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The national unity formed last year in response to terrorism soon vanished as more typical political infighting returned. Although overshadowed by the buildup to and the conduct of a second war against Iraq, political issues grounded in the nation's federal character contributed to a rise in divisiveness. The mid-term elections of 2002 and redistricting battles in several states drove partisanship to new heights. The continued sluggishness of the nation's economy also exacerbated interparty bickering. Republicans controlled the White House and both houses of Congress, yet some of the president's policy initiatives encountered more serious resistance in his own party than from the opposition. Many of the feuds within the majority party rested on state and regional interests typical of federalism politics. State and local governments remained trapped in the third year of a fiscal crisis, and even large reductions in expenditures did not extricate these governments from the financial fix. Despite their pleas, state and local officials were unable to obtain any significant relief from the federal government. Federal-state relations, as a consequence, exhibited more contentiousness than cooperation.

The war in Iraq and the attempts to revive the economy eclipsed but did not eliminate federalism issues from the nation's political life. Implementation of homeland-security measures engaged officials of all governments, and these officials played familiar intergovernmental “games” in pursuit of jurisdictional interests. National policy battles exhibited unanticipated partisan and geographic combinations as the president encountered serious resistance not only from the opposing party but also from diverse factions within his party. The U.S. Supreme Court's "Federalism Five" did not do much to advance their state-friendly federalism jurisprudence, but the Court did agree to hear several cases that may offer opportunities to advance their agenda. State governments continued to be constrained by the long-running fiscal crisis, and local governments paid part of the price as states reduced intergovernmental transfers. The fiscal crunch notwithstanding, state governments produced a remarkable array of policy initiatives. Two of the nation's most populous states—California and Texas—served as arenas for bitter political battles that had spillover effects on the rest of the nation.

Once the Taliban were driven from power in Afghanistan, President George Bush's administration turned its attention to other nations believed to be engaged in terrorist activities; in the process, Bush labeled Iraq, Iran, and North Korea an "axis of evil." With the president's popularity soaring with the success of military operations in Afghanistan, the White House initiated a full-court press of criticism against Saddam Hussein and Iraq. The administration's case that Iraq posed an imminent threat to the United...
States rested on the twin claims that Iraq possessed weapons of mass destruction and had links to Al-Qaeda. Congress in early October 2002 agreed with the president’s assessment and passed a resolution authorizing the use of force if necessary to disarm Saddam Hussein.1

The struggle for advantage in the November 2002 congressional elections turned into a partisan debate over “guns versus butter.” Republican candidates stressed the war against terrorism, but the public’s principal worries turned out to be jobs and the economy. The Democrats tried to exploit these concerns as well as those over corporate malfeasance and health care. The November election would be crucial because Congress was closely divided, and a shift in partisan alignment could set the stage for major changes in the course of public policy.2 President Bush, in a risky and unusual tactic, spent three weeks in October traveling around the country urging voters to support his party’s candidates. Bush’s aggressive campaigning paid dividends. The Republicans added six seats to their slim majority in the U.S. House of Representatives and managed to recapture a thin 51-49 majority in the U.S. Senate. The results ran counter to the usual historical pattern of losses in mid-term elections by the party in control of the White House, and thus provided the president with an important political victory.

Two unexpected changes in party leadership made the transition to the 108th Congress noteworthy. Senate Majority Leader Trent Lott (R-MS) made controversial comments about segregation at a centennial birthday party for Senator Strom Thurmond (R-SC). Despite his best efforts to downplay and later apologize for his gaffe, southern senators refused to forgive him and Lott was forced to resign his leadership post. Senator William Frist (R-TN) emerged out of the caucus as the new majority leader. Over in the House of Representatives, the Democrats had to choose a new minority leader when Representative Richard Gephardt (D-MO) resigned. The ensuing intraparty struggle culminated in the selection of Representative Nancy Pelosi (D-CA). Pelosi, a senior member of the House Appropriations Committee, is the first woman to lead a party in Congress.

Through winter, the White House sharpened its criticism of Hussein and produced a portfolio of information to demonstrate the validity of the president’s claims; however, its indictment of Iraq encountered considerable opposition and skepticism at home and abroad. Despite a concerted diplomatic effort to persuade other nations, including a major briefing at the United Nations by Secretary of State Colin Powell, key allies such as France and Germany resisted following Bush’s lead. On 17 March 2003, the president declared Iraq to be in “material breach” of U.N. Security Council resolutions requiring it to disarm, and Bush warned Hussein and

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his sons they must leave Iraq in 48 hours or military conflict would begin.\textsuperscript{3} Two days later, Bush announced to the nation that the United States had attacked Iraq.\textsuperscript{4} Combat operations by U. S. and British armed forces in Iraq were surprisingly quick and successful. The president, in a speech from the deck of the USS Abraham Lincoln, declared the end of major combat activity on 1 May 2003.\textsuperscript{5} The rapid rout of Iraqi military forces, however, did not end the hostilities. Survivors of the old regime mounted a rear-guard, guerrilla style resistance that slowly escalated into daily attacks on the occupying forces. By early summer 2003, the disorderly environment in Iraq became a major political issue in the opening phase of the 2004 presidential contest.

The economy’s deterioration still bedeviled the Bush administration. Unemployment reached a nine-year high, wages fell, and businesses cut costs. The administration had gained passage of tax cuts two years in a row, let the dollar decline against other currencies, and increased federal spending. The Federal Reserve, fearing deflation, lowered interest rates to a 45-year low. Yet the economy remained stagnant, except for the housing market, which was sustained by the low interest rates. Working against the national government’s stimulative efforts were several factors, including the multi-year fiscal crisis faced by state governments, the concomitant reduction in state and local government spending, a falling stock market, and the outsourcing of jobs to overseas locations.\textsuperscript{6} Not only were manufacturing jobs being exported overseas, so were service jobs. Several state governments, following the example set by the private sector, hired firms located in India to answer toll-free assistance lines to respond to state residents seeking unemployment and welfare benefits.\textsuperscript{7} By early summer, a turnaround in the stock market and a rise in business spending raised hopes that the economy would improve more substantially, given that the recession had actually ended in November 2001.

New cases of corporate scandals emerged, and their persistence dragged on economic growth. Several financial and business consulting firms had assisted Enron and other large corporations by guiding the companies through complex financial schemes to avoid taxes. Some of the maneuvers included the establishment of hundreds of off-shore subsidiaries, manipulation of information contained in corporate accounting reports, and the creative use of tax shelters. As a result, corporate profits reported

to the Internal Revenue Service (IRS) were $155 billion less than those reported to shareholders. Another set of cases focused on securities brokers who employed fraudulent practices, such as recommending the purchase of "junk" stocks to clients and giving favored clients preferences in initial public stock offerings. The Securities and Exchange Commission’s (SEC) failure to police brokerage houses and a crackdown by the attorney general of New York provoked a clash between federal and state government regulators. Wall Street firms rushed to Congress to prevent New York and other states from imposing disclosure, conflict-of-interest, and other reporting requirements that differed from those mandated by the SEC. Passage of this type of legislation would effectively undercut a state’s ability to investigate securities fraud. For its part, the SEC supported restrictions on state government jurisdiction over brokerage activities.

One might have expected the two political parties to work together to address the twin challenges of war and the economy, especially with the narrowness of the Republican majority in both congressional chambers. But the opposite occurred; throughout the year, partisanship became more extreme, not just in Washington, but across the nation. An effort to pass a new redistricting plan in Texas provided the most visible and visceral example of this unrestrained partisanship. Conceived by U. S. House Majority Leader Tom DeLay (R-TX), the proposed plan would significantly decrease the number of congressional seats likely to be won by Democrats. The Republicans controlled the governorship and the legislature, and expected the plan to be approved quickly. In a desperate gambit, the Democratic minority in the state house fled to Oklahoma in an effort to stymie any vote in May. When Governor Rick Perry tried once again in June to pass the redistricting plan, Senate Democrats hid out in New Mexico. A similar redistricting battle, but with less drama, occurred in Colorado. Democrats threatened to retaliate by redrawing congressional lines in New Mexico and Oklahoma, where they controlled state government. The level of partisan rancor rose to new heights because these redistricting battles would have huge consequences for the 2004 congressional elections. But the bitterness was also exacerbated by the novelty of the intrusion of a national political figure into state political matters. "This is a political strategy we haven’t seen before," said Tom Storey, redistricting analyst for the National Conference of State Legislatures. "People who study this area can’t find a case in the last 100 years of mid-decade redistricting without a court order." In less than two years, the nation’s political climate changed

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from the unity immediately following the 9/11 attack to a new low in divisiveness.

**HOMELAND SECURITY**

In the months following the 11 September 2001 terrorist attacks, all governments initiated numerous actions designed to prevent future attacks as well as to upgrade the nation’s ability to manage the consequences of any future incident. Governor Tom Ridge was sworn in as the first Secretary of the Department of Homeland Security (DHS) on 24 January 2003, and the Department assumed responsibility for the nation’s security on 1 March 2003. The DHS immediately launched several initiatives, notably the Ready Campaign, a citizen-preparedness movement designed to educate citizens about basic survival equipment, supplies, and tools as well as appropriate responses to possible attacks; Operation Liberty Shield, a comprehensive national plan to protect citizens and infrastructure; and the Homeland Security Center, a continual monitoring and reporting operation.12

Most observers agree that the program initiatives have been impressive.13 However, there has been much less agreement about whether the funding for homeland security is sufficient. The pre-9/11 budget of the agencies consolidated into the DHS was approximately $22 billion, and the Bush 2003 budget proposal increased this total to $37.7 billion, "or roughly twice the original 2002 plan and four times what the government was spending on homeland security in the mid-1990s."14 A FY 2003 supplemental appropriation passed in April added another $6.71 billion to the DHS’s budget, of which $4.3 billion was allocated to Operation Liberty Shield and the remaining $2.4 billion was targeted to the airline industry to cover costs of improvements associated with thwarting terrorist acts.15 Congress also established numerous federal grant programs in support of homeland-security activities. It is no surprise that these assistance programs vary by type of recipients (state versus local governments), by allocation methods (formula versus categorical), and by requirements (match versus no match; maintenance of effort versus no maintenance of effort).16

Members of Congress from both parties declared the initial budget to be insufficient and complained that Bush was slow to request adequate funding. Quarrels over the DHS’s budget persisted through 2002, holding hostage the 2002 domestic security funds. Law enforcement costs associated with each new change in the threat alert status imposed large financial

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14Ibid., 158.
burdens on local governments and prompted a January 2003 letter to Congress from the U.S. Conference of Mayors in which the mayors pleaded for the $3.5 billion of federal funds promised the previous January. A study released in February 2003 by the National Fire Protection Association found that "only 13 percent of the nation's fire departments were prepared to deal with the collapse of buildings of 50 or more occupants, and that only about a quarter of the departments had equipment for easy communication with state and federal emergency-response agencies." In a speech to the National Governors Association (NGA) at the end of February 2003, Bush gave into the pleas from state and local officials as well as to mounting public pressure fanned by the Democrats and conceded that more money was needed for homeland security. Republicans especially from populous states with large metropolitan areas joined Democrats in a call to boost federal spending, and thus supported a larger federal share of total security costs. Bush finally signed a bill to pay for homeland security on 16 April 2003.

