

<sup>145</sup> See Kenneth A. Shepsle, *Congress Is a “They,” Not an “It”: Legislative Intent as Oxymoron*, 12 *INT’L REV. LAW & ECON.* 239, 241-42 (1992). Relatedly, positive political theory suggests that the end results of legislative processes may be produced more by the structure of the decision-making process than the underlying preferences of voters and legislators. See McNollgast, *Legislative Intent: The Use of Positive Political Theory in Statutory Interpretation*, 57 *LAW & CONTEMP. PROBS.* 3, 7-8 (1994).

<sup>146</sup> Of course, it is possible that there are easy short-cuts for estimating state officials’ attitudes towards tax increases. For instance, if a state’s electorate had a strong preference for increased spending that persisted over time, but the state nonetheless did not raise taxes, that might suggest the perceived political costs of tax increases were quite large. There is an argument that the “flypaper effect” I described earlier could be evidence of just such a tax shortfall. See *infra* Part V.

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remains possible that the personal motivations that drive officials, aside from the kinds of reelection-related motives canvassed in the earlier discussion of public choice theory, will produce outcomes quite similar to those that would result if there were perfect agency. In this Part, I consider whether the self-interest motivations of politicians may themselves preserve federalism values well enough to make judicial intervention unnecessary.

A. *Which Costs Matter?*

It obviously would be absurd to argue that state officials will, by chance, always have self-interested motivations that align their decisions with the interests of their constituents. Federal grants cover the waterfront of policy questions, and the decision to accept a grant therefore may have a variety of subjectively negative effects. Mandatory motorcycle helmet laws may reduce the welfare of those who enjoy both risk and the feeling of wind in their hair. But, the effect of interest groups aside, it is not clear why a self-interested state official would oppose such laws.

Accordingly, the claim here is rather narrow. I argue that only certain third-party effects should concern federal courts. Some prominent critics of conditional spending, including Professor Baker, have at times argued that conditional spending is unconstitutional because it reduces overall welfare.<sup>147</sup> These general claims about voter welfare prove far too much. By themselves, they offer no account of why state legislative decisions, even those that may reduce statewide welfare, are grounds for federal judicial intervention. States make bad decisions all the time, and so, of course, does Congress and other federal political actors. But basic tenets of modern constitutional law reject as illegitimate and impractical such an expansive role for courts in setting aside the reasonable decisions of fairly-constituted legislatures.<sup>148</sup> While there is surely a place for welfare maximization, that principle must be cabined by some federal interest derived from the Constitution or a federal statute that justifies federal judicial intervention.

Probably the most prominent candidate for a federal interest underlying the

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<sup>147</sup> Baker, *Conditional Spending*, *supra* note 22, at 1950-53, 1972-73; Baker & Berman, *Getting Off the Dole*, *supra* note 5, at 474.

<sup>148</sup> *E.g.*, JOHN HART ELY, *DEMOCRACY AND DISTRUST* 73-183 (1980) (setting out, and justifying as consistent with existing doctrine, the author's theory that the U.S. Supreme Court's role is primarily to protect fair democratic processes, not to impose what it perceives as best policy results). For an example of how expansive the welfare-maximization theory could reach, consider that an anonymous Note author in the Harvard Law Review applies much the same analysis in effect to condemn generally any federal legislation crafted during a period in which the same political party controls both the White House and Congress. Note, *No Child Left Behind and the Political Safeguards of Federalism*, 119 HARV. L. REV. 885, 900-901 (2006) [hereinafter Note, *No Child Left Behind*].

*Arlington* rule is the diversity values of a federalist system of government.<sup>149</sup> I do not claim this as an original insight on my part. A hallmark of federal legislation is that it often displaces or prevents a diverse set of state or local-level rules.<sup>150</sup> One of federalism's central goals – and in the views of some skeptics, such as Professors Rubin and Feely,<sup>151</sup> its only goal – is exactly to preserve that diversity.<sup>152</sup> Diversity produces many good ends such as opportunities for citizens to maximize their own happiness by locating in a jurisdiction with a congenial set of rules, chances to experiment with different solutions to similar problems, and competitive pressures on local governments to adopt the most appealing of these solutions.<sup>153</sup> In addition, state freedom to diverge from federal rules may serve as a constraint on federal lawmaking by offering a sort of “vertical” competition between state and federal government for the most effective governance.<sup>154</sup>

Accordingly, I do not endeavor to show here that state officials always improve national welfare, but only that they tend to protect state policy diversity. I accept the claim that diversity is a constitutionally-grounded good

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<sup>149</sup> See Baker, *Conditional Spending*, *supra* note 22, at 1948; Baker & Berman, *Getting Off the Dole*, *supra* note 5, at 470 (stating that the judicial enforcement of states' rights serves the function of protecting states “from federal homogenization in areas in which they deviate from the national norm,” which increases and preserves “diversity among the states”); Engdahl, *supra* note 4, at 85; Neil S. Siegel, *Commandeering and its Alternatives: A Federalism Perspective*, 59 VAND. L. REV. 1629, 1651 (2006); Somin, *Closing the Pandora's Box*, *supra* note 16, at 464; Stewart, *supra* note 22, at 919-20.

<sup>150</sup> See Michael C. Dorf, *Foreword: The Limits of Socratic Deliberation*, 112 HARV. L. REV. 4, 60-61, 64-65 (1998) (explaining that the states can serve as experimental laboratories and thus the Supreme Court should limit the federal government's ability to uniformly deny recognition of a right on a national level “before there has been a substantial period for experimentation”).

<sup>151</sup> Edward L. Rubin & Malcolm Feeley, *Federalism: Some Notes on a National Neurosis*, 41 UCLA L. REV. 903, 914-26 (1994) (arguing that “federalism allows the states to vary as they choose, pursuing their own policies instead of the national one,” and thus “can be justified only by arguments favoring a variety of policies, not by arguments favoring the implementation of a single policy by a variety of methods”).

<sup>152</sup> Robert P. Inman & Daniel L. Rubinfeld, *The Political Economy of Federalism*, in PERSPECTIVES ON PUBLIC CHOICE 73, 83-85 (Dennis C. Mueller ed., 1997); McGinnis & Somin, *Federalism vs. States' Rights*, *supra* note 20, at 106.

<sup>153</sup> For a sampling of the many interesting discussions on these points see, for example, *Gregory v. Ashcroft*, 501 U.S. 452, 458 (1991); GEOFFREY BRENNAN & JAMES M. BUCHANAN, *THE POWER TO TAX: ANALYTICAL FOUNDATIONS OF A FISCAL CONSTITUTION* 173-86 (1980); BREYER, *supra* note 27, at 56-65; Michael W. McConnell, *Federalism: Evaluating the Founders' Design*, 54 U. CHI. L. REV. 1484, 1493-1500 (1987); Oates, *supra* note 101, at 1122-23; Stewart, *supra* note 22, at 918; Ribstein & Kobayashi, *supra* note 113, at 3-5.

<sup>154</sup> See *Gregory*, 501 U.S. at 458; Andrzej Rapaczynski, *From Sovereignty to Process: The Jurisprudence of Federalism After Garcia*, 1985 SUP. CT. REV. 341, 380-95; Stewart, *supra* note 22, at 918.

whose protection may well be a federal judicial obligation. In the remainder of this Part, I consider whether conditional spending poses any threat to that good.<sup>155</sup> In particular, I claim that state officials' decisions to accept conditional funds likely approximate the decisions such officials would reach if they were perfect agents of their constituents.

One difficulty for this discussion, which I want to acknowledge at the outset, is the uncertainty in how officials would behave if they were perfect agents. Decentralized decision-making is not an unmitigated good; the study of public finance is in many ways an effort to identify those instances in which centralized government is superior to local and vice-versa.<sup>156</sup> Therefore, what I can show, at best, is that state officials will often have incentives of their own to take heed of the centralizing effects of federal grants. I cannot show that these incentives produce the socially optimal level of decentralized government, because the socially optimal level is unknown. My claim is simply that the divergence between the unknown optimal and *some* concern for decentralization is likely smaller than the gap between optimal and zero, which is the amount of concern critics seem to assume. In this respect, my argument is quite similar to the political theory of the Dormant Commerce Clause, which posits that, while it is impossible for courts to specify just how much weight states should give to the effects of their actions on outsiders, the fact of *some* in-state surrogate for outside interests is sufficient to ward off judicial intervention.<sup>157</sup>

#### B. *Official Incentives to Produce Diversity*

Critics of conditional spending overlook significant incentives for state officials to actually over-produce decentralization and policy diversity. To some extent these points are familiar, especially to those who study state and local taxation, although they have not yet found their way into the debate over conditional spending.

First, there are a set of what we might call "race to the top" incentives for state officials that would tend to weigh against a decision to opt into a set of uniform federal rules. Local jurisdictions compete against one another for mobile capital and productive citizens.<sup>158</sup> An official who succeeds in that

<sup>155</sup> My arguments here also tend to demonstrate that conditional spending on average is welfare enhancing overall. However, my argument does not rest on that point because, as I contend in the main text, determining the net welfare effect of a policy is the province mainly of legislatures, not federal courts.

<sup>156</sup> See generally Oates, *supra* note 101.

<sup>157</sup> See Shaviro, *Federalism in Taxation*, *supra* note 131, at 931-34; Mark Tushnet, *Rethinking the Dormant Commerce Clause*, 1979 WIS. L. REV. 125, 130-33.

<sup>158</sup> See ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, INTERJURISDICTIONAL TAX AND POLICY COMPETITION: GOOD OR BAD FOR THE FEDERAL SYSTEM? 60-63 (1991); WILLIAM A. FISCHER, THE HOMEVOTER HYPOTHESIS: HOW HOME VALUES INFLUENCE LOCAL GOVERNMENT TAXATION, SCHOOL FINANCE, AND LAND-USE POLICIES ix (2001) (stating that

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**Deleted:** (examining the effect of interjurisdictional competition on government spending)

competition, at least relative to the yardsticks her constituents use for comparison,<sup>159</sup> will likely reap political gains.<sup>160</sup> These newcomers can offer additional tax revenues, added jobs, higher home values, and perhaps, aside from their revenue effects, lead to better schools and safer streets.<sup>161</sup> At a minimum, the ability to attract outsiders perceived as valuable sends a positive signal to existing voters about the quality of their local government, and the reverse is almost certainly true.<sup>162</sup> Thus, entrepreneurial officials should want to develop innovative new projects or new technologies, or methods for delivering old ones that offer a comparative advantage over their neighbors.<sup>163</sup>

On the other hand, as Susan Rose-Ackerman and others have pointed out, if innovations are easy to copy, then perhaps there is a free-rider problem, and officials will not see enough reward in being the first politician to motivate much innovation.<sup>164</sup> While the question is complex, overall it is likely there is

the homeowner voters' stake in local politics which makes them attentive to public policy may explain local governments' race to the top in public education and environmental protection); Abraham Bell & Gideon Parchomovsky, *Of Property & Federalism*, 115 *YALE L.J.* 72, 103 (2005).