Intergovernmental implementation problems plagued the efforts to enhance domestic security capabilities. While jokes about the Ready Campaign's admonitions to citizens to buy duct tape and plastic sheeting with which to create "safe rooms" gained the nation's attention, more serious issues received less notice. For example, the plan to vaccinate health-care workers against smallpox forced many state and local public health agencies to transfer their own monies from other services to pay for the vaccinations. Communication and information-sharing failures frustrated progress. A General Accounting Office (GAO) report found that nine federal agencies, a year and half after 9/11, had yet to promote inter-agency sharing of terrorist "watch lists." Obstacles included different types of databases and software as well as a lack of agency policies. While information sharing among federal agencies, as described by GAO, was "inconsistent and limited," the Police Executive Research Forum, in its own report, noted that many local police officials complained that "... the FBI still kept them uninformed about terrorist developments." Senator Charles Grassley (R-IA) criticized the agencies by noting "Federal bureaucracies have an institutional disease where they think they own their information. Our state and local police can't watch out for anybody if they're kept in the dark." Another GAO study found state and local health units varied tremendously in their levels of preparedness for a bioterrorism attack. Problems identified in the report included workforce shortages, inadequacies in disease surveillance and laboratory systems, lack of regional coordination and compatible communication systems, absence of specific

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federal standards on appropriate level of preparedness, and lack of federal guidelines on assessing vulnerabilities for foodborne or waterborne diseases.\textsuperscript{20}

By contrast, few problems were reported about the intergovernmental flow of funds. The National Emergency Management Association (NEMA) reported on 2 April 2003 that states had expended or obligated 76 percent of the 1999 to 2002 federal monies distributed by the Office of Domestic Preparedness (ODP) and the remainder of the FY2002 funds were in the process of being obligated. NEMA’s study also showed that 81 percent of all ODP grant monies sent to the states were passed through to local governments, and in a number of cases the pass-through was 100 percent. A major problem identified in the NEMA report was the uncertainty of the federal budget process. Because of delays in the passage of the federal budget, states received three years of ODP funding in a period of six months between Spring and Fall 2002.\textsuperscript{21}

Other critical implementation issues have yet to be resolved and are not likely to be in the near future. The current intergovernmental system designed to respond to natural disasters has been built up over several decades, and it can be expected that these arrangements will perform effectively provided a terrorist-induced incident exhibits features associated with natural disasters. Less certain is the ability of the system to handle attacks that do not fit the natural disaster mold such as bioterrorism or radiological contamination.\textsuperscript{22} Similarly, the country’s highly decentralized law enforcement institutions confront a much more difficult coordination challenge to identify, monitor, and apprehend highly trained terrorists, especially so-called “lone wolf” terrorists. Decisions about targeting public resources to high probability or important symbolic targets versus ensuring some minimal level of protection to all locations pose devilish problems. How does one decide among public infrastructure, communication systems, food supplies, financial systems, monuments, and the needs of special populations such as school children?

Perhaps the most important intergovernmental issue is the classic question of the appropriate division of responsibilities among the federal, state, and local governments. There is already pressure to “federalize” activities—whether by preemptions or by mandates—that have been in the domain of state and local governments. In some cases, federal agencies have acted to centralize control as has happened in transportation; in other cases, state and local officials have sought national guidelines and standards as in public health. But the federal government does not possess enough

resources—money, expertise, personnel—to assume total responsibility for domestic security. Instead, intergovernmental and intersectoral partnerships are more likely to create effective as well as legitimate arrangements by which to conduct planning, share information, establish new communication and information systems, solve interoperability problems, develop surge capacity (i.e. meet a rapid increase in demand for a given good or service), and finance required activities.

Similarly, the division of responsibilities and obligations will have to be determined within each state. Tensions between state and local officials as well as intrastate feuds among local officials have surfaced and are likely to increase in frequency rather than decrease. Donald Kettl summarized the intergovernmental issues related to the implementation of homeland security policies:

... homeland security is primarily an issue of coordination, but coordination is fundamentally a problem in intergovernmental relations and federalism. Left to its own devices, federalism is not likely to respond effectively. It’s going to require some innovative strategies for coming at this problem. The consequences of failing to do so could very well prove to be dangerous—even catastrophic—so the urgency for attacking this problem is huge.²³

Whether federalism responds effectively to the threat of future terrorist attacks will depend critically on the willingness of officials at all levels of government to see the interests of their agency or jurisdiction as bound together with the interests of other agencies and jurisdictions. It is only a sense of common interest that can serve as the basis for collaborative actions and as a brake on dysfunctional competition.

Homeland Security and Civil Liberties

Since its passage in October 2001, the USA Patriot Act (P.L. 107-56) has become a political lightening rod for an increasingly acrimonious debate among those who advocate aggressive actions against possible or suspected terrorists, those who worry about a possible diminution of civil liberties and political freedoms, and those who oppose any growth in government and its authority. A “politics makes strange bedfellows” coalition of groups on the left and on the right that believe the Patriot Act gave too much intrusive power to the federal government has emerged in many places around country. These alliances against “Big Brother” have been successful in persuading local governments to enact resolutions denouncing the Patriot Act.²⁴ Sixty-five jurisdictions between April and mid-July 2003 approved resolutions calling for the repeal of the Act, bringing the total to 134 cities


and counties, plus three states: Alaska, Hawaii, and Vermont. A U.S. Department of Justice (DOJ) inspector general’s report in late July “identified dozens of cases in which department employees have been accused of serious civil rights and civil liberties violations” in their enforcement of the act. The multiplicity of jurisdictions that make up American federalism creates numerous opportunities for citizens of all political persuasions to voice their views. Consequently, the political battle over the proper balance of safeguards to ensure domestic security and safeguards of an individual’s liberty will continue to be fought out intergovernmentally.

**THE INTERGOVERNMENTAL POLICY MIX**

The 107th Congress endured a protracted budget battle that stymied several items on Bush’s “compassionate conservatism” agenda. Debates over homeland security funding and the Patriot Act were particularly passionate as were debates over “charitable choice” and the use of faith-based organizations to deliver social services. Senate Democrats worked hard to scuttle some administration initiatives, but divisions within the Republican majority in both chambers created even more serious challenges to the White House’s policy leadership. Increasingly preoccupied with the situation in the Middle East and with the sluggish economy, Bush did not push much of his original agenda with the same fervor he did in gaining passage of the 2001 No Child Left Behind Act. Consequently, by October 2002, not one of thirteen appropriations bills had been signed into law.

**Tax Cuts and Economic Stimulus**

President Bush greeted the 108th Congress with a stunning proposal that sought tax cuts much larger than had been expected even by supply-side advocates. The plan’s core elements were threefold: (1) accelerate the 2001 tax cuts, (2) end the double-taxation of dividends and provide aid to small businesses, and (3) extend unemployment benefits and create new re-employment accounts to assist displaced workers regain employment. The obvious goal of the plan was to force feed even more stimulus into the national economy, which remained sluggish in spite of two previous tax cuts, lower interest rates, and a decline in the value of the dollar. The total price of the Bush proposal was $726 billion, of which ending taxes on corporate dividends would cost $400 billion. The remainder was accounted for by lowering personal income taxes to the 2006 rate immediately, ending the marriage penalty, and expanding investment deductions for small businesses.
businesses. Although the new tax cuts would add substantially to the deficit, the Office of Management Budget's (OMB) macroeconomic assumption was the infusion of additional dollars into the economy would raise demand and create incentives for business to invest. Expectations for a swift victory were high because, for the first time in more than 20 years, one party was in control of the White House and both chambers of Congress.

Announcement of the plan started a complicated fight over enabling legislation. Republicans were caught in a political dilemma between the long-standing opposition of many conservatives to the progressive income tax, which made Bush's plan attractive, and the public image of the party as favoring fat cats, which could be exploited by the Democrats. Once analysis of Bush's plan showed that 40 percent of the tax cuts would go to persons with incomes above $200,000 who make-up less than 5 percent of all taxpayers, the Democrats leveled charges of "class warfare" and raised serious concerns about the loss of revenues while the costs to pay for homeland security and the war mobilization already underway were growing rapidly. Bush responded with a FY 2004 budget proposal that would hold increases in discretionary spending to 4 percent (about $30 billion), or less than half the rate in FY 2003. Of course, entitlements with automatic expenditures, such as Social Security and Medicare, did not fall under the president's limit. Nearly half of the new monies (approximately $14 billion) would be allocated to the military, homeland security, veterans' affairs, and education for poor children, thus leaving other domestic programs to incur cutbacks.

The proposed reductions in domestic spending fell heavily on programs that aid the poor and near-poor, and consequently, beneficiaries and congressional champions promptly complained. Because it was clear the combination of tax cuts and spending cuts would not yield a balanced budget, deficit hawks in both parties were displeased. Others argued that the president's plan, in essence, traded domestic spending for tax cuts. Prominent public figures attacked the theory that tax cuts stimulate the economy. Alan Greenspan, chairman of the Federal Reserve Board, stated "tax cuts were not needed for growth," and Warren Buffet, the nation's second wealthiest person and a guru of investors, declared the tax-cut proposal to be "voodoo economics" based on "Enron-style accounting." State and local government officials were stunned by the potential negative impacts of the Bush tax cuts on their ability to raise revenues. The National Governors Association (NGA) and the National Conference of State Legislatures (NCSL) feared the end of federal taxation of corporate dividends would also stop state taxation of dividends with a resulting loss of tens of millions of dollars. They also feared that dividend stocks would be

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become a more attractive investment than municipal bonds, thus forcing localities to pay more interest to carry debt. State officials also worried that proposed changes in Medicaid funding effectively acted as a "loan" to the states and that they would have to pay back the modest temporary increase in federal Medicaid funds just as the baby boomers were retiring and when federal Medicaid monies were scheduled to decline. Some state and local officials expressed concern that the Bush budget proposals undercut the federal government's ability to maintain the long-standing "shared responsibility" for programs to assist poor citizens. 31

Given the Republican control of Congress, one might have predicted smooth sailing for Bush's tax-cut proposal. But rifts soon emerged among Republicans in both chambers. Senate Republicans found themselves divided over the impact of the tax cuts on deficits. For supply-side Republicans, reducing taxes was the road to economic growth; but for Republican moderates, reducing taxes was the road to fiscal ruin. House Republicans were divided along lines similar to their Senate counterparts, and soon the House reduced by the tax cut by $176 billion, or 24 percent.

President Bush was not idle. Once formal hostilities in Iraq were proclaimed to be over, the president began to stump the country in support of the tax cuts. He had to convince Republican moderates to support his plan, and if that failed, convince a few Senate Democrats to switch their position. To gain votes from Senate moderates, the president agreed to support a $20 billion package of aid to state governments in the FY2004 budget. Pushed by Senators Ben Nelson (D-NE), Susan Collins (R-ME), John Rockefeller (D-WV), and Gordon Smith (R-OR), the proposal would temporarily (over 18 months) increase the Federal Medical Assistance Percentage to Medicaid by 2.95 percent ($10 billion) and provide block grants for essential services and unfunded federal mandates ($10 billion). The trade-off for Bush was a small price to pay for additional votes in support of his tax cut. After a tie-breaking vote cast by Vice-President Dick Cheney, the Senate on 15 May 2003 passed President Bush's tax plan on a 51-49 vote.

Unfortunately, the bill passed by the Senate treated dividends differently than the House bill, and the House bill included a tax reduction on capital gains; these differences necessitated a conference committee. A week of negotiations made tense by partisanship, personality clashes, policy differences, and rivalry between the two chambers forced the president to plead with congressional Republicans to end the intra-party feuding. 32 Finally, in a session presided over by the vice president, the conference committee gained the needed 50 votes. On 28 May 2003, President Bush signed the Jobs and Growth Act of 2003 (P.L. 108-27), the third tax cut in three years.

Triumph lasted barely one day as child-advocacy groups discovered that the increase in the per child tax credit from $600 to $1,000 would not apply to families with incomes between $10,500 and $26,625. These families work at jobs paying at or just above minimum wages. The conference committee dropped these families from the increased tax credit during the final feverish negotiations over the tax bill as part of their efforts to bring the tax plan under a $350 billion ceiling. The gap itself is a function of an inflation-indexed formula in the 2001 Economic Growth and Tax Relief Reconciliation Act (P.L. 107-16). Once the omission became public, all the political tensions surrounding passage of the 2003 act resurfaced. Again, inter-party as well as intra-party differences hardened and negotiations dragged on through June and into late July.

Bush's ability in leading Congress to enact laws reducing taxes in three consecutive years is a striking example of political adeptness. Few presidents have been so successful, even those who also benefitted from a Congress controlled by their party. The president followed his faith in supply-side economics and his belief the 2001 and 2002 tax cuts helped the economy. In the face of a $455 billion deficit, Bush gambled that even more tax cuts would give another strong boost to the economy and that the anticipated growth would avoid the soaring deficits that forced President Ronald Reagan to enact a tax increase. Whether this gamble succeeds will be determined by the course of the economy, but from a political perspective, this third tax cut appears to have several important consequences. First, the president continued his take-charge image with another action to move the economy forward; once again, he put money into the voters' pockets, he pleased the conservative base of his party, and once more, he put the opposition party on the defensive. Second, the spending reductions required to keep the total cost of the package within the $350 billion ceiling as demanded by Senator George Voinovich (R-OH) further reduce the ability of the federal government to enact new programmatic initiatives or to continue to pay the full cost for programs shared with the states such as Medicaid. Third, the increased and steady use of tax policy to effectuate change justifies a further reduction in the federal bureaucracy. Fourth, the three Bush tax cuts, with little regard for the deficit expansion they create, constitute a complete reversal of the traditional Republican position as defenders of the treasury and opponents of profligate public spending. Many current Republicans believe it is more important to cut taxes and limit the size of government than it is to balance the budget. Conservative strategist Grover

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33The laws are the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) and the Job Creation and Work Assistance Act of 2002 (P.L. 107-147).
34Judy Keen and Laurence McQuillan, "Bush's drive for tax cuts fueled by his principles," USA Today, 19 May 2003 (Netscape version).
35Senator George Voinovich (R-OH), as a leader among the Republican moderates who worried about the impact of further tax cuts on the deficit, became the pivotal 50th vote in the Senate. He forced the conference committee to impose a $350 billion ceiling on the tax package, a total slightly less than half of Bush's original proposal.
Norquist articulates this view, "If we had a little teeny government and a big deficit, I wouldn't care. It's the size of government we're focused on. It's also the size of government the left is focused on." In essence, the Bush crusade to lower federal taxes leaves the Democrats unable "to tax and spend" if they regain control of Congress or the White House.

The consequences for states and localities are equally restrictive. The small $20 billion aid package in the 2003 act will lower each state's deficit only marginally; it will not resolve the fiscal crisis. More likely, Washington's continuing use of unfunded mandates such as those in education policy will worsen budget problems, and will push state and local governments to raise taxes. In fact, governors of both parties have proposed tax increases for FY2004. Politically, Bush can claim credit for bold action to boost the national economy while avoiding fall-out from any reduction in services delivered by state and local governments.

Education

The No Child Left Behind Act (NCLB) of 2001 (P.L. 107-110), the first major legislative victory of the Bush presidency, is experiencing the normal "implementation pains" associated with all new public programs. Although considerable support exists for NCLB's core goals of improving the achievement of all students, closing the achievement gaps between various racial and ethnic subgroups of students, and raising teacher quality, the list of complaints by state and local officials about the act identifies most of the barriers commonly encountered in program implementation. A report entitled From the Capital to the Classroom: State and Federal Efforts to Implement the No Child Left Behind Act, issued by the Center for Education Policy, finds significant progress being made by the states in "revising their assessment systems and developing and refining their approaches to track the quality of teachers." State officials, however, "are also expressing significant concern about the speed of implementation, the costs required, the government's focus on compliance over flexibility, and some unanticipated consequences." Major obstacles to effective implementation of the NCLB, as identified by state officials, are shortcomings in funding, guidance, flexibility, time, consistency, and accuracy. State officials also point out they have seen little parental interest in school choice, a key element of the NCLB, and yet they are frustrated the federal government insists that "lack of capacity in a school is not grounds for refusing choice" because this requirement "could result in overcrowded schools, lowering the achievement of already good schools."

38 Ibid.
To measure improvement, the act requires the use of achievement tests that are "scientifically based" in grades three through eight, and states had until 31 January 2003 to submit plans for the use of standardized tests. Final regulations from the U.S. Department of Education (ED) were not promulgated until late November 2002, thus leaving school officials little time to complete their plans. The act also mandates states raise the achievement levels of students in each of five distinct racial and ethnic subgroups as well as low-income students, disabled students, and students with little or no English proficiency. A school may be declared as "low-performing" if any of the subgroups in the school fail to improve over two consecutive years – even if these are two different subgroups each of the two years. Schools labeled as "low performing" for several years in a row face serious consequences, including the loss of federal monies and possible reorganization.

As states have begun testing, the results have not been very positive, and a significant number of schools in many states, even those with high accountability standards, may be declared "low-performing." For example, the Texas Board of Education, based on "grim results" from the first year of testing, "voted to reduce the number of questions students must answer correctly to pass it, to 20 out of 26, from 24, for third-grade reading." It is ironic that Texas, the state Bush held up as the model for NCLB, should find itself now in the position of lowering testing standards. Other states such as Michigan and Colorado also lowered their standards to minimize the number of schools found to be "low-performing." Ohio decided to raise achievement levels from 40 to 60 percent by 2009, and then raise levels from 60 to the required 100 percent for all subgroups by the federal deadline of 2014. Ohio's plan requires a jump in annual improvement from 3.3 percent to 10 percent for 2010 to 2014. Chester Finn, former assistant secretary of education, in discussing this situation, said: "Some states are lowering the passing scores, they're redefining schools in need of improvement and they're deferring the hard task of achievement-boosting into the distant future. . . . That's really a cynical approach."

The act also establishes higher standards for teacher's credentials; in particular, all teachers must have a college degree in the discipline of each major course they teach or they must pass an examination to demonstrate they are "highly qualified" to teach the subject matter. The effect of this requirement has hit rural communities especially hard because rural schools often have one instructor for multiple subjects. "We have so many schools where one person teaches biology, chemistry, physics and the physical, earth and life sciences. This law would make them have a major in each subject—and that's just physically impossible," stated Don Christensen, Nebraska

4Qouted in Ibid., 2003.
Commissioner of Education. Officials in other rural states have expressed concerns that NCLB was designed to reform big-city schools, but because it is a “one-size fits all” policy, it contains numerous provisions unworkable in rural areas.

NCLB is not only suffering from the problems typical to implementation, but it is also becoming a sore point in federal-state relations. Dan Langan, a U.S. Department of Education spokesperson, claims: "This law appropriately identifies education as a national priority, and we believe it values and respects local autonomy." Richard Elmore, professor of education at Harvard University, called the law "the single largest, and the single most damaging expansion of federal power over the nation’s school system in history." Jack Jennings, director of the Center on Education Policy, offered the middle ground in this debate as he discussed the results of the center’s report on NCLB: “Delays in providing crucial information and threats of rigorous enforcement have made state leaders increasingly anxious about how to go about introducing the most sweeping changes in education in 40 years.”

**Welfare Reform**

The 1996 Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) was scheduled for reauthorization in 2002, but Congress and the president wrangled over various changes far into 2003. Failure to re-approve PRWORA and its primary program, the Temporary Assistance to Needy Families (TANF) block grant, left the states with little choice but to begin cutting aid to low-income families. During the mid- to late 1990s when the national economy was booming, states were able to reduce welfare rolls by more than 60 percent; families on monthly cash assistance in 1994 exceeded five million, but by July 2002, the number had fallen to just above two million. States, once they made the adjustment from the previous Aid to Families with Dependent Children (AFDC) entitlement to the 1996 TANF block grant, broadened their spending to assist low-income working families with child care and other supports (e.g., transportation, work clothes, and job placement). In FY1998, state TANF outlays were about $3.2 billion below the annual federal block grant of $16.5 billion; by FY 2002, state outlays exceeded the federal block grant by nearly $2.2 billion. As fewer previously unemployed persons remained on cash assistance and more were working, albeit at low-wage jobs, states increased their expenditures to ensure low-income families stay employed. By FY 2001, states were spending 38 percent of their state and federal TANF funds on cash assistance (a drop of

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4Ibid.
5Ibid.
6Center on Education Policy, "No Child Left Behind Gains Some Traction."
60 percent from FY1998) and 30 percent of their combined funds on child care and other aid to low income working families.\textsuperscript{46}

Although the states had built up considerable reserve funds because of early under-spending on TANF, these funds were drawn down rapidly to pay for rising child-care costs because many of the previously unemployed AFDC recipients were women who are the heads of families and who need child-care assistance to remain at work. State legislators and governors had few options in the face of the deepening fiscal crisis but to reduce state TANF expenditures. States have diminished TANF services by making child care less accessible, by cutting back programs designed to improve recipients’ work skills, and in some states ending aid to low-income families.\textsuperscript{47}

In January 2003, Bush asked Congress to extend TANF for five years and to revise it following his previously announced plan entitled “Working Toward Independence.” The House of Representatives in February 2003 passed a bill to re-authorize TANF but only included $1 billion in new funds over five years for child care, more than 85 percent below the Congressional Budget Office’s (CBO) estimates of needed funds. By contrast, a bipartisan proposal in the Senate provided $6 billion in additional federal dollars for child care over the next five years. House opponents to the Senate’s additional child-care monies argued the states had not exhausted their reserve funds for TANF. Once the tax cut bill was passed, House Republicans also objected to additional child-care dollars because the states had won $20 billion in temporary federal aid, half of which could be used for purposes other than Medicaid.\textsuperscript{48} These and other differences stymied progress on the reauthorization of TANF.

Other Bush welfare proposals targeted Section 8 housing subsidies and food stamps. In February 2003, Bush sought to replace the Section 8 program, the federal government’s largest rental subsidy program, with a block grant as part of a larger effort to shift housing and other social programs such as food stamps to the states. This devolutionary move, according to the White House, “would give states the ability to streamline disparate poverty programs.”\textsuperscript{49} The proposed housing block grant would send $13.6 billion in Section 8 funds to the states instead of directly to local public housing authorities, as is currently the case. This transfer from local to state authority would constitute a major shift in the administrative and political dynamics of the program. Elizabeth Morris, chief executive of the San Diego Housing Commission, reflected the view of many local housing authority officials in her assessment of the proposal: “Who needs an extra

\textsuperscript{46} Zoe Neuberger, \textit{Annual TANF Expenditures Remain $2 Billion above Block Grant} (Washington, DC: Center on Budget and Policy Priorities, 30 October 2002).


\textsuperscript{48} Shawn Fremstad, \textit{State Fiscal Relief Funds Do Not Address The Need For Substantial Increases In Child Care Funding} (Washington, DC: Center on Budget and Policy Priorities, 28 July 2003).

layer of bureaucracy? States would take 5 percent to 10 percent of the money for administrative costs, so there might be less for low-income families.50

Closely related to the proposed shift of programs to the states was the administration's move to crack down on alleged errors and fraud in the National School Lunch Program (NSLP). If a family's income is only 130 percent of the poverty level, a student is eligible for a free lunch. If a family's income is no more than 185 percent of the poverty level, the cost of the lunch is subsidized. The Food and Nutrition Service, U.S. Department of Agriculture, "estimates that as many as a quarter of children getting free lunches may come from households with incomes too high to qualify." Efforts by the IRS to determine the level of errors by asking families for documentation of their incomes led to a 21 percent drop in eligibility for free lunches and a 8.8 percent drop in eligibility for subsidized lunches.51

Opponents countered the changes would eliminate approximately 2.4 million children from the NSLP and cut the food-stamp maximum benefit from 91 cents per day to 84 cents per day. Further, opponents noted that the House bill to enact the president's plan would lead to a cut of $265 billion from entitlement programs over 10 years, of which $165 billion would come out of programs that assist low-income Americans.