<sup>159</sup> In a relatively unregulated system of interjurisdictional competition, citizens lack information on which to compare the performance of their public officials. Some empirical research suggests that voters may make up for this gap by using heuristics, or mental shortcuts, such as rough comparisons between their own officials and those in other nearby jurisdictions, or perhaps between local and federal officials from their own jurisdiction. Besley & Case, *supra* note 139, at 29-31. Thus, a candidate's success in keeping taxes low may be judged, not in absolute terms, but in comparison to trends in tax rates in neighboring jurisdictions. *Id.*

<sup>160</sup> See PAUL E. PETERSON, *THE PRICE OF FEDERALISM* 17-18 (1995) (stating that local governments must provide public services that meet local businesses' and residents' needs to keep the citizens in-state because marginal businesses and marginal residents determine the market value of property in the locality); William W. Bratton & Joseph A. McCahery, *The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World*, 86 *GEO. L.J.* 201, 207-09 (1997) (stating that under Tiebout's model, a rational individual will choose a jurisdiction based on its taxes and available public goods); McGinnis & Somin, *Federalism vs. States' Rights*, *supra* note 20, at 109 (arguing that there is an incentive to compete because if state governments can increase their tax base, they can use the increase in tax revenue to fund popular programs and gain the support of powerful interest groups).

<sup>161</sup> See Lee Anne Fennell, *Beyond Exit and Voice: User Participation in the Production of Local Public Goods*, 80 *TEX. L. REV.* 1, 88 (2001); McGinnis & Somin, *Federalism vs. States' Rights*, *supra* note 20, at 109.

<sup>162</sup> See BRENNAN & BUCHANAN, *supra* note 153, at 178; cf. Mancur Olson, *Dictatorship, Democracy, and Development*, 87 *AM. POL. SCI. REV.* 567 (1993), reprinted in *READINGS IN POLITICAL ECONOMY* 130, 139 (Kaushik Basu ed., 2003).

<sup>163</sup> See Bratton & McCahery, *supra* note 160, at 207-09.

<sup>164</sup> David Lazer, *Regulatory Capitalism as a Networked Order: The International System as an Informational Network*, 598 *ANNALS AM. ACAD. POL. & SOC. SCI.* 52, 55, 60 (2005); Susan Rose-Ackerman, *Risk Taking and Reelection: Does Federalism Promote*

**Deleted:** (proposing a national list of property forms because local governments will adjust their taxes and services to reach the lowest average cost of providing desired goods and services, and the high cost of relocation lowers states' incentives to develop new property forms)

**Deleted:** In labeling this a heuristic, I do not mean at all to imply that it is irrational. For example, many firm managers are compensated based on the performance of their company's stock relative to others in similar industries, in order to screen individual performance from industry-wide shocks or trends.

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**Deleted:** (noting capital flight from poorly governed nations)

at least some motivation for local actors to innovate, albeit at below socially optimal levels.<sup>165</sup>

Other aspects of state competition are less conducive to the national welfare but equally effective at making local officials disinclined to accept conditional federal grants that would reduce diversity and state autonomy. For example, scholars of the Supreme Court's Commerce Clause jurisprudence often describe states as eager to "export" their own costs to those who reside outside the state.<sup>166</sup> A classic example is Delaware's hefty tolls at the Delaware Memorial Bridge which represent a substantial portion of Delaware's budget. Out-of-state travelers who drive the fifteen-mile stretch of I-95 that passes through Delaware largely bear the costs of the toll.<sup>167</sup> Uniform sets of federal rules tend to greatly reduce state opportunities for cost exporting.<sup>168</sup> The Constitution will usually prohibit outright discrimination, at least absent congressional authorization.<sup>169</sup> Accordingly, states must craft legal rules that

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*Innovation?*, 9 J. LEGAL STUD. 593, 594-95 (1980); Koleman S. Strumpf, *Does Government Decentralization Increase Policy Innovation?*, 4 J. PUB. ECON. THEORY 207, 208 (2002); Lars P. Feld et al., *Federalism, Decentralization, and Economic Growth* 10 (Marburg Working Paper on Econ., No. 30/2004, 2004), available at [http://www.uni-marburg.de/fb02/makro/forschung/gelbereihe/artikel/2004-30-FederalismGrowthDP\\_gesamt.pdf](http://www.uni-marburg.de/fb02/makro/forschung/gelbereihe/artikel/2004-30-FederalismGrowthDP_gesamt.pdf).

<sup>165</sup> Brian Galle & Joseph Leahy, *Laboratories of Democracy? Policy Innovation in Decentralized Governments* 81-82 (Aug. 3, 2008) (unpublished manuscript, available at <http://ssrn.com/abstract=1198835>) (exploring whether states have an incentive to innovate despite the threat of free-riding).

<sup>166</sup> See Ernest J. Brown, *The Open Economy: Justice Frankfurter and the Position of the Judiciary*, 67 YALE L.J. 219, 228-33 (1957); Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1191 (1986); Shaviro, *Federalism in Taxation*, *supra* note 131, at 910-12.

<sup>167</sup> See DEL. DEP'T OF TRANSP., DELAWARE TRANSPORTATION FACTS 2006 60-61 (2006), [http://www.deldot.gov/information/pubs\\_forms/fact\\_book/pdf/2006/2006\\_deldot\\_fact\\_book.pdf?22608](http://www.deldot.gov/information/pubs_forms/fact_book/pdf/2006/2006_deldot_fact_book.pdf?22608); Federation of Tax Administrators, 2005 State Tax Collection by Source, <http://www.taxadmin.org/fta/rate/05taxdis.html> (last visited Aug. 13, 2008) (sourcing 43.9% of Delaware's collected taxes as coming from sources other than the individual income tax, corporate income tax and excise tax). [ES: I expanded this parenthetical so that the reader knows what "other" sources are.] [ES: I suggest deleting this source. I don't really think it is necessary here since the other two sources give enough information about Delaware's tolls.]

<sup>168</sup> See Galle, *SSUTA*, *supra* note 78, at 1399-1400.

<sup>169</sup> See, e.g., *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 576 (1997) ("We have 'consistently . . . held that the Commerce Clause . . . precludes a state from mandating that its residents be given a preferred right of access, over out-of-state consumers, to natural resources located within its borders or to the products derived therefrom.'" (quoting *New England Power Co. v. New Hampshire*, 455 U.S. 331, 338 (1982))); *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 201 (1994) (finding a program unconstitutional "that simultaneously burdens interstate commerce and discriminates in favor of local producers"); *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 331 (1977) (discussing a tax where "[t]he obvious effect . . . [was] to extend a financial advantage to sales on the New York exchanges at the expense of the regional exchanges").

**Deleted:** (discussing "a Maryland statute which exacted from the owner of any vehicle operated as a common carrier a tax of two per cent of the value of the vehicle before it could be used on the state's highways")

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are facially neutral, but as a result of some distinctive feature of the state, produce disproportionate benefits for themselves. That will typically be difficult if the state agrees to accept a single nationwide rule or set of rules.

This foregone opportunity to discriminate is not only economically costly to the state but also politically costly to state officials. Again, there is a strong public choice component to state officials' preference for diverse sets of rules that permit them to attempt to export costs. Out-of-state individuals certainly can participate in the political process of a state that exports its costs on them, albeit not generally with a simple vote.<sup>170</sup> They can lobby, contribute money to well-disposed officials, organize any in-state interests that might be sympathetic, buy advertising against the undesired position, and so on.<sup>171</sup> In addition, in some cases, the possibility that a heavily burdened outsider might relocate into the exporting state and consume resources there might force the state to consider the impact of its policies on the outsider.<sup>172</sup> In many instances, however, it will be difficult for burdened out-of-state interests to organize as an effective political force because the interests are widely scattered, reside or do business primarily in many different places, and individually suffer only modest harms.<sup>173</sup>

Even well-organized groups of outsiders may face the problem that they do business in or travel to hundreds or thousands of jurisdictions, meaning that they would have to carry out hundreds or thousands of ongoing monitoring, organizing, and lobbying efforts.<sup>174</sup> This is precisely the dynamic that has led to more than 7,000 different sets of state and local sales tax regimes in the United States, notwithstanding the efforts of powerful nationwide retailers to curtail the ever-expanding diversification.<sup>175</sup> Scholars of the Dormant Commerce Clause often point to these forms of political market failure – that is, the over-production of state diversity – in justifying their calls for more stringent judicial oversight of state regulations affecting interstate commerce.<sup>176</sup>

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<sup>170</sup> See GEOFFREY R. STONE ET AL., *CONSTITUTIONAL LAW* 232 (5th ed. 2005).

<sup>171</sup> *Id.*

<sup>172</sup> See CHOPER, *supra* note 68, at 190-93.

<sup>173</sup> See Shaviro, *Federalism in Taxation*, *supra* note 131, at 931-32; Tushnet, *supra* note 157, at 130-33.

<sup>174</sup> A typical solution for the out-of-state interest in this situation is to seek national legislation preempting the state and local rules. See Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism*, 76 VA. L. REV. 265, 271-73 (1990); Revesz, *supra* note 98, at 564. The fierceness of many of these preemption battles, I believe, nicely demonstrates the scale of what local jurisdictions perceive to be at stake in their opportunity to set their own rules. It follows that the price for accepting uniformity as a condition of a federal grant may be quite high.

<sup>175</sup> Galle, *SSUTA*, *supra* note 78, at 1394-1400.

<sup>176</sup> See Jim Chen, *A Vision Softly Creeping: Congressional Acquiescence and the Dormant Commerce Clause*, 88 MINN. L. REV. 1764, 1767-68 (2004); Dan T. Coenen,

The Tax Reform Act of 1986 illustrates some other political costs of capitulating to federal offers.<sup>177</sup> Among its many other provisions, the 1986 Act eliminated a section of the Tax Code allowing taxpayers to deduct on their federal income tax return any state or local sales tax they had paid in a given tax year.<sup>178</sup> State and local income and property taxes remained deductible.<sup>179</sup> In theory, deductibility should act almost exactly like a matching grant.<sup>180</sup> Local jurisdictions should shift their taxes to the forms that are deductible because the after-federal-tax price of raising money through deductible taxes is cheaper. As a result, local jurisdictions can raise more money through those measures.<sup>181</sup> Thus, the effect of the 1986 Act should have been that states would have a choice of either cutting taxes or shifting away from sales taxes. If anything, though, states increased their reliance on sales taxes after 1986, with no discernible pattern of changes in revenue levels.<sup>182</sup> Needless to say, fiscal policy is highly complex, and there are probably many contributing causes for the shift to sales taxes. Still, in essence, Congress offered the States a massive payment to switch away from sales taxes, and the States refused.<sup>183</sup>

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*Business Subsidies and the Dormant Commerce Clause*, 107 YALE L.J. 965, 984-97 (1998); Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 442-43, 453-58 (1996); Maxwell L. Stearns, *A Beautiful Mend: A Game Theoretical Analysis of the Dormant Commerce Clause Doctrine*, 45 WM. & MARY L. REV. 1, 154-55 (2003).

<sup>177</sup> For more detailed discussion of the political and economic aspects of the 1986 reform, see W. ELLIOT BROWNLEE, *FEDERAL TAXATION IN AMERICA: A SHORT HISTORY* 124-50 (1996); Alan J. Auerbach & Joel Slemrod, *The Economic Effects of the Tax Reform Act of 1986*, 35 J. ECON. LITERATURE 589, 589-99 (1997).

<sup>178</sup> Tax Reform Act of 1986, Pub. L. No. 99-514, § 134(a)(1) (1986).

<sup>179</sup> 26 U.S.C. § 164 (2006).

<sup>180</sup> See Charles E. McClure, Jr. & George R. Zodrow, *Treasury I and the Tax Reform Act of 1986: The Economics and Politics of Tax Reform*, 1 ECON. PERSP. 37, 55 (1987).

<sup>181</sup> U.S. DEP'T OF THE TREASURY, *THE PRESIDENT'S TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH, AND SIMPLICITY* 65 (1984); Bruce Bartlett, *The Case for Eliminating Deductibility of State and Local Taxes*, 28 TAX NOTES 1121, 1122-23 (1985) ("[D]eductibility of state and local taxes has been estimated to increase total state and local government spending by as much as 20.5 percent . . ."); Douglas Holtz-Eakin & Harvey Rosen, *Federal Deductibility and Local Property Tax Rates*, 27 J. URB. ECON. 269, 270-71, 289, 291 (1990).

<sup>182</sup> Paul N. Courant & Edward M. Gramlich, *The Impact of the Tax Reform Act of 1986 on State and Local Behavior*, in *DO TAXES MATTER? THE IMPACT OF THE TAX REFORM ACT OF 1986* 243, 244-63 (Joel Slemrod ed., 1990); Gilbert E. Metcalf, *Tax Exporting, Federal Deductibility, and State Tax Structure*, 12 J. POL. ANALYSIS & MGMT. 109, 111 (1993); Pollock, *supra* note 127, at 298.

<sup>183</sup> Professor Pollock estimates that, as a result of the mechanics of deductibility, sales-tax deductibility resulted in about a six percent savings to states prior to 1986. Pollock, *supra* note 127, at 298. He deems this a small amount, although for many states it amounted to half a billion dollars or more *per year*. *Id.*

Contrary to some suggestions, it is not uncommon for states to refuse conditional federal

As we have seen, one likely contributing cause was that States perceived an opportunity to export tax costs through sales taxes, a mechanism that is not easily duplicated with taxes on income or real property.<sup>184</sup>

The political economy of taxation, however, offers an equally plausible explanation for state responses to the 1986 Act. Abandoning sales taxes would have meant abandoning a system of potentially infinite variety, with corresponding impacts on varying consumers and producers. Keeping the sales tax in place offered officials the opportunity to demand rents from various groups either to forebear from taxation or to continue taxation on others.<sup>185</sup> One can generalize this lesson: anytime state officials credibly bind themselves to a unified system, they will lessen opportunities to extract rents from constituents – that is, they can demand less in exchange for a promise not to enact or change a rule.<sup>186</sup> And state officials must share any credit for good outcomes that result (for example, from the macroeconomic effects of wise taxation) with officials from the federal government and other states involved in the nationwide bargain.<sup>187</sup> Therefore, local officials have strong political incentives to maintain distinctive and diverse sets of rules.

One could argue, however, that state fondness for sales taxes rests most heavily on the simple fact that they are difficult for taxpayers to notice. Few taxpayers tally their yearly sales tax bills. Income and property taxes almost certainly have more “salience” for the average taxpayer – they are easier to

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grants. For example, many states initially refused Aid to Families with Dependent Children grants. Volden, *supra* note 61, at 227. Others refused Clinton-era grants to pay for local teachers and police officers. *Id.*

<sup>184</sup> See Pollock, *supra* note 127, at 299. On the relative difficulty of tax exporting with income taxes, see *supra* text accompanying notes 166-169.

The economics literature includes two other hypotheses for the unexpected adherence to sales taxes in the wake of the 1986 Act. As Gilbert Metcalf points out, less-than-full deductibility of sales taxes prior to 1986, together with the lower tax benefit of deductibility that came with 1986’s lower federal tax brackets, may have compounded the allure of the opportunity to keep sales taxes as a tool for exporting taxes onto other jurisdictions. Metcalf, *supra* note 127, at 220-21. Howard Chernick also suggests that states may have adjusted their mix of sales and other taxes in order to restore a desired level of progressivity following the changes of the 1986 Act. Howard Chernick, *A Model of the Distributional Incidence of State and Local Taxes*, 20 PUB. FIN. Q. 572, 572-75 (1992).

<sup>185</sup> Cf. FRED S. MCCHESENEY, MONEY FOR NOTHING: POLITICIANS, RENT EXTRACTION, AND POLITICAL EXTORTION 26-29 (1997) (claiming that public officials enact regulatory regimes in order to demand rents from private parties for granting exemptions or forbearing from further regulation); *id.* at 124-31 (applying rent extraction theory to taxes and user fees).

<sup>186</sup> Cf. Saul Levmore, *Precommitment Politics*, 82 VA. L. REV. 567, 572-776, 586-91 (1996) (arguing that Congress can extract greater rents where it can offer interest groups assurances that it will be able to fulfill their demands in the future).

<sup>187</sup> Cf. Volden, *supra* note 61, at 219 (claiming that state governments likely prefer not to share credit for successful programs with federal government).

know and more prominent in the taxpayer's mind when she goes to vote.<sup>188</sup> Experimental work in taxpayer psychology supports this intuition: individuals are willing to pay more tax if the tax comes in small, bite-sized pieces.<sup>189</sup> Thus, while income and property taxes may have been cheaper as a matter of fiscal reality, as a matter of voter perception – and therefore of officials' preferences – sales taxes looked cheaper.<sup>190</sup> This illustrates that states may well turn down grants, as they turned down the implicit matching grant offered in the 1986 Act, where the *political* cost of substituting their own tax revenue is lower.

To sum up, public choice analysis indeed predicts, as critics of conditional spending maintain and as Justice O'Connor claimed in *New York v. United States*, that state officials may not fully take into account the national interest in federalism when considering offers from Congress.<sup>191</sup> However, a more complete survey of the political factors at work suggests that the question is complicated. There are significant reasons to doubt whether Justice O'Connor's generalization about the breadth and depth of the benefits and burdens of grants is correct. Perhaps more significantly, state officials have very powerful incentives to resist uniformity, even against the temptation of funds they need not impose taxes to obtain. While I know of no good metric for determining how much a state official "discounts" the federalism costs of accepting a grant, it would be very surprising if diversity is not prized by those officials at least as highly as the welfare benefits it creates.

Finally, I freely acknowledge the limitations of my analysis on this front. For the most part my discussion here has assumed that, in keeping with the bulk of the public choice literature, officials maximize their own welfare, or at best, their opportunities for enacting their own set of ideological preferences.<sup>192</sup> However, individuals may also be motivated by beliefs about the norms and obligations of their role in society.<sup>193</sup> Norms, in turn, may be sensitive to the institutional structure in which officials must operate.<sup>194</sup> Thus,

<sup>188</sup> See Christine Jolls, *Behavioral Economics Analysis of Redistributive Legal Rules*, 51 VAND. L. REV. 1653, 1662-63 (1998); Edward J. McCaffery & Jonathan Baron, *Thinking About Tax*, 12 PSYCHOL. PUB. POL'Y & L. 106, 119-20 (2006).

<sup>189</sup> See Krishna & Slemrod, *supra* note 135, at 193-94.

<sup>190</sup> The 1986 Act may have in fact accelerated the move to sales taxes by decreasing their salience. Taxpayers who deducted their sales taxes presumably had to tally them, thereby realizing the full extent of the burden they were bearing each year.

<sup>191</sup> See *New York v. United States*, 505 U.S. 144, 183 (1991); Somin, *False Dawn*, *supra* note 7, at 137-38.

<sup>192</sup> See, e.g., GORDON TULLOCK, *THE POLITICS OF BUREAUCRACY* 134-36, 167-70 (1965); Aranson et al., *supra* note 76, at 38, 47-48.

<sup>193</sup> See STEVEN KELMAN, *MAKING PUBLIC POLICY* 244-45 (James Q. Wilson ed., 1987) (recognizing that people may "reserve certain decisions to self-interest and others to altruism"); Edward L. Rubin, *Getting Past Democracy*, 149 U. PA. L. REV. 711, 767 (2001); Mark Tushnet, *Non-Judicial Review*, 40 HARV. J. ON LEGIS. 453, 455 (2003).