Taken together, Bush's recommendations on welfare reform and social services for low income families are retracing the policy path carved out by the Reagan administration—enact a tax cut, reduce social services to the poor, block grant numerous individual programs, cap federal dollars for the block grants, and downplay the long-term effects of deficits. Bush's stance on social policy continues the 30-year Republican effort begun by President Richard M. Nixon to return social service program responsibility to the states.

**Faith-Based Initiatives**

The White House established in January 2001 an Office of Faith-Based and Community Initiatives to lead and support centers in seven federal agencies to help faith-based and community organizations compete for federal grants on a more equal basis with secular organizations, receive more private support, and encounter fewer bureaucratic barriers. On 3 October 2002, Health and Human Services (HHS) Secretary Tommy G. Thompson announced the creation of a $30 million fund to help faith-based and community organizations enhance their capacity and improve their ability to provide social services to those in need. The Compassion Capital Fund, as the new grant is titled, awarded $24.8 million to 21 so-called "intermediary organizations," and these organizations in turn made sub-awards to small faith-based (FBOs) and community-based organizations (CBOs) to pay for start-up costs, operation or expansion of programs, and

51Kaufman, "Are the Poor Suffering From Hunger Anymore?"
other forms of technical assistance and non-religious social services. Another $850,000 was awarded to three universities and a private firm to conduct research on ways in which FBOs and CBOs can provide social services and on the roles these organizations play in the lives of their communities. HHS contracted for $2.2 million with Dare Mighty Things to establish a national resource center and clearinghouse for information on technical assistance to FBOs and CBOs, and HHS also awarded a $1.35 million contract to Branch Associates to evaluate innovative practices and promising approaches used by FBOs and CBOs so that these innovations may be disseminated to other organizations.52

The administration views the Compassion Capital Fund as an important tool to remove barriers that prevent FBOs and CBOs from competing for federal funding. The justification for incorporating sectarian organizations into the social-service delivery system is that FBOs "have unique strengths that government cannot duplicate."53 These strengths include operating in the daily lives of persons and families in need, reaching individuals and families the government cannot, existing as part of a local community and thus being able to understand the community, holding the trust of their community neighbors and leaders, possessing a cultural awareness of issues and relationships in their communities, and working from a sense of mission and dedication to service that translates into unique approaches to service delivery.54 Opponents see these faith-based initiatives as a violation of church and state. Furthermore, it is not the case that FBOs face barriers that prevent them from competing for social service dollars; in many states, religious organizations, such as Lutheran Family Services and Catholic Charities, to name a few, routinely receive social services contracts and grants from state and local governments, including for programs funded by the federal government. A news report about one research study calls into question the view that FBOs are better at social service delivery. A study in Indiana found no difference between secular and religious organizations in job placement rates or starting wages of the people who received job training from the 27 organizations studied. Interestingly, persons trained by the FBOs, once employed, worked fewer hours on average and were less likely to receive health insurance.55

Just as Bush's welfare-reform proposal struggled in Congress, so have his "faith-based initiatives." The House in 2001 passed legislation to enable FBOs to receive federal money for social services and included a controversial section preempting state and local anti-discrimination laws

54Ibid.
from applying to FBOs operating federally funded programs. The Senate Republican leadership could not immediately approve a companion measure which did not include the anti-discrimination provision. Eventually, the Republicans decided to strip the faith-based language out of the bill and move forward the bill's provisions on tax deductions to: (a) encourage charitable giving, (b) reduce the federal excise tax on charitable foundations, (c) remove the tax penalty for rolling-over an Individual Retirement Account directly to a charity, and (d) permit low-income families to establish personal savings accounts with contributions matched by banks. The final bill also created a $1.3 billion block grant to social services charities. However, by May, the House decided that it would not support the Senate's and the president's efforts to allow religious organizations to receive federal money for social services. Instead, the House moved to pass a bill in support of tax incentives for charitable contributions. Conservatives and liberals alike raised issues about the merits of the faith-based initiatives. For conservatives, the fear was that government money would secularize FBOs, while for liberals, the fear was government money would be diverted by FBOs to support evangelization as well as foster religious-based discrimination. These ideological differences suggest that the president's faith-based initiatives will not easily emerge from Congress.

Health Care

Pressure to resolve the nation's health-care problems rivaled in intensity and scope the pressure to secure the homeland. The upward trend of health-care costs continued at a pace four times that of growth in the national economy. Health-care spending increased at a rate of 10 percent in 2001 and 9.6 percent in 2002. Although overall 2002 health-care spending was less than in 2001, private health insurance premiums increased an average of 15 percent in 2003, even while private plans shifted more costs to the payer. These figures underline the failure of managed care plans to bring health-care costs under control. By contrast, Medicare spending in 2001 rose only 7.8 percent, about half the rate of private insurance plans.

The Bureau of the Census estimated that 41.2 million Americans did not have health insurance in 2001, or 14.6 percent of Americans. The number of children not covered by health insurance was 8.5 million, or 11.7 percent. The U.S. spends more per capita on health care than any other industrialized nation, and health-care spending accounted for 14.1 percent of GDP. By comparison, health-care spending in 2000 as a percentage of GDP was 10.7

percent in Switzerland, 10.6 percent in Germany, 9.5 percent in France, and 9.1 percent in Canada.\textsuperscript{60}

In his January 2003 State of the Union address, President Bush committed an additional $400 billion over the next decade to reform and strengthen Medicare. The policy would offer individuals more choices through private health-insurance plans and encourage persons on Medicare to move from the government-managed program to one of the private health plans. The availability of a prescription-drug benefit was included as an incentive to move to a private plan. It is important to recall that Medicare does not provide prescription drugs, but Medicaid does cover drug costs.

Bush’s reform would replace the Great Society entitlement of specific benefits for all with a variety of plans that differ in their benefits and costs. Early supporters of Bush’s proposal touted its ability to modernize a program designed in 1965 and to restrain the growth in outlays for Medicare. Opponents immediately raised concerns and doubts about Bush’s plan. While Democrats attacked the abandonment of the principles of equity and universality as well as the move to a market-based approach to health care akin to the discredited proposal to privatize Social Security, key Republican committee chairs in the House and Senate opposed the president’s position that the elderly would have to leave the government-operated Medicare program to obtain a prescription-drug benefit.

State officials, when asked to support the Bush plan, responded instead with numerous concerns and reservations. These concerns grew when Bush announced an additional proposal to alter Medicaid by giving states much more discretion to expand, reduce, or eliminate benefits for low-income persons served by Medicaid. In return for this expanded discretion, states would receive a fixed amount of federal money, according to a formula, in each of the next ten years. In effect, Medicaid would become a block grant. The NGA sent the White House a list of 60 questions related to the Medicaid proposal. Especially worrisome to the governors was the fixed amount of funds for a program in which costs were escalating.\textsuperscript{61}

This bipartisan opposition to Bush’s plan did not reach the intensity of the firestorm that flared up when President Bill Clinton attempted to reform health care, but the resistance was sufficient to persuade the president to retool his proposal. On 4 March 2003, Bush announced his “Framework to Modernize and Improve Medicare.” In it, he committed $400 billion over ten years in his FY2004 budget to pay for reforms in Medicare. To implement Bush’s principle of giving seniors more choice, the Framework included three options from which seniors could choose.\textsuperscript{62} Other important elements

\textsuperscript{60}Pear, “Spending on Health Care Increased Sharply in 2001.”
\textsuperscript{62}Bush’s “Framework to Modernize and Improve Medicare” included three options from which seniors would choose: (1) Traditional Medicare, but with a federally provided prescription drug discount card that
of the Framework were an immediate provision of discount drug cards to all seniors and an immediate $600 subsidy to low-income seniors to help pay for prescription drugs.

The differential prescription-drug benefit, proposed by Bush as a lure to encourage Medicare participant movement to private health plans, became the focus of the debates over the president’s initiative. The most serious obstacle for the president was the opposition of rural state senators from both parties, in particular, Sen. Charles Grassley (R-IA) who chaired the all-important Finance Committee which had jurisdiction over the proposed plan. Grassley and other rural state senators such as Max Baucus (D-MT), the ranking member of the Finance Committee, worried that the differential drug incentive would not help their constituents because in rural areas “private health plans have historically been unavailable or inaccessible to Medicare beneficiaries.”

Especially problematic for the president was the unremitting resistance of many governors, including Jeb Bush (R-FL) and John G. Rowland (R-CT), to changing Medicaid funding to a fixed amount of federal money over the next ten years. Medicaid is the nation’s largest health-insurance program and provides services to 50 million low-income persons, not all of whom are elderly. States pay about 43 percent of total program costs, and Medicaid costs are the fastest growing area of state budgets (13 percent in 2002). The White House entered into secret negotiations with the governors, but these sessions failed, partly because the governors themselves could not agree. Some governors supported the president, but others preferred different solutions, among which were (a) annual or biennial recalculation of the federal share of Medicaid, (b) continue the open-ended entitlement to the most vulnerable recipients, but cap the federal funds for about one-third of the recipients, and (c) give the states discretion to vary Medicaid benefits by different population groups. The one problem that all governors agreed had to be resolved was that of the so-called “dual eligibles,” or persons who are fully eligible for Medicare and Medicaid, most of whom are in nursing homes. The six million “dual eligibles” are 12 percent of the Medicaid population, and services to them consume over 30 percent of the program’s expenses. Bush’s plan to include a prescription-drug benefit in Medicare would allow states to shift the current $7 billion per year cost of drugs to the federally funded Medicaid program, if Medicare participants switched to the market-based options. However, the Bush plan did nothing

would save seniors 10 to 25 percent plus a cap on out-of-pocket prescription drug costs, all at no additional premium; (3) Enhanced Medicare, multiple private plans modeled after the health-care plan used by members of Congress and other federal employees, included in all plans would be a prescription drug benefit, protection against high out-of-pocket drug costs, full coverage of preventive services, and cost sharing designed not to penalize those who need the most care; and (3) Medicare Advantage, multiple managed care plans with different benefits and costs, included in all plans would be a subsidized prescription drug benefit. See The White House, Framework to Modernize and Improve Medicare Fact Sheet, 4 March 2003 (www.whitehouse.gov/news/releases/2003/03).

to help states with the $24 billion a year cost of nursing home care for "dual eligibles"—a cost expected to rise sharply as the aged lived longer.  

In early June 2003, Bush abandoned his attachment to the differential prescription-drug benefit and accepted the provision of equal drug benefits for individuals in traditional Medicare and in the market-based plans. Late June brought the president a surprising piece of good news; Senator Ted Kennedy (D-MA) announced he would support the Bush plan now that it offered equal drug benefits in all options. By the end of June, companion measures on Medicare passed both houses by votes of 76-21 in the Senate and 216-215 in the House, where several conservative advocates of market-based social policy joined Democrats in opposition to the equal drug benefit provision. Important differences between both bills remained, and had to be resolved in conference. That the conference committee remained deadlocked into August gave testimony to the complexity of the issues and to the intensity of the opposing sides.