<sup>194</sup> See JON ELSTER, *THE CEMENT OF SOCIETY: A STUDY OF SOCIAL ORDER* 130-31 (1989);

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institutions for carrying on interstate agreements should reflect in part our hopes for developing norms consistent with the mission of the agreement.<sup>195</sup> I therefore am open to the argument that the real debate in conditional spending should be over how to design government in a way to mitigate the temptations of state officials to sell out their constituents rather than whether state officials suffer such temptations.

That conclusion leads to a larger point about the clear statement rule generally. The diversity values of federalism do not support the outcome in *Arlington* and its ancestors. All parties at the table in a negotiation over a conditional grant have good reasons to take into account the value of diversity in their decision. There is not yet any convincing explanation of why state and local officials would systematically under-value diversity as compared to other goods, especially in light of the possibility that local taxes might substitute for burdensome federal dollars. I agree that, in theory, a court might be licensed to reject local decisions to accept funds where there is obvious political-process failure. However, it is hard to see how a court could reliably make that judgment even in individual cases, given the thicket of conflicting factors identified above.

#### V. CREDIT, BLAME, AND FISCAL PRESSURES (OR LACK THEREOF?)

My second-best story about official incentives to respect the need for decentralized government so far neglects two other potential federal values that may be served by curtailing conditional federal spending. In this Part, I consider accountability and vertical cost exporting. On the accountability front, I argue that concerns that federal grants may confuse voters about whom to credit or blame for policy outcomes are largely overblown except in one or two special cases. Where local jurisdictions would be unable to self-finance their residents' preferences for essential local services, or are unable to obtain funds for less-vital services because of outside constraints, there is a stronger argument that the state official should not be "blamed" for the consequences of accepting federal funds. Similarly, on the exporting question, where local governments are needy, there is an inference that Congress would be able to export more easily the costs of regulation. Thus, the bulk of this section questions whether these two scenarios ever arise. I conclude that they are, at best, seldom seen in the modern United States. That fact suggests little need for a judicial role in protecting local government from Congress.

#### A. *Accountability and Coercion*

Federal mandates to state officials raise the possibility that voters will

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Robert Cooter, *Expressive Law and Economics*, 27 J. LEGAL STUD. 585, 585-86 (1998); Richard H. McAdams, *The Origin, Development, and Regulation of Norms*, 96 MICH. L. REV. 338, 355-66 (1997).

<sup>195</sup> I have argued this point elsewhere. Galle, *SSUTA*, *supra* note 78, at 1433-34.

ultimately blame the state officials for any bad outcomes, thereby distorting the political process at both national and local levels.<sup>196</sup> Some commentators have argued that the same dynamic is at play in conditional grants.<sup>197</sup> State decisions to accept funds subject to Congress's conditions may confuse voters about whom to blame for the burdens that result.<sup>198</sup> Evidently, the suggestion is that voters ought properly to blame Congress rather than their local official.<sup>199</sup>

Standing alone this voter-confusion story is not very persuasive. It may be true that voters will in part blame their local officials for the results of conditional grants, but that is not confusion at all. It takes two to contract, and local officials who make bad deals should be held to account for them, whether those deals are with trash-collection contractors or Congress.<sup>200</sup>

One might construct a more persuasive accountability argument based on Professor Baker's claim that Congress often effectively coerces states into accepting federal offers.<sup>201</sup> This argument might posit that state officials should not bear blame for accepting the offer they cannot refuse. The difficulty is that Baker sees coercion in virtually every federal-state

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<sup>196</sup> See *supra* note 26 and accompanying text.

<sup>197</sup> See Hills, *Cooperative Federalism*, *supra* note 16, at 825-27 (arguing the voter confusion point could be applied to all intergovernmental arrangements, but stating that this is a reason to believe the argument proves too much); McGinnis & Somin, *Federalism vs. States' Rights*, *supra* note 20, at 91; Deborah Jones Merritt, *The Guarantee Clause and State Autonomy: Federalism for a Third Century*, 88 COLUM. L. REV. 1, 48-50 (1988); Stewart, *supra* note 22, at 958; Note, *No Child Left Behind*, *supra* note 148, at 902-03.

<sup>198</sup> Hills, *Cooperative Federalism*, *supra* note 16, at 826; McCoy & Friedman, *supra* note 4, at 124; Siegel, *supra* note 149, at 1657; Somin, *Closing the Pandora's Box*, *supra* note 16, at 485; Stewart, *supra* note 22, at 958; Young, *Two Cheers*, *supra* note 22, at 1360; Rebecca E. Zietlow, *Federalism's Paradox: The Spending Power and Waiver of Sovereign Immunity*, 37 WAKE FOREST L. REV. 141, 203 (2002); Note, *Federalism, Political Accountability, and the Spending Clause*, 107 HARV. L. REV. 1419, 1420 (1994); Note, *No Child Left Behind*, *supra* note 148, at 902-03; Note, *Federalism, Political Accountability, and the Spending Clause*, 107 HARV. L. REV. 1419, 1420 (1994) [hereinafter Note, *Federalism*].

<sup>199</sup> See McCoy & Friedman, *supra* note 4, at 124-25; Somin, *Closing the Pandora's Box*, *supra* note 16, at 485; Young, *Two Cheers*, *supra* note 22, at 1360-61; Zietlow, *supra* note 198, at 203; Note, *Federalism* *supra* note 198, at 1420, 1429.

<sup>200</sup> Cf. Erwin Chemerinsky, *Protecting the Spending Power*, 4 CHAP. L. REV. 89, 100 (2001) (arguing that officials remain free to point out to their constituents that they are not responsible for decisions of other officials). Notably, in recent political events voters seem to have had little trouble in blaming what they perceive as maladministration of the war in Iraq on President Bush's administration as well as the Congress that voted to authorize it.

In any event, as I have noted before, careful institutional design can largely cure any structural distortions in the correct allocation of political accountability. Galle, *Getting Spending*, *supra* note 11, at 200-02.

<sup>201</sup> Baker, *Conditional Spending*, *supra* note 22, at 1936-39.

exchange.<sup>202</sup> She claims that states are so hard-pressed to raise funds that they must accept federal grants.<sup>203</sup>

It is doubtful that situations such as those offered by Baker, in which state officials are reluctant to raise their own revenue, are coercive in any meaningful sense.<sup>204</sup> If government services are too expensive at the state level, then state government could simply choose not to provide them. If they are essential services, the federal government can provide them instead. In essence, it seems as though Baker's point really is that accepting federal dollars is politically cheaper for state officials than raising funds themselves, along the lines illustrated with the figures in Part III above.<sup>205</sup> This more modest claim would not buttress any argument about accountability. The accountability concern is that voters will mistakenly blame state officials for federal officials' choices. If state officials have themselves chosen, out of political expediency, to piggyback on federal efforts, it is difficult to see why any blame voters attach to the state officials would be misplaced.<sup>206</sup>

To be fair, there are some situations that would present a closer question. Imagine, for example, a region where citizens cannot afford to provide truly essential services for themselves. In this region, the central government does not provide those services, and the local government is severely constrained in its revenue-raising capacity for reasons beyond its own control. In this scenario, it may be unfair for voters to blame their local government for any conditions the central government attaches to its grants.<sup>207</sup> A large measure of the uncertainty here is based on the problem that concepts like "blame," "choice," "coercion," and "republican government" are not easy to define, at least not without controversy.<sup>208</sup> I am willing to concede here that close

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<sup>202</sup> Lynn A. Baker, *Conditional Federal Spending and States' Rights*, 574 ANNALS AM. ACAD. POL. & SOC. SCI. 104, 106 (2001) ("[T]he federal government has a monopoly power over the various sources of state revenue, which renders any offer of federal funds to the states presumptively coercive." (emphasis added)); see Baker, *Conditional Spending*, *supra* note 22, at 1936-39; Baker & Berman, *Getting Off the Dole*, *supra* note 5, at 519-21.

<sup>203</sup> See Baker, *Conditional Spending*, *supra* note 22, at 1935-38.

<sup>204</sup> See Engdahl, *supra* note 4, at 82-83.

<sup>205</sup> Cf. Baker & Berman, *Getting Off the Dole*, *supra* note 5, at 520, 535-36 (acknowledging that states may have a "choice" to decline funds, but arguing that as a normative matter, the states' choices are unfairly narrow).

<sup>206</sup> Perhaps the argument in response would be that voters will attach *too much* blame to their state officials, relative to some outside, objective standard of political blameworthiness. But any such argument would depend on a theory of political accountability that to date no one on either side of the spending debate has articulated.

<sup>207</sup> Cf. Sullivan, *supra* note 63, at 1492-96 (arguing that conditions attached to grants of aid may be deserving of closer judicial attention if political failures result in the federal government assuming too much power relative to ideal constitutional design, and that such an arrangement might be described as "coercive" in some sense).

<sup>208</sup> See Siegel, *supra* note 149, at 1656. Professor Baker straightforwardly acknowledges the difficulty of defining these concepts; indeed, one of her arguments for her own approach

judicial scrutiny may well be appropriate in situations that would squarely present the need to make such judgments. However, those situations do not likely arise with any frequency in the United States, as Part V.C. illustrates.

B. *Accountability and Vertical Cost Exporting*

If Congress can oblige state governments to bear the cost of implementing federal policies, then Congress does not internalize its own costs. The federal government may then produce too much regulation or regulation that is inefficiently priced.<sup>209</sup> Voters may also be induced to shift responsibility from local government to Congress, because it appears that Congress can accomplish its ends at lower cost.<sup>210</sup> Thus, as Bruce La Pierre has argued, one way to understand the Supreme Court's federalism jurisprudence is as an effort to ensure that Congress internalizes all of the tax cost of regulation.<sup>211</sup>

This cost-exporting rationale seems to have little bite when it comes to conditional spending.<sup>212</sup> The costs of implementing policy by means of conditional spending are often quite large because of opportunities for strategic behavior by individual states.<sup>213</sup> Individual states, particularly those which are confident the federal government cannot act without their cooperation, can "hold out" for payoffs that exceed their costs.<sup>214</sup> Part IV analyzed a number of other political economy considerations that tend to weigh against the possibility that local officials will "discount" the costs Congress seeks to shift to them.<sup>215</sup> As a result, those costs will be passed back to Congress as the payout price for accepting any accompanying conditions. Finally, to the extent that Congress does succeed in exporting some of its costs, it does so at the price of sharing credit for any beneficial outcomes with state officials.<sup>216</sup> This

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to the Spending Clause is that it presents a bright-line alternative that approximates her sense of the best notion of coerciveness. See Baker, *Conditional Spending*, *supra* note 22, at 1972-74; Baker & Berman, *Getting Off the Dole*, *supra* note 5, at 485, 521-22.

<sup>209</sup> See Siegel, *supra* note 149, at 1644.

<sup>210</sup> Again, this may be largely another way of restating the diversity argument. See *supra* Part IV.B.

<sup>211</sup> See D. Bruce La Pierre, *Political Accountability in the National Political Process—The Alternative to Judicial Review of Federalism Issues*, 80 NW. U. L. REV. 577, 644-46 (1985); cf. Stewart, *supra* note 22, at 966.

<sup>212</sup> Cf. La Pierre, *supra* note 211, at 658-60 (arguing that cost exporting is not a concern where the federal government requires a state to act as a condition of the federal government's refrain from preempting the state, on the theory that if the state refuses the federal government it would in fact have to pay costs of preemption).

<sup>213</sup> See Hills, *Cooperative Federalism*, *supra* note 16, at 880-83.

<sup>214</sup> See Galle, *Getting Spending*, *supra* note 11, at 188-89.

<sup>215</sup> See *supra* text accompanying notes 145-197.

<sup>216</sup> Cf. Volden, *supra* note 61, at 218-19 (arguing that local governments expend their own funds on top of federal grants in order to ensure they will receive some credit for programs, and may turn down some grants in order to avoid sharing credit).



will tend to diminish the political rewards that federal lawmakers realize from regulating, and therefore constrain the overproduction or inefficient production of regulation.<sup>217</sup>

In any event, for either of these rationales one does not need to rely on broad predictions about institutional behavior or national circumstances. The States' fiscal standing can be tested empirically. Even if we cannot get an exact diagnosis, we can at least take the States' fiscal temperature. In particular, we can examine data on what states do with the money they get from federal grants. I take up that challenge in the next section.

### C. *Testing the Coercion and Exporting Hypotheses*

As outlined in the last two sections, there are two plausible arguments for restraining state agreements to accept conditional spending. In extreme situations, state officials might be so desperate for funds that they feel "coerced" into accepting and perhaps should not receive blame for accepting the conditions attached to a federal grant.<sup>218</sup> Alternatively, Congress might use conditional spending to export the costs of regulation.<sup>219</sup> This section subjects both of these claims to testing against existing empirical research. In addition, reviewing the states' fiscal standing may shed some light on the extent to which their own-source revenues may reduce the appeal of grants, as outlined in Part III.

#### 1. "Flypaper" Effects as Measures of State Fiscal Standing?

Both of these accountability arguments ultimately depend on further claims about the states' fiscal conditions.<sup>220</sup> The coercion point arises convincingly only where it is genuinely difficult for states to raise funds for essential services. As for the danger of cost-exporting, logically that possibility could arise only where Congress can persuade a state to regulate (as a condition of a grant) for less than it would cost the federal government to regulate directly. It is difficult to analyze or predict the relative cost structures of different levels of government, particularly because decentralized regulation may have efficiency gains that counter-balance any centralized economies of scale, depending on program design.<sup>221</sup> However, as Part III showed, if federal money looks

<sup>217</sup> There also is an argument that there are some federal goods we should be happy to see "over-produced." For example, if we think that for other political-process reasons Congress does not ordinarily do enough to protect the rights of oppressed or neglected political minorities, then cost exporting would be a way of subsidizing more expansive federal efforts. If those costs are borne by state governments who themselves under-produce rights regulations, then the state governments probably have little grounds for complaint.

<sup>218</sup> See *supra* Part V.A.

<sup>219</sup> See *supra* Part V.B.

<sup>220</sup> Cf. Adler, *supra* note 6, at 1208.

<sup>221</sup> A complicating point here is that while it may be demonstrably cheaper to regulate at

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substantially “cheaper” than locally-generated funds, state officials may be willing to accept federal projects at a discount.<sup>222</sup>

Existing econometric studies on the “flypaper effect” might bear significantly on both questions. Again, the flypaper effect is a wide-spread phenomenon in which vertical grants induce the grant recipients to spend more than expected on the targeted grant activity.<sup>223</sup> One possible inference drawn from these studies is that state and local governments are short of cash.<sup>224</sup> That is, spending increases because the local jurisdiction prefers more services prior to the grant but it is unable to generate the tax revenues to meet those preferences. Thus, a persistent flypaper effect for essential government services could strongly support at least one component of the coercion argument – the claim that local government and local residents could not obtain those services on their own.

Alternatively, the flypaper effect data might support the story that states view federal money as “cheaper” than their own. For example, the economist Jonathan Hamilton has argued the possibility that more efficient taxes at the federal level cause the flypaper effect.<sup>225</sup> If federal taxation is more efficient,

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one level or another, we have to be certain to compare the costs of similar quality outputs. Federal regulation may be cheaper, but of lower quality, or vice-versa.

<sup>222</sup> For example, suppose it would cost Congress \$100 to implement the Widget Protection Act of 2008 in the state of South Utopia (“SU”). It will similarly cost the South Utopian government \$100 in real dollars to implement the Act. SU residents believe they receive no benefit at all from the Act. However, Congress offers SU a \$90 grant on the condition that it will agree to administer the Act. Because of various discounting effects, SU lawmakers perceive the cost of implementation as \$80. I claimed in Part III **ES: There is no III.D. Do you just want this to be Part III?!** that the determining factor in whether SU officials will accept the grant offer is their perceived cost of raising \$90 from the SU tax base. If they perceive the cost as less than \$80, they will reject Congress’s offer. Congress then must bear the entire \$100 itself. If SU perceives their tax cost as higher than \$80, then they will accept the grant, and Congress will have succeeded in exporting some of the costs of implementing the Widget Protection Act.

<sup>223</sup> To review, we should expect that unmatched grants would on average have only a weak impact on recipient spending. Giving a state of 1,000 people a \$1 million grant is fiscally identical to giving each resident \$1,000. If residents generally prefer to spend eight cents of each dollar on government services, then the grant will simply increase spending by \$80 per capita, or \$80,000 of the \$1 million, allocated in proportion to preferences for various services. Tax cuts or spending reductions will “offset” the remainder. In the flypaper effect studies, however, grants tended to increase spending by far more than the existing rate, sometimes by as much as dollar-for-dollar (or, in rare cases, even more). Additionally, grants tend to be spent largely in their targeted category, rather than being redistributed according to existing distributions of government spending. *See supra* Part II.B.

<sup>224</sup> *Cf.* Lutz, *supra* note 103, at 24 n.22 (“Low income communities, which have relatively high [property] tax rates, may be constrained from their optimal education expenditure from fear of losing their commercial real estate base.”).

<sup>225</sup> Jonathan H. Hamilton, *The Flypaper Effect and the Deadweight Loss from Taxation*,

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the federal government can extract more money than states from the same base (or they can extract the same amount of money at lower overall economic cost).<sup>226</sup> Voters' marginal preference for government services should shift upwards when revenue is raised through federal instruments, because their tax price in effect is lower than it was when the state levied their taxes.<sup>227</sup> Hamilton's research therefore shows that the flypaper data suggest federal taxes are literally cheaper than local taxes. [\[ES JH: Add FN for support\]](#)

We might be able to tell a similar story about perceived tax costs. Federal revenues could potentially derive from sources the local taxpayers *perceive* as imposing a smaller economic burden.<sup>228</sup> That, in turn, might incline officials to substitute federal grant dollars for local revenues. Flypaper studies would not tell us anything directly about the relative discount rates of local taxes as compared to the perceived burdens of any given grant condition, because they deal with unconditional, unmatched grants. But, if the perceived economic burden account held up, it would at least give us significant information about the likely attitude of voters about local taxes. Large flypaper effects would suggest that the discount rate for local taxes is small or negative, diminishing the likelihood they would constrain decisions to accept funds. If nothing else, these results might offer a starting place for judicial scrutiny of conditional grant transactions. Instances of large flypaper effects in response to federal grants might occasion more careful consideration of the terms of the grant

**Comment [BDG2]:** There's no citation to support this; it's an inference I'm suggesting can be drawn from Hamilton.

19 J. URB. ECON. 148, 148-50, 153-54 (1986); *see also* Brennan & Pincus, *supra* note 104, at 232, 238-39 (proposing a model for the flypaper effect based on "differential tax efficiency"); Volden, *supra* note 61, at 221, 224-25 (modeling the assumption that federal grants are more attractive to local governments when the federal government is more efficient at raising funds).

<sup>226</sup> *See* Gary S. Becker & Casey B. Mulligan, *Deadweight Costs and the Size of Government*, 46 J.L. & ECON. 293, 303 (2003); Hamilton, *supra* note 225, at 153 (explaining how individuals avoid state taxes by moving away from the jurisdiction or purchasing goods in other jurisdictions, thereby decreasing the revenue efficiency of state taxes); Volden, *supra* note 61, at 224-25.

<sup>227</sup> *See* Becker & Mulligan, *supra* note 226, at 306, 308; Brennan & Pincus, *supra* note 104, at 236, 238; Hamilton, *supra* note 225, at 153. Here is another simple numeric example. Suppose South Utopian ("SU") citizens prefer to spend \$.08 per dollar of their personal income on government services paid for with SU tax funds. To obtain that \$.08 in tax, the SU government in fact causes other economic distortions that result in an actual economic burden of \$.12 per dollar on each SU citizen. So the citizens actually were willing to pay \$.12 per dollar for services, but received only \$.08 per dollar in value. Now suppose that federal taxation of \$.08 per dollar, combined with attendant distortions, produces a burden of only \$.10 per dollar on SU citizens. If the federal government gives SU a \$1 million grant, SU citizens should be willing to spend more of it than their own income. They can spend more and still bear only a \$.12 per dollar burden. To be precise, they should be willing to spend 80% of 12 cents (.08/.10 = X/.12), or 9.6 cents on the dollar.