The struggle to enact a major change in a long-standing federal program offers instructive lessons about the nature of policy formulation in America's federal system. First, the story here confirms the old adage about domestic policy that "what the president proposes, the Congress disposes." Senator Grassley in describing the negotiations in Washington, D.C., to his constituents in Iowa illustrates the power of Congress:

> When it finally got said and done, Bush never had a bill to present to Congress, because they didn't really know what they were doing. Not that their ideas were wrong, but they didn't have them well thought out, or put together in a perfect piece of legislation. So they ended up just establishing some principles. Now, those of us who have been working on Medicare and prescription drugs for the last two or three years, we feel like we know how to do it. So what we finally talked the president into, back in probably February or early March, was, 'We ain't going to wait for a bill; we're going to go ahead.'

Second, the alignment of proponents and opponents is not determined solely by partisan affiliation; the nation's electoral geography also strongly influences policy positions taken by members of Congress, as evidenced by the bipartisan alignment of rural senators opposed to the president's differential drug benefit as well as the abandonment of traditional Medicare. Third, state governors, as officials independent of the nation's chief executive officer, can often exercise strong influence on the course of congressional legislation that contradicts the president's position. Fourth,


significant changes in one major program in a policy area are likely to provoke demands to make compensatory changes in complementary programs. Reform of Medicare meant addressing its interaction with Medicaid. Fifth, complicated public programs emerge not just from the competing goals various factions seek to incorporate into the legislation, but also from the political compromises necessary to build a majority coalition in support of a viable measure. Finally, Bush’s Medicare reform plan illustrates the usual process by which new social policy is made in the United States. A crisis builds, several alternative solutions are brought forward by various groups and officials, and under the pressure to avoid blame for failure to act on the pressing problem, compromises are forged in such a way as to permit most sides to claim some credit for the new program. 67

THE STATES

In the November 2002 election, 36 of the 50 governorships (nearly three-fourths) were contested as were over 6,200 of the 7,400 state legislative seats. The election produced two dozen new governors, half Democrats and half Republicans, thus narrowing the partisan split among state executives to 26 Republicans and 24 Democrats. Twenty of the 24 new governors replaced incumbents of the other party, and four women were elected as governors, bringing the national total to six. Critically for the Democrats, they recaptured governorships in 13 of the 20 most populous states, consequently, “more Americans will be living under Democratic governors than under Republicans—at least 20 million more, as a matter of fact.” 68 Republicans for the first time in 50 years became a majority of state legislators; they controlled 22 statehouses, the Democrats controlled 16 state legislatures, 11 remained divided, and one is officially nonpartisan. Nationally, the total partisan division by chambers is very close; for state senates it is 974 Republicans to 939 Democrats, and for state houses it is 2694 Democrats and 2687 Republicans. 69

The biggest electoral change was not so much a partisan one as it was one of general turnover because half of the new governors and more than a quarter of the state legislators were new to office, and many of these elected officials had never served in state government. 70 No doubt some of this turnover was due to term limits because “a total of 322 legislators in 11 states will be termed out in the 2002 elections . . .” with 71 percent of Michigan’s Senate ineligible for re-election and 45 percent of the Missouri House. 71 These new governors and state legislators faced an unusually large

number of serious policy challenges from education, health care, and welfare to air quality, economic growth, homeland security, and information privacy, yet their ability to address these issues was severely constrained by the continuation of the states’ fiscal crisis into a third year.

A Financial Disaster of Biblical Proportions

The financial trauma of the American states that began in the last two quarters of 2001 worsened in a steadily agonizing fashion through 2002. Thirty-seven states were forced to reduce their already enacted FY 2002 budgets by more than $12.8 billion. Efforts to halt the fiscal slide were drastic. On the expenditure side of the ledger, 28 states cut budgets across-the-board, 22 states used reserve funds, 17 laid off employees, eight offered early retirement programs, 10 reorganized programs. On the revenue side, in 15 states governors proposed sales tax increases, 10 states raised personal income taxes, 11 states closed loopholes and eliminated credits in corporate income taxes, 14 states raised excise taxes on cigarettes, tobacco, and alcohol, 19 states raised various fees, two states increased motor vehicle taxes, and 17 states raised additional revenue through gaming taxes, nursing home surcharges, and hotel occupancy taxes. But these massive efforts failed to halt the slide, and by the end of FY 2003, the states’ general fiscal condition had sunk to levels not seen since before World War II.

The tide of red ink that has flooded the states for three straight years became a disaster of biblical proportions, as evidenced by the gallows humor of Governor Tim Pawlenty (R-MN) who said, “I joke with people that the only things we’re waiting for are the plagues and locusts.” The Center on Budget and Policy Priorities described the fiscal crisis as “severe” and explained:

States are facing budget deficits of approximately $100 billion that must be closed over the next several months — $25 billion in the deficits for the current fiscal year and between $70 and $85 billion for the fiscal year that begins in June. These new budget gaps are on top of the $50 billion gap states closed when they enacted their fiscal year 2003 budgets.

State reserve funds—composed of final fiscal year balances plus “rainy day” funds—have nearly disappeared. Total state fiscal balances had peaked in FY 2000 at $48.8 billion (10.4 percent of expenditures), but by the end of FY 2003 had plummeted to a mere $6.4 billion (1.3 percent of expenditures), a fall of 87 percent! Little wonder that as of 1 July 2003, 19 states predicted negative growth for FY 2004.

Changes in Expenditures and Revenues

State officials tried valiantly to stem the tide of deficits. NCSL President and Oklahoma State Senator Angela Monson observed, "Broad cost-cutting measures are being enacted everywhere. Lawmakers are leaving no stone unturned. Services once thought to be sacred are now on the chopping block. K-12 education, social services, Medicaid eligibility, corrections are all being scaled back as states struggle to bring their books into balance."76 Even the slaughter of sacred cows did not prevent 37 states from having to revise downward by nearly $14.5 billion their already enacted FY 2003 budgets—"the largest spending cut in the history of the 27 year-old Fiscal Survey" published jointly by NGA and the National Association of State Budget Officers (NASBO).77

Stories of extreme decisions taken by state officials abound; for example, the governor of Missouri ordered every third light bulb unscrewed to save money, Connecticut laid off prosecutors, and Oklahoma teachers doubled as janitors. While these stories underscore the desperation with which state officials have acted, they do not plumb the dimensions of the fiscal problem. From 1991 to 2001, total state spending went up 88 percent ($556 billion) with an average rate of 6.57 percent for the ten-year period. At the same time, population grew one percent per year, and inflation (for government purchases) increased 2.2 percent per annum. Simply put, inflation and population growth account for about half of state expenditure growth in the decade prior to the onset of the fiscal crisis. The rest of the expenditure growth can be accounted for by significant increases in five traditional areas of state responsibility: health, education, welfare, corrections, and state trust funds for pensions and workers' compensation. The 10-year percentage increase in total state spending for education was 89.97, for corrections it was 98.36, for the trust funds it was 84.64, for health and welfare (less Medicaid) it was 39.52, and for Medicaid alone it was an astounding 149.17. Taken together these five responsibilities comprise nearly three-fourths of total state spending.78 These programmatic areas continued to shape state spending decisions even in the face of rapid decline in revenues. The June 2003 Fiscal Survey of the States reported that actual state spending growth increased only 1.3 percent in 2002 and a mere 0.3 percent in 2003, and is expected to be down 0.1 percent in 2004. State expenditures for FY 2004 will be led for the third consecutive year by Medicaid, which is budgeted for a 4.6 percent increase, while K-12 education is budgeted only for a 1.5 percent increase and corrections for an increase of 1.1 percent. Higher education, by contrast, is budgeted for 2.3 percent less than 2003 levels.79

78Ronald K. Snell; Corrina Eckl, and Graham Williams, State Spending in the 1990s (Denver: Fiscal Affairs Program, National Conference of State Legislatures, 14 July 2003).
State real adjusted tax revenues began to climb with the end of the early 1990s recession, and by 2000 the year-to-year growth had accelerated to more than 6 percent a year. In April 1998, the annual percentage change in state real adjusted tax revenue hit a peak of 10 percent in the 41 states with a personal income tax, and this figure was nearly matched in April 2000. But April 2001 and 2002 produced negative revenue rates of 5.0 and 13 percent respectively.80 Forty states had revenue collections less in FY 2002 than in FY 2001, and in FY 2003 state revenues were only 0.7 percent above FY 2002. Eleven states collected less revenue in 2003 than they did in 2002, and nine states suffered with year-to-year declines in both years.81 In FY 2003, 30 states failed to make their budgeted revenue targets as sales tax collections were 2.5 percent below FY 2002, personal income tax was 8.6 percent lower, and corporate income tax was 8.3 percent less.82

The Impact of the Fiscal Crisis

Studies of state responses to the protracted shortfalls in revenue agree that the typical strategy entailed several similar actions (1) draw down state reserve funds, (2) utilize numerous accounting techniques to defer costs and accelerate revenues, (3) cut budgets, usually across-the-board, though some states protected K-12 education, and (4) borrow, often from state employee and teacher pension funds.83 As the deficits deepened over three years, fewer functions were exempted from expenditure reductions. The human impact of these budget cuts is increasingly widespread to the point that Jim Doyle, the new Democratic Governor of Wisconsin, lamented, "Everybody gets bad news."84 State government employment fell by 20,000 from 2001 to 2002, and further reductions were expected through 2003. Nationally, states tightened Medicaid eligibility, and the estimated number of persons losing their Medicaid health insurance as of March 2003 was 1.7 million. A similar story occurred with TANF as several states reduced child-care assistance thus making it harder for parents to remain in the workforce, even though they are required as a condition of aid. Numerous states made large cuts in fiscal assistance to local governments, and this left cities and counties with the choice between service reductions or revenue increases. Some states closed prisons or sharply reduced prisoner populations, often by moving non-violent offenders (typically first-time drug offenders) to parole status. Sharp reductions in state university and college budgets

84 Bai, “Drip, Drip, Drip.”
coupled with double-digit tuition increases occurred in many states. Even primary and secondary education, the most sacred of cows, suffered financial cuts in FY 2003. By mid-year, 11 states implemented or planned to implement cuts in K-12 education. The results are larger class sizes, fewer subjects offered, and shorter school years.86

These financial problems afflict New England and certain western states most severely, but, according to a recently completed study of state finances, “only 13 out of the 50 U. S. states are in a financially sustainable situation.”86 Although states cannot go bankrupt overnight, the study projects that more than 30 states will face long-term shortfalls in their finances. States with the biggest fiscal imbalances include New York, California, Pennsylvania, Arizona, Washington, Alaska, and Wyoming, and these states account for one-fifth of the nation’s population. Demography in the form of aging populations is the primary factor causing the budget problem, and all of these states will be forced to raise taxes or cut expenditures by at least 10 percent, or some equivalent mix of both. The immediacy and seriousness of the fiscal imbalance can be seen not just in the current cash flow problems, but also in the widening spread between yields on state and municipal bonds and U.S. Treasury notes as well as in the decline of state and local bond ratings.87 Most broadly, the states’ fiscal woes make it more difficult to re-energize the national economy. Current estimates suggest that state spending cuts and tax increases are “... taking at least half a percentage point out of the growth of the economy,” thus counteracting the national government’s stimulus policy.88

The Debate Over Causes or “Who is to Blame?”

Crises invariably prompt finger pointing, and with the states’ fiscal troubles going into a third year, the question of “who is to blame?” is being asked more and more frequently. The list of causes offered by academic analysts as well as partisan pundits is at once extensive and rather obvious (1) overspending by the states, (2) excessive tax cuts by the states, (3) structural problems in state revenue systems, (4) unfunded federal mandates, (5) declining federal aid to states and localities, (6) devolution of national program responsibilities to the states, (7) homeland security expenditures, (8) federal tax policy, (9) rising numbers of new immigrants, and (10) the sudden collapse of the “dot.com” bubble coupled with a broad and continuing decline in manufacturing.89

88 Ibid.
The length of this list reflects the complexities of American federal governance in which policies, politics, and finances are intertwined within a jurisdictional and organizational matrix composed of public and private elements, none of which are static. Although this list of causes is interesting, it is the debate over the various causes that is more important because the debate will likely influence policy choices in the near term. What makes this debate increasingly quarrelsome is that evidence exists to support each of the suggested causes. Unfortunately, there has been little effort to sort out the differential influence of a given cause.

From a federalism perspective, there are additional contributing factors that should not be overlooked in any analysis of the current fiscal crisis of the American states. First, the institutional features of state governments shape policy outcomes. For example, almost every state has a balanced budget requirement, and thus must adjust its annual budget to the ebb and flow of revenues while simultaneously sustaining on-going obligations such as education, health care, infrastructure, and social services. Closing hospitals, prisons, and schools are not easy decisions that can be made quickly or without some planning devoted to phase-out issues. Second, although state legislatures possess final say on the state’s budget, the management of some state policy areas is shared with independently elected state officials and local governments, thus complicating any rapid shift in policy. Third, interstate variation in budget instruments such as the item veto and its use as well as the existence of tax and/or expenditure limits (TELs) accounts for variation in state expenditures, both generally and by policy area.

The intergovernmental relationships among federal, state, and local governments create another set of factors influencing the fiscal crisis. The over 30-year old movement to devolve activities from Washington, D.C. to states and localities has contributed to an expansion of state responsibilities, even if part of the costs are subsidized by federal grants. Medicare, Medicaid, the Childrens’ Health Insurance Program (CHIP), TANF, and the 2001 NCLB are just a few examples of federal programs that have expanded state obligations. Second, the increasing reliance on the federal tax code as the preferred vehicle for achieving national policy objectives constrains the preferred vehicle for achieving national policy objectives constrains the


*See Kincaid, "Trends in Federalism: Is Fiscal Federalism Fizzling?"

states' ability to raise revenues. More frequent and more expansive changes in the federal tax code not only alter state tax bases, but also force states to change their tax codes more often, thus making budget planning more difficult especially in states with biennial budgets. Third, some observers argue the financial asymmetry between federal and state governments exacerbates the tendency of states to accept federal grants-in-aid as well as the strings attached, even though federal regulations are not necessarily welcomed by the states. Because federal aid makes it possible for states to pay for goods and services at a discounted rate when using grants with matching requirements, the effect of these grants is stimulative and additive. New activities and better activities are made possible by shared financing; homeland security provides a compelling example. Political pressure as well as democratic principles fuels the drive to provide minimum or adequate levels of many goods and services in all parts of the country. This in turn requires federal aid be designed to address resource inequalities among the states as well as the federal-state fiscal mismatch in ability to raise revenues. The financial asymmetry argument often ignores this shared financing that typifies U.S. intergovernmental relations. Fourth, in response to fiscal pressures on local government, most states have acted either to transfer a given function to state responsibility or to increase state aid to local units. A particularly expensive example is public education where state court decisions have required state governments to equalize per pupil funding across school districts. The fiscal disparity among school districts that state courts have acted to remedy also contributes to the push to obtain additional federal funding for local schools as well as the movement toward a minimum national performance level.

Another combination of factors shaping the states' fiscal situation are changes in demographics and economics. A number of studies note that state spending has grown somewhat faster than the overall inflation rate, but many of these same studies fail to mention, as noted earlier, about half of state expenditure growth is a function of inflation and population growth. It is well known in public finance circles that population growth is a major driver of government spending, even if per capita spending is held constant (and public productivity does not change), an increase in population results either in more absolute spending or a service reduction. A particularly powerful example of demographic forces at work is the daily arrival of more immigrants. Second, in the last 20 years, state governments have experienced three recessions and two expansions. The current downturn is, as all acknowledge, the most serious in several decades, and so it should come as no surprise that states would encounter deficits. The larger issue is state government capacity to support and sustain long-term obligations in the face of economic volatility. The usual prescription is more economic growth, but states find themselves not just in competition with each other,
but also in competition with other nations. Less obvious and more insidious is corporate tax sheltering that, according to the Multistate Tax Commission, resulted in a $12.4 billion loss to the states in 2001. Corporate profits paid to states have declined from 9 percent in the 1980s to under 6 percent today. R. Bruce Johnson, Utah's tax commissioner, described corporate tactics by noting:

Some large, sophisticated companies are using sheltering devices, aggressive restructurings and other steps to avoid paying taxes at the state level. A third of these resources are dropping off the radar because aggressive companies are availing themselves of tax planning strategies that are not available to smaller companies or individuals, and the result is unfair to the vast majority of taxpayers.92

Examples of states suffering the largest losses due to tax sheltering include West Virginia (58 percent), Ohio (56.9 percent), Florida (48.7 percent), and Mississippi (43.1 percent).

Politics and partisan policy positions also contribute to the states' fiscal downturn. The Bush administration has adopted, rightly or wrongly, the policy that it is better for the federal government to stimulate economic growth by cutting taxes which it hypothesizes will generate rising revenues for all governments. By contrast, previous Republican administrations have supported strategies based on expenditures as exemplified by General Revenue Sharing during the Nixon era and the failed Reagan administration effort to "swap and turnback" certain responsibilities among the states and federal government. Second, interstate variation in the depth of the fiscal crisis is not solely the result of bad policy decisions or economic misfortunes, it is also a product of interstate variation in state political culture, including which interest groups dominate.93 The fundamental features of a state's politics determine whether state officials insist on a pay-as-you go approach or are willing to borrow heavily, whether Sunday sales of liquor will be permitted or gaming expanded, whether to engage in accounting gimmickry or to refrain from spending rainy-day funds. Third, partisan control of state government branches directly affects state spending growth. According to a recent study, state spending during the period 1997-2002 grew slower by almost a percentage point per year in those states characterized by divided government—i.e., the governorship and the legislature in the hands of different political parties—compared to those states where one party controlled both the governorship and the legislature. The highest rate of expenditure growth occurred when Republicans controlled the governorship and both houses of the state legislature, and the lowest rates occurred when a Democratic governor faced a Republican controlled legislature.94

93See Series on the Government and Politics of the American States, University of Nebraska Press.
Should Washington, D.C. Bail Out The States?

For more than a year, the National Governors Association has called on the Bush administration and the Congress to provide some measure of relief to the states. These pleas have been made by governors representing both parties, but to no avail. President Bush, a former governor as are four members of his Cabinet, has not offered any financial assistance other than a modest $20 billion (half for Medicare, and half for other state needs). The aid package came only as part of a last-minute deal to lock up a few more Senate votes for Bush’s 2003 tax cuts.

Running parallel to the debate over “who is to blame” for the states’ fiscal crisis is a highly charged debate over the merits of a federal bailout of the states. A report issued by the American Legislative Exchange Council declares that federal bailouts will not solve the states’ fiscal problems. Michael Greve in a report issued by the American Enterprise Institute for Public Policy Research argues that “federal funding programs tend to expand state budgets” and that one solution would be to let states opt out of many current federally supported programs, including the newly minted NCLB.

For some, this opposition to a federal rescue of the states is a continuation of the Goldwater and Reagan campaigns to return programmatic and financial responsibility for social programs back to the states. This policy position holds that it is better for most domestic programs to be operated by the states because that makes the connection closer between those who pay for and those who benefit from a given service. In addition, returning programs to the states more likely guarantees that a program will reflect citizen preferences and state political culture. But for others, opposition to a federal bailout is part of a more generalized ideology of smaller government is better government. If state officials are forced to balance their budgets without federal aid, according to this view, they will have to make serious decisions as to which programs and which services their state is willing to fund. A Heritage Foundation report exemplifies this position:

States, just like the federal government waste billions on mismanaged and unnecessary programs. Deficits provide states with a golden opportunity to examine their budgets and reduce wasteful and ineffective spending, which will help them keep taxes low and aid the economic recovery.

If it is important to shrink the size of the bureaucracy in Washington, it is also important to shrink state government bureaucracy. One way to accomplish this objective is to drive states to the edge of bankruptcy; therefore, the federal government should not rescue the states. “I hope a


Bai, “Drip, Drip, Drip.”
state goes bankrupt,” proclaimed Grover Norquist, a White House adviser, in what is no doubt the strongest statement of the anti-bailout position. Norquist explained his opinion by saying “I hope a state has real troubles getting its act together, so that the other 49 states can say, ‘Let’s not do that.’ We need a state to be a bad example, so that others will start to make the serious decisions they need to get out of this mess.” The advocates believe this strategy would ultimately produce a re-balancing of program responsibilities between the states and the federal government.

Some see Bush’s indifference to the plight of the states as a byproduct of the war against terrorism. Domestic priorities lose out to the struggle and the costs of containing Al-Qaeda and the war in Iraq. Richard Schrader, a prominent labor leader in New York, expressed this view by stating: “He’s (Bush) wearing this wartime halo but someone needs to ask him [President Bush] why we can rebuild Baghdad but we can’t rebuild Ground Zero and our cities and states.” Others see the refusal to aid the states as part of the long-standing tension between states and the federal government fueled by the increasing use of unfunded mandates in which the federal government pursues a policy objective by imposing it on the states without providing the necessary funds. The 2001 NCLB is the most current and visible example. Finally, others view these arguments against a financial rescue of the states as part of a clever political ruse in which the Administration’s push for reductions in federal taxes does not result in real tax cuts for citizens, but instead results in a shift of program costs to state and local governments. By devolving program and financial responsibility to the states, the effect will be to decentralize funding decisions. Instead of Congress raising taxes, it will be state legislatures, county boards, and city councils.

Bruce Katz of the Brookings Institution notes that it is “odd and ahistorical to do nothing for the states and not expect it to hurt the national economy.” The federal government historically has stepped in to aid states and localities weather all manner of disasters and problems, including economic downturns, social disruption, and natural events. Further, domestic policy in the United States rests on a structure of programmatic, financial, and administrative responsibilities that have been shared by federal and state governments for much of the nation’s history. To abandon this shared responsibility during the “worst fiscal crisis” the states have faced in

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99Quoted in Firestone, “Does Pain Make States Stronger?”


103Wright, “Federalism and Intergovernmental Relations: Traumas, Tensions and Trends.”

104Bai, “Drip, Drip, Drip.”

105Quoted in Powell, “Rescue’s Just Not Part of the Plan.”

decades would be an abrupt and highly unusual about-face in federal policy. Second, there are serious methodological questions about the evidence offered to make the case against a federal bailout. More than one of the analyses held up as illustrating the profligate nature of state government relies on simple current account figures and ignores inflation and population growth. The difference is important and striking. From FY1979 to FY 2004, the nominal increase in state budgets was 6.2 percent, but the real increase was 2.2 percent.107 Third, the call for additional federal aid to the states is bipartisan with governors and other elected officials from both parties publically supporting additional aid to the states.108 For example, Governor Jeb Bush (R-FL) asked President Bush for more federal money to pay for the reforms in voting equipment and electoral procedures mandated by the Help America Vote Act (P.L.107-20).109

However the debate is resolved, Washington’s indifference to the fiscal crisis of the states constitutes a failure of leadership. Fundamental public services such as education, health care, infrastructure, and public safety cannot be left to the vagaries of the marketplace without seriously compromising the quality of those services as well as the ability to administer them in a cost-effective manner. John Kincaid pointedly notes that the federal government has a remedial responsibility to assist the states because "... has loaded costs onto states via policy changes and conditions of aid for such programs as Medicaid, failed to fund mandates, declined to appropriate fair shares of funds for new policy initiatives, and preempted or curtailed states’ authority to adjust their tax systems to contemporary economic realities."110 It should be noted that Greve concurs with Kincaid on this indictment of federal action. As a remedy, Kincaid suggests the federal government use targeted aid and specific program reimbursements instead of a more general form of fiscal relief.