<sup>228</sup> *Cf.* Fisher, *supra* note 99, at 342 ("[F]iscal illusion may cause individuals to perceive different tax increases than those that actually occur or individuals may respond to tax increases on the basis of some perceived use of the money.").

conditions.

Unfortunately, the theoretical picture of the flypaper effect is rather muddled. Critics of the efficiency theory argue that it explains only a very small portion of observed flypaper effects.<sup>229</sup> Some studies show only temporary flypaper effects or none at all.<sup>230</sup> Further, there are a variety of explanations for the observed data, perhaps none of them entirely inconsistent with the others.<sup>231</sup> In the next subpart I try to sort these issues out.<sup>232</sup>

## 2. The Flypaper Data

By one count there are more than ten theories to account for observed flypaper effects.<sup>233</sup> One set of hypotheses, as I noted, suggest that grant recipients increase expenditures because federal dollars are cheaper or represent tax funds they could not themselves easily raise.<sup>234</sup> A number of others posit rational or irrational voter ignorance combined with political opportunism by public officials as the cause of the flypaper effect.<sup>235</sup> In these

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<sup>229</sup> Peter Mieszkowski, *Comments on Chapter 5*, in MODERN PUBLIC FINANCE 157, 159-60 (John M. Quigley & Eugene Smolensky eds., 1994).

<sup>230</sup> See Bailey & Connolly, *supra* note 102, at 339-42; Gordon, *supra* note 103, at 1773.

<sup>231</sup> See Fisher, *supra* note 99, at 324; Hines & Thaler, *supra* note 29, at 220-22; Lutz, *supra* note 103, at 1.

<sup>232</sup> A reasonable question for the reader to ask at this point would be whether there might be a more direct measure of a state's fiscal situation. Unfortunately, the most common economic tools for measuring state "fiscal capacity" and "financial need" are themselves problematic in a number of ways. See Stephen M. Barro, *State Fiscal Capacity Measures: A Theoretical Critique*, in MEASURING FISCAL CAPACITY 51, 81-84 (H. Clyde Reeves ed., 1986); Max B. Sawicky, *The "Total Taxable Resources" Definition of State Revenue-Raising Ability*, in 1 U.S. DEP'T TREASURY, FEDERAL-STATE-LOCAL RELATIONS: TECHNICAL PAPERS 63, 78-94 (1986); Tannenwald, *supra* note 127, at 4. A particular problem for our purposes is that there appears to be no neutral way of measuring the financial "needs" of a state without first defining what forms and levels of services state and local governments ought to provide. *Id.* at 7. For instance, the leading measure of "need" simply analyzes the costs a state would incur if it provided the same bundle of services offered by the "average" U.S. state. *Id.* at 7-8. As authors of these studies note, many states that appear "needy" under this metric in fact may have a preference for a low level of government services, such that they could comfortably provide those services even under fairly tight budgets. *Id.* at 16, 19-22. Thus, the appeal of the inferential flypaper approach I suggest here is that it might account for the local jurisdiction's own perception of its fiscal capacity and its "need" for government services. It is worth noting, though, that the flypaper studies deal almost exclusively with unconditional grants, so that applying their findings to conditional grants does require a bit of an inferential leap.

<sup>233</sup> See Bailey & Connolly, *supra* note 102, at 342-47.

<sup>234</sup> See Becker & Mulligan, *supra* note 226, at 306, 308; Brennan & Pincus, *supra* note 104, at 230, 232; Hamilton, *supra* note 225, at 153; Lutz, *supra* note 103, at 24 n.22.

<sup>235</sup> Bae & Feiock, *supra* note 107, at 580-81; Bailey & Connolly, *supra* note 102, at 348-49; William R. Dougan & Daphne A. Kenyon, *Pressure Groups and Public Expenditures: The Flypaper Effect Reconsidered*, 26 ECON. INQUIRY 159, 160 (1988); Lars P. Feld &

views, voters fail to notice grants, value them improperly, or do not realize that grant dollars could be viewed as equivalent to their own tax payments.<sup>236</sup> Public officials take advantage of these misperceptions to expand their own operations without having to raise taxes.<sup>237</sup> Alternatively, even fairly virtuous public officials serving less-than-fully-informed voters might direct grant dollars to spending rather than tax cuts out of fear that federal funds might dry up in the near future, leaving local officials in the position of raising taxes to return to their original level of funding.<sup>238</sup>

Two other explanations draw on the fact that federal grants are a repeated game.<sup>239</sup> In one of these theories, the argument is that all grants are really implicitly matching grants.<sup>240</sup> Remember the flypaper effect is an expected result, rather than a surprise, for matching grants.<sup>241</sup> If local officials spend their money in a way that displeases the grant-makers, they will not receive money next time.<sup>242</sup> Therefore, the grantees spend money largely as the grantor allocates it (at least if there is any evident monitoring by the grantor). In another repeated game story, grants sometimes result from political effort on the part of local constituencies, who local officials reward in order to encourage similar efforts by others in the future.<sup>243</sup> As a result, some portion of the grant sticks to the categories urged by the successful local coalition.<sup>244</sup>

One challenge for all the theories is to explain not only why overall local

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Christoph A. Schaltegger, *Voters as a Hard Budget Constraint: On the Determination of Intergovernmental Grants*, 123 PUB. CHOICE 147, 151, 167 (2005); Filimon et al., *supra* note 103, at 52; Hines & Thaler, *supra* note 29, at 223; Lutz, *supra* note 103, at 29-30; Mitias & Turnbull, *supra* note 103, at 347-48; Turnbull, *supra* note 103, at 3-7.

<sup>236</sup> See Feld & Schaltegger, *supra* note 235, at 149-52; Filimon et al., *supra* note 103, at 57; Hines & Thaler, *supra* note 29, at 223.

<sup>237</sup> See Bae & Feiock, *supra* note 107, at 580-81; Filimon et al., *supra* note 103, at 52, 57.

<sup>238</sup> Bailey & Connolly, *supra* note 102, at 343, 346-47; James W. Fossett, *On Confusing Caution and Greed: A Political Explanation of the Flypaper Effect*, 26 URB. AFF. Q. 95, 95-97, 106-07 (1990); Volden, *supra* note 61, at 227; cf. Gordon, *supra* note 103, at 26 ("If districts do not anticipate permanent changes in revenue, they may be hesitant to increase total spending."). Thus, this version of the theory depends on the assumption that the political costs of raising taxes tend to be larger than the political rewards of cutting taxes. There is a fair amount of empirical research to support that assumption. *E.g.*, Bae & Feiock, *supra* note 107, at 585; Fossett, *supra*, at 107-09; Louise Marshall, *New Evidence on Fiscal Illusion: The 1986 Tax "Windfalls,"* 81 AM. ECON. REV. 1336, 1342 (1991); Mitias & Turnbull, *supra* note 102, at 355, 361.

<sup>239</sup> See Knight, *supra* note 103, at 71-72 (modeling a legislative bargaining model of intergovernmental grants); Singhal, *supra* note 104, at 8 n.9.

<sup>240</sup> See Baicker, *supra* note 103, at 150; Fisher, *supra* note 99, at 338.

<sup>241</sup> See *supra* notes 99-107 and accompanying text.

<sup>242</sup> See Baicker, *supra* note 103, at 152.

<sup>243</sup> See Singhal, *supra* note 104, at 549.

<sup>244</sup> *Id.*

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spending increases in response to a grant, but also why spending increases in the actual category targeted by the grant.<sup>245</sup> By themselves the underinformed voter narratives struggle with that point.<sup>246</sup> It is not clear why local officials would choose to spend their “free” resources only on the activities encouraged by the grantor. The hypothesis is that officials will take advantage of voter ignorance to use federal money for their own purposes. It would be a very large coincidence if the purposes of the federal officials authorizing the grant and the local officials accepting it happened to align. Even if both grantor and grantee officials are responding to what they perceive as the spending areas likely to deliver the largest political rewards, individual official preferences among services, the information available to the two sets of officials, and the constituencies most closely tied to the officials should all vary considerably.

The cash-strapped states theories are more compelling on this point. Proponents of those notions could posit that officials need federal funds when there are real public needs going unmet, and therefore, a large political reward available to whomever can meet them. Both grantor and grantee officials, in an effort to capture some of the reward pool, target their grant money for those needs.<sup>247</sup> The size and obviousness of the political reward available overcome the differences in preferences, constituencies, and information among the various levels of officials such that their spending decisions converge.

The repeated game adherents also have a good explanation for categorical stickiness. ~~[ES: I would delete this last clause unless you want to explain how they are weaker and on what fronts.]~~ In the repeated game stories, federal grants stick categorically because otherwise, in the next round, there would not be a federal grant, or not as much of one.<sup>248</sup> A challenge for these theorists, however, is the increasing number of studies showing that flypaper effects often have only a limited duration.<sup>249</sup> Money may stick to a category for a year or two, but by the third year of a grant program the funds are offset according to classical theory.<sup>250</sup> That result is surprising because, if anything, one would expect smaller flypaper effects in the first years of a grant, as it can take time to ramp up a large new spending project.<sup>251</sup> Perhaps the argument for

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<sup>245</sup> See Hines & Thaler, *supra* note 29, at 222.

<sup>246</sup> See Singhal, *supra* note 104, at 549.

<sup>247</sup> Cf. Knight, *supra* note 103, at 72 (observing that state officials may help federal officials determine how best to allocate grant dollars); Volden, *supra* note 61, at 226 (arguing the grant-maker will target grants to subject areas in which there is high public demand).

<sup>248</sup> See Baicker, *supra* note 103, at 152; Singhal, *supra* note 104, at 259.

<sup>249</sup> Gordon, *supra* note 103, at 1773.

<sup>250</sup> Gordon, *supra* note 103, at 1773, 1787-88, 1790-91; Lutz, *supra* note 103, at 19. *But see* Singhal, *supra* note 104, at 562 (finding the flypaper effect persisted in an instance where the source of funds was litigation against tobacco company rather than a grant from another government entity).

<sup>251</sup> See Lutz, *supra* note 103, at 19.

repeated-gamer theorists is that the attention of Congress or the local coalition has wandered; coalitions are notoriously difficult to hold together.<sup>252</sup> However, in these studies Congress is still interested enough, and coalitions still active enough, to produce billions of dollars in grants. It is hard to understand why the implicit matching component, or need for rewards, would diminish so quickly when the funding itself does not.

On the other hand, the theory that federal funds are cheaper than state dollars, or that the states are otherwise in need of federal money, is also a poor fit with short-duration flypaper effects. It is difficult to imagine that the relative efficiency of federal and local tax collection, or the fiscal condition of localities, changes dramatically in the span of a few years, no matter how successful the grant program.

Thus, the underinformed or irrational voter and repeated games arguments, *in combination*, fit the available evidence as well or better than the efficiency and financial need stories. When voter misinformation about grants presents the opportunity for increased government spending, the spending is sticky by category because there is *also* an implicit matching component or a need to reward active constituencies. At the same time, implicit matching or rewards are insufficient by themselves to increase spending in a targeted category, because once local voters understand their actual fiscal situation they will prefer to return most of the grant money to their own pockets in tax cuts (or to reallocate it in other categories). In the first few years of a grant, especially one that is of relatively low salience for voters, voters may not notice or understand it, but over time better-informed constituents teach or de-bias them.<sup>253</sup> Studies of New Hampshire's court-imposed school financing

<sup>252</sup> ROBERT A. DAHL, *DILEMMAS OF PLURALIST DEMOCRACY: AUTONOMY VS. CONTROL* 57 (1982); Steven G. Calabresi, *Political Parties as Mediating Institutions*, 61 U. CHI. L. REV. 1479, 1512-15 (1994).

<sup>253</sup> See Filimon et al., *supra* note 103, at 52 (considering but rejecting this possibility); Lutz, *supra* note 103, at 24 n.22; Marshall, *supra* note 238, at 1342 (discussing the role of the media in informing voters and constituencies about grants); cf. Baicker, *supra* note 103, at 156 n.15 (noting that some stickiness of categorical spending may result from fact that budgets of different agencies are allocated by different committees of the legislature, so that legislators do not initially consider budgets of other agencies when setting budget level of the agency overseen by their own committee). [ES JH: This parenthetical seems misplaced because it doesn't talk about the understanding of voters]

Professor Singhal argues against a "learning story," pointing to evidence from her own work indicating that anti-tobacco spending increased only after states received funds from their lawsuits against tobacco companies, rather than during the course of the litigation. Singhal, *supra* note 104, at 559-60. She suggests that, if increased spending is the result of improved voter information, the lawsuit itself should have served that function. *Id.* That argument mistakes the point of the "learning" hypothesis. The theory emphasizes that what voters do not understand is the fiscal situation of their government. There was nothing about the tobacco litigation Singhal studied that would have improved voter information on that front.

**Comment [BDG3]:** I would keep the paren. here; the analogy is between the misperception of voters and the misperceptions of legislators described by Baicker.

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realignment, which showed little flypaper effect in localities even from day one, support this theory.<sup>254</sup> The grants were the dominant political story in the state,<sup>255</sup> so there was never a window of voter misinformation through which “sticky” spending could climb.

This is not to say that other explanations of the flypaper effect are invalid. Indeed, one econometric study showed fairly convincingly that in Mexico, where regional per capita income was on the order of a few hundred dollars, the flypaper effect likely resulted from local inability to raise money from local citizens.<sup>256</sup> The taxpayers were simply too poor to pay for their own government. I acknowledge, then, that the true causes of a measured flypaper effect may vary widely depending on underlying circumstances.

As a result, my point is simply that, absent poverty on the scale exhibited in some places outside the United States, the existence of a flypaper effect does not establish that the states need federal money or prefer to substitute it for their own. Put another way, there is no clear evidence that the states are over-eager to accept federal dollars. Nor could courts easily use the presence of a flypaper effect as a shorthand method for triggering closer scrutiny. I am not claiming to have irrefutable evidence that the states are *not* over-eager to accept federal dollars. My argument, however, is that absent some compelling showing of a federal interest, state and local governments should be free to make agreements with Congress without restriction by federal courts.

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More challenging for my theory is Singhal’s finding that flypaper effects were persistent for five years. *Id.* at 562. However, as she notes, the funds at issue in her study derived from successful lawsuits against tobacco companies, rather than intergovernmental grants. *Id.* at 563-64. This difference may well be significant. Part of what voters may learn over time is the fact that the source of the intergovernmental grant includes tax dollars they have paid to the grant-making government. This could make them less inclined to be taxed, in effect, twice for the same services: once by the grant-maker, and again by the grant-recipient. Since the recipient is smaller, it is politically easier to offset the received grant with reduced local taxes than to reduce the grant by the amount of their contribution. In any event, Singhal’s version of the repeated-game story is, like the combination repeated-game/voter-learning story I tell here, consistent with the view that state and local governments are free to decline federal grants.

<sup>254</sup> Lutz, *supra* note 103, at 3, 25.

<sup>255</sup> *Id.* at 7-8 (discussing New Hampshire’s unique town hall system, which creates involvement on the individual level).

<sup>256</sup> Pablo Camacho-Gutierrez, *Essays on Mexican Fiscal Federalism: A Positive Analysis* 145-47 (2005) (unpublished dissertation), available at <<http://www.lib.utexas.edu/etd/d/2005/camachogutierrezp13970/camachogutierrezp13970.pdf>>; see also DAVID N. KING, FISCAL TIERS: THE ECONOMICS OF MULTI-LEVEL GOVERNMENT 114-17 (1984) (noting the possibility that flypaper effects may result from highly impoverished local government). For a discussion of the challenges of decentralized revenue-raising in developing economies, see Oates, *supra* note 101, at 1142-44.

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D. *Indirect Tax Supports for State and Local Government*

Finally, a few words on why it would have been surprising to find evidence that local governments are in need of federal assistance. In particular, I want to highlight some *unconditional* sources of federal support for state and local governments generally overlooked in the debate over conditional spending.

The U.S. Tax Code is the source of many of these forms of unconditional support. Nearly all modern grants from Congress come with at least some minor strings attached.<sup>257</sup> For example, at a minimum, essentially every federal grant comes with the condition that individuals who misdirect those funds for personal gain will be subject to federal prosecution.<sup>258</sup> In contrast, many federal tax provisions provide fiscal support to state and local government with few or no conditions.

Consider, for example, § 501 of the Tax Code, which exempts non-profit entities from taxation.<sup>259</sup> One explicit rationale for the exemption (and accompanying § 170 deductions for contributions to select non-profits) is that it encourages production of quasi-governmental services; services that local government might otherwise have to provide.<sup>260</sup> Non-profit schools, hospitals, and other civic associations produce hundreds of billions of local services, and there is strong evidence that they would produce less without tax exemption.<sup>261</sup>

Several other provisions offer somewhat more targeted subsidies for local government activities. Most prominently, § 164 allows a federal deduction for state and local income, property, and (in some cases) sales taxes paid by individuals and corporations.<sup>262</sup> State and local bonds are exempt from federal

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<sup>257</sup> See Baker, *Conditional Spending*, *supra* note 22, at 1918.

<sup>258</sup> See *Sabri v. United States*, 541 U.S. 600, 603-05 (2004) (deciding on the constitutional validity of 18 U.S.C. § 666(a)(2) (2000), which imposes federal criminal penalties on anyone who bribes a government agent, where the government agency has received federal benefits greater than \$10,000 via a grant or other form of federal assistance).

<sup>259</sup> 26 U.S.C. § 501 (2000). Of course, this section does impose some conditions on the *taxpayer* in order to obtain exempt status, but none on the local governments who need not duplicate the services offered by the non-profits.

<sup>260</sup> There are also other explanations for the deduction. For some excellent surveys of the field, see Rob Atkinson, *Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis, and Syntheses*, 27 STETSON L. REV. 395, 402-26 (1997); Johnny Rex Buckles, *The Case for the Taxpaying Good Samaritan: Deducting Earmarked Transfers to Charity Under Federal Income Tax Law, Theory and Policy*, 70 FORDHAM L. REV. 1243, 1282-96 (2002); Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1396-1433 (1988).

<sup>261</sup> See Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 72-75 (1981).

<sup>262</sup> 26 U.S.C. § 164 (2000). For a more detailed discussion of the arguments in favor of and against the explanation of § 164 as a subsidy for local governments, see Brian Galle, *A Republic of the Mind: Cognitive Biases, Fiscal Federalism, and Section 164 of the Tax Code*, 82 IND. L.J. 673, 680-701 (2007).

tax, although there is some debate whether local governments are able to capture all of the benefit of the tax advantage attached to the bond.<sup>263</sup> The low-income housing tax credit offers subsidies for developing or rehabilitating homes.<sup>264</sup> And lastly, a variety of federal tax subsidies for home ownership increase home values, expanding localities' property tax base.<sup>265</sup>

It is not immediately clear whether these subsidies outweigh the other fiscal pressures on states. For example, as I have outlined elsewhere, there is a vigorous debate among social scientists over federal deductibility.<sup>266</sup> Some scholars believe one of the aims of the deduction is to counter-balance the fact of interjurisdictional tax competition.<sup>267</sup> If local officials know that voters need not pay the full cost of the taxes they impose, the officials will not fully internalize the political cost of those tax increases, and therefore, in theory, raise them higher than they would otherwise.<sup>268</sup> But there have been a number of writers, including top tax officials in President Reagan's Treasury Department, who argue the deduction actually goes too far in encouraging local spending.<sup>269</sup> That is, they believe § 164 by itself more than compensates

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<sup>263</sup> See Brian D. Galle & Ethan Yale, *Can Discriminatory State Taxation of Municipal Bonds Be Justified?*, 117 TAX NOTES 153, 154-55 (2007); Clayton P. Gillette, *Fiscal Federalism and the Use of Municipal Bond Proceeds*, 58 N.Y.U. L. REV. 1030, 1044-46 (1983); Douglas J. Watson & Thomas Vocino, *Changing Intergovernmental Fiscal Relationships: Impact of the 1986 Tax Reform Act on State and Local Governments*, 50 PUB. ADMIN. REV. 427, 428-50 (1990).