One area of agreement within the debate over a federal bailout is the necessity of state governments to reform their own operations. Numerous experts have urged state officials to reform state tax systems to make them more congruent with the service based nature of the nation’s economy as well as with the rapid growth of Internet based commerce.111 Other recommendations include decoupling state personal income taxes from the federal code to minimize the effects of federal changes on state codes and modifying corporate tax credits and exemptions to make more predictable the year-to-year reductions in corporate payments. Since the double-digit annual increases in Medicaid spending constitute the single

110 Kincaid, "Trends in Federalism: Is Fiscal Federalism Fizzling?"
largest drain on state funds, states are being urged to rethink and make changes in the optional components of Medicaid services. More states and localities ought to move toward performance-based management systems so that elected policymakers can more readily link budget decisions to effective activities.

Finally, state officials do have an obligation to raise revenues when fundamental services are threatened. Dirk Kempthorne, the Republican governor of Idaho, succeeded in gaining support from the Republican-dominated legislature for a temporary increase in the sales tax and a doubling of the cigarette tax. His justification exemplifies the balance between revenues and expenditures that must be maintained to provide adequate public services:

I wasn’t going to make further cuts in education. I wasn’t going to release prisoners. I saw that in other states, and it was a disaster. We had proposals that would have eliminated the delivery of meals to elderly who had chosen to remain in their homes. If they don’t receive that food, then they have no choice but to go into a nursing home. Why would you take their dignity away from them? . . . I did what was unpopular, but in my mind and heart it was the right thing to do. And I think the measures that I’ve taken are being criticized by my brethren conservatives, well . . . they’re not standing in my shoes.

Despite their previous opposition to tax increases, several other Republican governors raised taxes, including Alabama’s Bill Riley, Arkansas’ Mike Huckabee, Connecticut’s John Rowland, Georgia’s Sonny Perdue, Maryland’s Bob Ehrlich, Nevada’s Kenny Guinn, Ohio’s Bob Taft, South Dakota’s Mike Rounds, and Utah’s Mike Leavitt. In 2003, 17 states raised revenues by more than one percent of 2002 collections, and 4 of the 17 raised revenues by more than 5 percent. Projected percentage change from FY 2003 to FY 2004 in state appropriations is only one percent compared to a 4.3 percent increase in state revenues. These adjustments are not likely to cure the fiscal crisis, but they do demonstrate that state officials are taking responsible steps to address the problem. Whether additional financial assistance will be forthcoming from Washington, D.C., remains to be seen.

State Policy Actions

Despite the bleak budget situation, states were not totally constrained from enacting important public policies, some of which run counter to policy positions favored in the nation’s capital. This past year in response to judicial and public acceptance of DNA evidence, seven states (CO, CT, GA, MT, NV, NM, and OH) adopted laws facilitating the use of DNA testing;

111 Bai, “Drip, Drip, Drip.”
at the same time, six states (AL, KS, MO, NE, WA, and TN) passed sentencing reforms that make early release easier for non-violent or low-risk, often first-time offenders or divert them to alternative sentences. In the waning days of his term, Governor George Ryan of Illinois provoked a national dispute when he commuted 164 death sentences to life without parole, and he declared that Illinois' capital punishment system was "haunted by the demon of error." He also proclaimed the state legislature had failed to reform the process. A larger feud over death sentences erupted between several northern states (e.g., Illinois, New York, Ohio, Rhode Island, and Vermont) plus Puerto Rico and U.S. Attorney General John Ashcroft. Previously, Janet Reno, Clinton's attorney general, permitted local prosecutors to decide when to ask for the death penalty, but the Justice Department under Ashcroft overruled a number of local prosecutors for failing to seek the death penalty in federal cases. Rhode Island abolished the death penalty in 1852, and Puerto Rico did so in its 1952 Constitution. Some claim that Ashcroft is trying to impose a southern conservative, traditionalist political culture on the rest of the nation, while others argue his Christian religious beliefs ignore the death-penalty positions of other faiths such as that of the Catholic Church, whose adherents populate Puerto Rico. Spokespersons for the Department of Justice claim their position is one of ensuring the death penalty is enforced "in a consistent and fair manner across the country." This federal-state feud will continue because juries in a number of states including more conservative ones such as Louisiana, Mississippi, Missouri, Tennessee, Texas, and Virginia have refused to render the death penalty even when federal prosecutors have requested it.115

Other states passed laws restricting racial profiling, hate crimes, or non-discrimination in employment. Several states also made it easier for immigrants to obtain driver's licenses or to pay in-state tuition to public universities. Workers gained new benefits or rights as some states adopted laws to foster gender comparable pay, increase the minimum wage, reduce disparities between public and private sector employees, or require public contractors to pay the prevailing wage. Other states enacted expansions of flexible sick leave, paid family leave, leave for domestic or sexual violence, and Governor Bill Richardson of New Mexico signed an executive order extending state employee benefits to gay and lesbian domestic partners.116 Over the last few years, New York, Rhode Island, Utah, and now Michigan have amended their constitutions to make them gender-neutral.117

States took actions to address the cost of prescription drugs as well as the Medicaid program's overall cost, the number of persons without health insurance, and the administration of state Medicaid programs. Nine states

plus the District of Columbia, using funds from The Heinz Family Foundation, developed plans to establish a pharmaceutical benefit management organization. This entity would be a nonprofit organization designed to handle contracts with pharmaceutical manufacturers to obtain for the states and the District the same discounts and rebates on prescription drugs manufacturers offer to private health-care providers. 118

With state budget deficits growing, state Medicaid programs did not avoid cuts especially since 2002 state Medicaid expenditures exceeded available funds by about $2.8 billion. "The most prevalent type of cost containment in both fiscal 2002 and 2003 is controlling pharmaceutical costs followed by reductions or limits to provider payments." 119 At the same time state Medicaid programs face reductions, some states broadened eligibility for the State Children's Health Insurance Program to parents of eligible youngsters. The justification for this expansion rests on the fact that offering health care to a child's parents increases the likelihood the child will receive health care. A number of states are also shifting "dual eligibles" to Medicaid coverage to free up Medicare dollars to pay for the growth in participants, while others have raised the income level to qualify for Medicaid. All of these actions made a modest dent in the number of uninsured. 120

The states' battle with corporate malfeasance continued unabated. North Carolina, following New York's lead, established new conflict-of-interest standards for securities firms that provide services to the state. State public pension systems are in hot pursuit of Enron officers, and the Ohio retirement system launched legal action against Global Crossing. TIAA-CREF, a retirement system for 2.4 million public workers, primarily university-based, announced plans to use its huge stock holdings to vote changes in corporate governance at shareholders meetings. 121 State attorneys general around the country (IL, MA, MN, NY, PA, TX) have taken numerous actions to regulate philanthropic organizations more closely. Of particular concern are issues such as lax oversight by charitable boards, inappropriate expenditures, improper contributions to political campaigns, nepotism, and outright theft of a charity's funds. 122

Activism against corporations by state attorneys general prompted a group of state attorneys general in 1999 to form RAGA, the Republican Attorneys General Association, to stop "government lawsuit abuse." 123 RAGA now has 20 members, and has allied itself with the U.S. Chamber of Commerce and with the Law Enforcement Alliance of America, an organization tied to the

gun lobby. Although RAGA was formed to restrain anti-corporate lawsuits, it appears that its members, while "less likely to generate such cases themselves, nevertheless, . . . have been happy to share in the wealth once a nationwide settlement agreement has been reached." Furthermore, RAGA has become increasingly active as a vehicle for electing more Republicans to the position of state attorney general. The growing entrepreneurialism of state attorneys general not only has raised their political visibility and power but also has caused some observers of state politics to worry that attorneys general have begun to eclipse governors in importance.

The California Recall

The severity of the budget crisis in California, as might be expected for the nation's largest state, exceeds in breadth and depth that of any other state. Various estimates indicate that California state government went from a surplus of $237 billion to a deficit of $455 billion, and that the state "could have laid off every employee from governor to the last custodian for three full years and still have had a general-fund shortfall." With almost every state mired in red ink, why has the situation in California resulted in a recall, when this has not occurred in other states?

According to one of Gray Davis' political strategists, the recall is a product of "right-wing radio, right-wing groups, the whole right-wing nut axis that has been shut out of California politics for some time." There is no doubt that partisan motivation played a role in the recall campaign as evidenced by the statements of Congressman Darrell Issa (R) who bankrolled the recall drive. Nor is there any doubt that policy missteps by the governor produced his very negative public opinion ratings.

But is there something unique to California politics, and not just to the personality or political style of the governor, that contributed to the political crisis? First, the surprisingly quick speed at which the dot.com industry heavily concentrated in California collapsed makes it hard to imagine that any governor or legislature would have been able to respond rapidly enough to avoid serious consequences. Second, the energy deregulation crisis hurt the state's budget. A combination of factors—the nature of the plan enacted before Davis became governor, the Enron manipulations of the electricity market, the lack of assistance from the Federal Energy Regulatory Commission, and Davis' own slowness in solving the problem—turned a potentially good policy into a fiasco. Third, and most important, the growing use of initiative politics cannot be overlooked as a major cause of the state's difficulties. Many state policies and their accompanying expenditures are the product of initiatives. In fact, "almost 44 percent of California's general

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12Ibid.


fund budget is expenditures mandated by voter-passed initiatives, these
decisions were made by voters, not by Davis or any other elected politician.127

The effects of Proposition 13 (now 25 years old) and Proposition 218 in
restricting local government revenue-raising has forced a centralization of
taxing and spending. The constitutional requirement for a two-thirds vote
in the legislature to raise taxes complicates efforts to find compromises
acceptable across party lines.

The "Federal Weight" of California

The electoral rules of America's federal system give considerable leverage
in the U.S. House of Representatives and in the electoral college to the
most populous states. No state in recent years has been able to exercise this
leverage more influentially than has California. True, it is only one state,
but California is home to one of eight Americans, exceeds the combined
population of the 20 least-populated states, and is the world's fifth largest
economy (larger than France). As a consequence, policy actions by
California do not merely ripple through the rest of the nation; increasingly
California policy choices counteract or even trump policies made in the
national capital. Environmental protection policies as well as changes in
automobile standards typically have a "made in California" stamp on them
as "the size and strength of environmental interest groups in the state have
made California the 'center of the environmental regulatory universe'."128

The list of policy areas in which California's preferred position contradicts
federal policy is long and getting longer (e.g., energy policy, global warming,
stem cell research, public pension system activism, identity theft, and
computer privacy).129

No doubt some of the antipathy between Sacramento and Washington,
D.C., is based in partisan differences: California state government is
overwhelmingly Democratic, while the Republican party dominates in
Washington. But this conflict also has roots in the types of interest groups
that dominate state politics, not just the environmental groups already
mentioned, but also the organizations representing various immigrant and
minority populations. California's contradictory stance against numerous
federal policies is also part of the larger surge in interstate activism and
entrepreneurial behavior by state attorneys general.130

Some of the policy differences also arise from legitimate frustration in
the states with the outcomes of the federal policy process. California is not
the only state to react negatively to federal policy decisions that countermand
state policies; Minnesota and Oregon are examples too. Globalization of
the economy has impelled private enterprise to abandon its long association

127 Cook, "Davis hardly deserves all blame for California's budgetary woes."
with state officials and turn to federal officials to deregulate industry and to overturn stringent state regulations. Joe Simitan, a California Assemblyman, expresses the interplay of economics with American federalism when he explains his authorship of a bill on database-breach disclosure: “I sympathize when the industry says it doesn’t want 50 state standards... But that’s not an excuse for inaction. Many of the folks who testify in Sacramento for a single national standard are the same folks who testify in Washington for no standards at all.”

It may be difficult to gauge, but antagonistic conflict between the states and the federal government seems to be on the rise. State government pursuit of policy options at odds with federal policy is, in Deil Wright’s words, “likely to elevate the significance of conflict (tension) and suppress the level(s) of cooperation (tolerance) in the foreseeable future.” Wright suggests the “twin traumas of terrorism and finance” are the prime points of contention, but this focus is too narrow in that the contentiousness between states and the federal government, as Wright notes, has fluctuated over time. Certainly, the Bush administration’s indifference to the states’ fiscal crisis increases federal-state conflict, but the conflict has its roots in the larger economic, political, and cultural trends that shape how policies are formulated within the matrix of American federalism. Whether state-federal tension is over gay marriages or school standards, global warming or economic deregulation, the conflicts are grounded in changes occurring in society that take different forms of expression as they percolate through the different components of the American federal system.

FEDERALISM IN COURT

In contrast to the state-friendly federalism jurisprudence of the U.S. Supreme Court since 1990, the Court’s 2002-2003 term produced no new federalism decisions that advanced the post-1990 federalism trends. Although the states won many cases, and of cases brought by state attorneys general, the states won 13 and lost seven, the states lost the widely regarded bellwether federalism case, Nevada Department of Human Resources v. Hibbs. In this 6-3 ruling, the Court upheld, against an Eleventh-Amendment challenge, the right of state employees to sue their state in federal court to enforce rights under the federal Family and Medical Leave Act of 1993. This ruling was a surprising departure from the Court’s recent Eleventh-Amendment rulings, and all the more so because Chief Justice William H. Rehnquist wrote the majority opinion and Associate Justice Sandra Day O’Connor joined in the majority along with David Souter, Ruth Bader Ginsburg, and Stephen Breyer.
Thus, two of the Court's "Federalism Five" voted against the states in *Hibbs.* The justices also upheld the federal Children's Internet Protection Act of 2001, which requires public libraries to install anti-pornography filters on all computers that provide library users with Internet access. An important factor in the Court's validating this act is that it is a condition attached to federal aid rather than a criminal statute. Two federal programs provide about $200 million per year for libraries to establish and link to electronic networks and to offer discount access to the Internet. "Congress has wide latitude to attach conditions to the receipt of federal assistance in order to further its policy objectives," opined Chief Justice Rehnquist.137

Otherwise, the Court held unanimously that local governments can be sued under the 1863 False Claims Act for defrauding the federal government, even though states cannot be sued under this statute.138 The justices upheld, however, a federal statute that makes documents produced by states in evaluating hazardous roads inadmissible in state or federal courts. The federal statute was a response to state concerns that a federal-aid requirement that they evaluate hazardous roads could generate documents that would attract lawsuits. The Washington Supreme Court had held that the federal statute exceeded Congress's enumerated interstate-commerce power.139

In another case, which further limited state involvement in foreign affairs, the Court struck down a 1999 California law that required subsidiaries of European companies to disclose the names of millions of persons who had purchased insurance policies from their parent firms in Germany and other European countries between 1920 and 1945 so as to provide payments to Holocaust survivors on unpaid insurance policies.140 Companies failing to make the disclosures would lose their license to practice in California. Justice Souter, who wrote the majority opinion in the 5-4 ruling, said that upholding the state law would "hamstring the President's settling international controversies." The U.S. government, opined Souter, has preferred to work with the International Commission on Holocaust-Era Insurance Claims to resolve claims through negotiation rather than litigation. However, more than 50 U.S. House members, led by Congressman Henry Waxman (D-CA), have co-sponsored a bill to allow states to require publication of lists of policyholders.

Although the Court also struck down a California law that retroactively eliminated statutes of limitations on sex-related child-abuse crimes so as to allow prosecution of individuals long after the expiration of a previous statute of limitation,141 the justices generally supported tough law-and-order state policies. The Court upheld California's "three strikes and you're out" criminal-sentencing statute in two cases, one brought by a man who was

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sentenced to 25 years in prison without parole for stealing three golf clubs from a shop and one by a man who was sentenced to two consecutive terms of 25 years to life for stealing $153.54 worth of videotapes from two Kmart stores. The Court also rejected challenges to states’ Megan’s Laws, which require sex-offender registration and community notification. The Court likewise ruled that limits placed on prisoner visitation by Michigan do not violate the right to association or the Constitution’s cruel-and-unusual punishment clause as incorporated through the Fourteenth Amendment.

The state prohibits, among other things, prison visits by former prisoners and children who do not belong to the inmate’s immediate family. Additionally, visits can be denied for two years if an inmate is twice caught possessing illegal narcotics.

In contrast, though, the justices held 8-0 that federal courts cannot close the door to a state prisoner who is appealing a state habeas corpus denial because he or she seems not to have a winnable case; instead, the inmate need only present a plausible case. The decision opens the door considerably for federal appeals after many federal courts had virtually closed their doors in efforts to comply with the restrictive provisions of the 1996 Antiterrorism and Effective Death Penalty Act. With respect to indigent defendants, the Court upheld, against a Fifth Amendment takings challenge, Washington’s “interest on lawyers’ trust accounts” (IOLATA) program, which uses such interest to help pay for legal services for the poor.

In Franchise Tax Board of California v. Hyatt, the justices ruled 9-0 that Nevada courts did not have to extend full faith and credit to a California law that gives California’s tax assessors and Franchise Tax Board absolute immunity for any tort suits arising from a tax assessment. The case involved a California resident who claimed that he moved to Nevada, a state with no income tax, shortly after he earned $20 million on a patent. The former resident sued California in Nevada courts under Nevada law for intentional torts committed mostly in California. California was supported by 20 states and by many state and local associations which argued that a ruling against California would undermine legitimate tax-collection efforts and encourage wealth to flee to tax-haven states. The Court ruled in a commerce case that lawsuits alleging that interest rates charged by national banks are illegally excessive must be heard in federal rather than state courts because the National Bank Act preempts state usury laws.

In important policy cases favoring the states, however, the Court limited the reach of the federal Employee Retirement Income Security Act (ERISA)
by upholding Kentucky’s “any willing provider” law, which allows any healthcare provider to join an insurance network so long as the provider accepts the insurer’s rules and payment levels. The insurance industry contended that ERISA preempted Kentucky’s statute. This important decision helps clarify the scope and conditions of ERISA’s preemption of state authority to regulate health care and to facilitate greater access to private-sector health insurance. In turn, the Court lifted an injunction that had blocked implementation the Maine Rx Program since its 2000 enactment. The program, directed at the state’s uninsured residents, seeks to obtain discounts on prescription drugs for them. Maine was supported by an amicus brief filed by 29 states.

Highly publicized were the Court’s decisions to uphold an affirmative-action admissions program operated by the University of Michigan law school while, at the same time, striking down the university’s undergraduate admissions system that awarded 20 extra points on a 150-point scale to black, Hispanic, and Indian applicants. The Court did not, however, require states to adopt affirmative action; thus, the decisions did not overturn California’s Proposition 209 on race-neutral admissions to state colleges and universities.

In another controversial ruling, the Court opined that a state can outlaw cross burning when such cross burning is intended to intimidate people but that, otherwise, merely burning a cross does not prove intent to intimidate others. Hence, a state cannot outlaw cross burning per se.

The Court, however, upheld a New York human-rights law that allows homeowners to prohibit solicitations by real-estate agents for sale of their home. The law’s intent is to prevent “block-busting,” the practice of soliciting home listings and sales by suggesting that a block or area is undergoing racial, ethnic, or religious change. At the same time, the Court protected the city of Cuyahoga Falls, an Akron suburb, against a $3 million lawsuit that accused the city of holding a racially motivated housing referendum in 1996 in order to block racial integration. Under a provision of the city’s charter, residents had demanded a referendum on an ordinance permitting construction of a low-income housing project. Voters defeated the ordinance in the referendum. Although the Ohio Supreme Court struck down the referendum, plaintiffs sued the city for violating the equal protection clause of the Fourteenth Amendment by holding the referendum and delaying construction of the housing. During oral arguments, Justice Antonin Scalia asked, “How can you have a wrong referendum?” Justice

O'Connor said that if the lawsuit was not vacated, governments across the country could be sued for putting "nutty proposals" before the voters.

Also highly publicized was the Court's 5-4 ruling overturning on broad privacy grounds a Texas law that criminalized same-sex sodomy, thus voiding the sodomy laws still extant in 13 states in 2003 and also overturning Bowers v. Hardwick (1986). The Court also held that states can use Social Security and other benefits to reimburse foster parents for purchasing such things as food and clothing.

Finally, and pertinent to partisan polarization today, the Court said that in redistricting, states can consider a minority group's general influence on the electoral process rather than only the number of minority voters in a district. The decision was a victory for Democrats who had sought to spread black voters across more districts so as to produce more victories for Democratic candidates rather than packing African-Americans into majority-minority districts where they produce fewer Democratic victories. Republicans and the U.S. Department of Justice contended that any reduction in the percentage of minority voters in such a district is an unconstitutional "retrogression" or dilution of minority voting rights.

CONCLUSION

The unusual partisan unity displayed on the steps of the national Capitol in September 2001 disappeared in less than a year and more typical policy disagreements returned with a vengeance. Even the extension of the war on terrorism to a second country did not restrain conflict, rather it fueled it. Enmity between the parties quickly reappeared in the mid-term election fights as Democrats accused the White House of using the threat of Iraq's weapons as part of a "wag the dog" strategy to divert public attention from more pressing economic ills. However, the more serious and often more intense opposition to presidential initiatives came from within Republican ranks. For example, factions within the Republican majorities in both congressional chambers forced significant changes in the third round of tax cuts. Bush also encountered frustrations within his own party over other important policies such as his faith-based initiatives, Medicare reform, and TANF reauthorization. Instead of the unity one might expect because the majority party possessed only a slim edge in seats in each chamber, one found factionalism. Instead of unity prompted by shared wartime goals, one found rising levels of interparty acrimony.

One source of these conflicts rested on predictable state and regional interests; for example, rural members of Congress worried over the absence of private health-care providers in their areas, while congressional delegates

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from metropolitan areas complained loudly about the lack of sufficient funds for homeland security. A second source of conflict can be traced to the excessive partisanship of national politics and the growing unwillingness to compromise. The debates over Medicare reform, for example, pitted supporters of the Great Society public approach to health care against proponents of a market-based approach—a confrontation not easily amenable to compromise. A third and more subtle source of conflict can be found in a declining commitment by both political parties to a consistent stance on federalism principles. Whereas in the past one could expect Republicans to defend states' rights and Democrats to advocate federal action, these positions have become quite inconsistent. The No Child Left Behind Act of 2001, labeled by President Bush as “the cornerstone” of his domestic policy, exemplifies this inconsistency on federalism principles. Not since the Elementary and Secondary Education Act of 1965 has the federal government imposed such a sweeping set of new policies on public education, but this time “the party of local control had become the party of federal mandate.” Part of this seeming reversal on federalism principles is tied to regional and group interests influential in each party. Some of the reversal also results from demographic changes in each party. Whatever the combination of causes, this emerging alteration of each party’s position on the roles of national and state governments undercuts long-standing policy positions and mobilizes policy supporters to oppose the change. As principles and policies become untied from traditional moorings, the level of conflict within and between parties increases. This important trend in American federalism will have to be followed closely because all signs point to its continuation.


161 Ibid., 29.