<sup>264</sup> 26 U.S.C. § 42 (2000). For a review of the LIHTC and its mechanics, see Andrew Zack Blatter & Elena Marty-Nelson, *An Overview of the Low Income Housing Tax Credit*, 17 U. BALT. L. REV. 253, 255-70 (1988); Sagit Leviner, *Affordable Housing and the Role of the Low Income Housing Tax Credit Program: A Contemporary Assessment*, 57 TAX LAW. 869, 871-75 (2004); U.S. Dep't of Housing and Urban Development, *HOME and Low Income Housing Tax Credits (LIHTC)*, <http://www.hud.gov/offices/cpd/affordablehousing/training/web/lihtc/> (last visited Aug. 13, 2009).

<sup>265</sup> Julie Roin, *The Consequences of Undoing the Federal Income Tax*, 70 U. CHI. L. REV. 319, 331 (2003).

<sup>266</sup> Galle, *supra* note 262, at 676-81, 685-87.

<sup>267</sup> Bratton & McCahery, *supra* note 160, at 248 & n.196; see Kirk J. Stark, *Fiscal Federalism and Tax Progressivity: Should the Federal Income Tax Encourage State and Local Redistribution?*, 51 UCLA L. REV. 1389, 1410, 1431 (2004); Lior Jacob Strahilevitz, *The Uneasy Case for Devolution of the Individual Income Tax*, 85 IOWA L. REV. 907, 927-32 (2000). Recall that competition among states for mobile capital and high-income taxpayers tends to reduce state and local tax levels. *E.g.*, Oates, *supra* note 101, at 1121 & n.3. For a more general discussion of central government fiscal counters to the problem of local tax competition, see Sam Bucovetsky & Michael Smart, *The Efficiency Consequences of Local Revenue Equalization: Tax Competition and Distortions*, 8 J. PUB. ECON. THEORY 119, 120-22 (2006).

<sup>268</sup> See Michael Smart, *Taxation and Deadweight Loss in a System of Intergovernmental Transfers*, 31 CAN. J. ECON. 189, 206 (1998); Tannenwald, *supra* note 127, at 4.

<sup>269</sup> 2 U.S. DEP'T OF TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC

for any fiscal pressures on state and local government.<sup>270</sup> If these commentators are correct, then it would be surprising if there were evidence that states are over-eager to accept federal money. State and local government may, indeed, already over-produce government services.

One could argue this point cuts in favor of restrictions on federal grants.<sup>271</sup> Again, competition among states for mobile resources may increase pressure on state government to perform more efficiently, or, at a minimum, to hold taxes below the level that empire-building officials might prefer.<sup>272</sup> If states already perceive themselves as fiscally comfortable, and grants add to that comfort, then grants may have the effect of dampening what might otherwise be welfare-enhancing competition.<sup>273</sup> For instance, in the extreme case in which all revenue-raising is centralized, there is no interstate tax competition at all.

Even in this extreme case, however, states should still be able to compete. States can compete using not only taxes, but also benefits, so that in the absence of tax competition one would expect competition for favorable rules and efficient services.<sup>274</sup> In some instances this shift away from tax competition can actually increase overall welfare.<sup>275</sup> Nor is it clear that grant

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GROWTH 63-64 (1984); Christian Kelders & Marko Kthenbrger, *Tax Incentives in Fiscal Federalism: An Integrated Perspective* 3-4 (Nov. 2005) (unpublished manuscript), available at <http://www.lrz-muenchen.de/~ces/Marko/FiscalFederalism.pdf>.

<sup>270</sup> I acknowledge, however, that the Treasury offered their views before it was clear for how many households the Alternative Minimum Tax would effectively eliminate the § 164 deduction. The AMT obliges taxpayers above a certain income threshold to recompute their tax without many deductions, including § 164. 26 U.S.C. § 56(b)(1)(A)(ii) (2006). Critically, that threshold is not indexed for inflation, so budget projections now suggest that in short order it will be more expensive to repeal the AMT than to repeal the entire rest of the individual income tax. CONG. BUDGET OFFICE, REVENUE & TAX POLICY BRIEF, THE ALTERNATIVE MINIMUM Tax 1, 8 (2004), <http://www.cbo.gov/showdoc.cfm?index=5386&sequence=0>.

<sup>271</sup> I am grateful to Ilya Somin and Todd Zywicki for raising this argument.

<sup>272</sup> PETERSON, *supra* note 160, at 17-18, 25-26. Regarding the effects of tax competition on tax rates, see generally Michael Keen & Christos Kotsogiannis, *Leviathan and Capital Tax Competition in Federations*, 5 J. PUB. ECON. THEORY 177 (2003) (analyzing how tax competition both horizontally between states and vertically between various levels of government may increase tax rates in a competitive environment).

<sup>273</sup> There is an extensive debate in the public finance literature over whether this competition is, on balance, welfare-enhancing. For summaries of the conflicting views, see Wallace E. Oates, *Fiscal Competition and European Union: Contrasting Perspectives*, 31 REGIONAL SCI. & URB. ECON. 133, 133-43 (2001); John Douglas Wilson & David E. Wildasin, *Capital Tax Competition: Bane or Boon?*, 88 J. PUB. ECON. 1065, 1088 (2004); George R. Zodrow, *Tax Competition and Tax Coordination in the European Union*, 10 INT'L TAX & PUB. FIN. 651, 651-66 (2003).

<sup>274</sup> See Jonathan H. Adler, *The Ducks Stop Here? The Environmental Challenge to Federalism*, 9 SUP. CT. ECON. REV. 205, 224-25 (2001).

<sup>275</sup> See Richard Revesz, *Federalism and Environmental Regulation: A Normative*

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levels short of 100% of a state's funding needs will reduce tax competition. Indeed, one might expect tax competition to increase as states become more fiscally solid, because the state is better able to afford generous tax breaks for its most mobile taxpayers.<sup>276</sup> Thus, to the extent that interstate competition enhances national welfare, there is little indication that the fiscal effects of federal grants and other federal supports reduce that competition.<sup>277</sup>

On a final note, the proliferation of relatively unconditional supports for local government raises an additional question about the logic of the clear statement rule. If the Constitution obliges the federal government to avoid coercing state governments, why does it follow that the solution is restrictions on grant conditions? Why is it not the solution for courts simply to require more unconditional financial support for states, to the point that states obviously will be free to accept or decline further grants? It seems clear that courts would refuse to consider, as beyond their institutional capacity, claims about what level of funding a local government needed in order to meet the minimum level of functionality "guaranteed" by Article IV.<sup>278</sup> But if claims about the coerciveness of grants ultimately turn on the same question, then they should similarly be outside a federal court's proper functions. While I remain somewhat open to the argument that Congress should internalize the costs of its own regulatory decisions, the "coercion" and cost-exporting arguments for judicially constraining conditional spending seem untenable.

#### CONCLUSION

In sum, my analysis here suggests there is little justification for the clear statement rule. The rule, like other forms of constitutional enforcement, displaces the expressed preferences of political actors, including both federal

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*Critique*, in THE NEW FEDERALISM: CAN THE STATES BE TRUSTED? 97, 104-05 (John Ferejohn & Barry R. Weingast eds., 1997) (arguing that the existence of tax competition may induce states to set superoptimal levels for other regulation, in order to avoid drawing in capital in excess of local infrastructural capacity).

<sup>276</sup> Moreover, although I have for the most part here assumed that federal grants will be offered in the worst possible form, in reality Congress has a number of incentives to cultivate competition among states. Competition enables Congress to gather experimental data about alternative approaches which it can then appropriate for use in national legislation, as well as to diversify the risks of such experiments. And, of course, if competition in fact increases national welfare, and officials are judged on the performance of the economy, congresspersons have at least some reason to be interested in the welfare effects of grants.

<sup>277</sup> On the other hand, it is possible the architecture of some fiscal supports may reduce competition by undermining the exit or participation incentives of local taxpayers. See Galle, *supra* note 262, at 696-701. But that is a question of program design, not one about the merits of grants generally.

<sup>278</sup> U.S. CONST. art. IV. Cf. Stewart, *supra* note 22, at 930-31 (mentioning that courts have traditionally left claims about proper or just allocation of societal resources to political process).

grant-offerors and state and local grant-acceptors. Any analysis of the clear statement rule, including Professor Tribe's political-process story, must account for that fact by pointing to some flaw in the decisions officials make in offering and accepting grants that might justify federal judicial intervention. Yet there is no real evidence that state decisions to accept funds fail to preserve the values that federalism protects, even if that is not what in fact motivates the state officials. Officials have their own reasons for preserving diversity. The perceived discount on raising funds locally often counter-balances the costs of accepting federal money. And there is little evidence that state officials perceive difficulty in raising funds through their own tax systems, especially in light of other federal tax supports, such as the federal deductibility of many state and local taxes.

Of course, the reader may wonder whether any of this matters at all. After all, we might think of the clear statement rule as just a sort of default rule. Perhaps if Congress views it as an unwise rule, Congress might simply enact conditional spending statutes with a disclaimer providing that all the provisions of the statute are to be interpreted purposively, or that some rules may be binding on states even if not expressly stated in the text of the statute. That, of course, assumes that the costs of overcoming legislative inertia are relatively low.<sup>279</sup> Additionally, even if Congress acted, it is not clear that the Supreme Court would let stand efforts to displace the clear statement rule. If the Court views the clear statement rule as a form of constitutional enforcement, or as necessary to protect its own institutional prerogatives, the Court is unlikely to give it up easily. For instance, some commentators believe Congress can displace the *Gregory* clear statement rule only one statute at a time.<sup>280</sup> Well, what is a "statute?" The Court could demand an enormous amount of specificity for provisions supposedly setting aside the clear statement rule: a super-clear statement rule.<sup>281</sup> It is a safe bet that, absent some reconsideration by the Supreme Court, the issue of the clear statement rule is here for a long stay.

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<sup>279</sup> See Ferejohn & Friedman, *supra* note 65, at 855-58 (arguing that many supposed default rules may simply become legislative rules, due to difficulty in mobilizing Congress and other actors to displace them).

<sup>280</sup> E.g., Nicholas Quinn Rosenkranz, *Federal Rules of Statutory Interpretation*, 115 HARV. L. REV. 2085, 2097 (2002).

<sup>281</sup> For a more extensive discussion of this point, see Brian Galle & Mark Seidenfeld, *Administrative Law's Federalism: Preemption, Delegation, and Agencies at the Edge of Federal Power*, 58 DUKE L.J. 1933, 2005 (2008).