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The State of American Federalism, 2001-2002:
Resilience in Response to Crisis

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The past year has been one of repeated shocks to government and the larger society. Terrorist attacks in New York City and Washington, D.C., the burst of the dot.com bubble in the stock market, a wave of corporate scandals, and a slowdown in the economy posed severe problems for officials of all governments in the federal system. The combined effects of the war on terrorism and the economic turmoil forced federal policymakers to create new agencies and to enact new policies. State and local governments also responded to the multiple shocks with a variety of initiatives, often independent of Washington. Instead of a move toward centralization that might have been predicted as a consequence of the serious shocks, all elements of the American federal system demonstrated a capacity and energy to marshal resources in a time of urgency.

On 11 September 2001, four commercial airliners were hijacked by terrorists. Within an hour, two planes were deliberately crashed into each of the two towers of the World Trade Center in New York City. Soon afterward, a third plane was rammed into the Pentagon in Washington, D.C., and the fourth was forced down in Pennsylvania by the actions of the passengers. The surprise attacks on the Pentagon and the World Trade Center resulted in the tragic loss of approximately 3,000 lives. Without warning, these events thrust the United States of America into the first war of the twenty-first century, not a traditional conflict between nation-states, but a conflict with a non-state organization known as Al-Qaeda. Just as on 7 December 1941, when a surprise attack killed 2,400 people at Pearl Harbor, the nation turned to the president, the Congress, and the rest of the federal government to protect the country from further assaults and to punish those responsible.

It is difficult to make any country or community completely secure, but the task is especially daunting in a country as large, as free, and as open as the United States. The task of homeland security is further complicated by the country’s democratic procedures for making public policy decisions and its federal arrangements for sharing power and authority across multiple orders of government. Unitary governments reputedly have an advantage in the speed at which policy is decided and in their ability to command and direct actions toward a goal. By contrast, the American federal union with its more than 87,000 jurisdictions creates a challenge to the development of a unified strategy and its effective implementation. Nevertheless, the

general expectation is that the federal government will mobilize the nation's resources in response to a major crisis or threat. The natural "rally around the flag" response that occurs every time the nation has been attacked gives the president and the Congress great discretion to chart a course of action and to command compliance with the national strategy.

The federal government immediately initiated actions at home and abroad to counter the threat of new terrorist attacks and to prevent future ones. An Office of Homeland Security (OHS) was created, and President George W. Bush appointed former Republican Governor Thomas Ridge of Pennsylvania as its director. The office's mission was to develop a comprehensive strategy for homeland security to (1) prevent terrorist attacks within the United States, (2) reduce America's vulnerability to terrorism, and (3) minimize the damage and recover from attacks that do occur. As actions to secure the home front proceeded, the armed forces were mobilized and sent to Afghanistan to dislodge the ruling Taliban regime, which had provided a base of operations for Al-Qaeda. The military succeeded in swiftly driving out the Taliban forces, and an interim government was established with United Nations support.

Through the year as these events unfolded, two other serious problems demanded attention by the federal government. First, the economy slowed considerably as it readjusted to the collapse of the so-called "new economy" based on information technology. The burst of the dot.com bubble had begun in 2001 and manifested itself in the sudden end of a large number of venture enterprises and the consequent crash in the value of technology stocks. The 11 September attacks further slowed the economy as thousands of employees, especially in the New York City area, lost their jobs, even if only temporarily. In addition, fear of flying after the attacks prompted many to avoid travel by plane, and the airline industry went into a tailspin. The reluctance to fly also affected adversely areas of the country in which tourism is a principal part of the state or local economy. All of these events brought the nation's economy to a recession, something the country had not experienced since the early 1990s.

Second, a series of corporate scandals occurred suddenly, and in quick succession several large energy and telecommunications companies went bankrupt. The daily news was filled with revelations that senior executives engaged in misleading accounting practices and financial artifices, and that these machinations were aided and abetted by certified public accounting firms and well-regarded Wall Street financial houses. In short order, the stock market plummeted to levels that had not been seen in over five years, the value of many personal and public pension funds dropped steeply, and public trust in Wall Street and in corporate leaders was replaced by resentment and demands for prompt punishment.

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The combination of the war on terrorism and the economic upheaval put the locus of decision-making in the nation’s capital. Federal policymakers rushed to meet these problems with new agencies and policies such as the Office of Homeland Security, the USA Patriot Act (P.L. 107-56), the Transportation Security Administration (Aviation and Transportation Security Act, P.L. 107-71), and the Public Company Accounting Reform and Investor Protection Act (P.L. 107-204). One might have expected state and local governments to have been eclipsed by these unusual events and by the extensive set of actions taken by federal officials. To respond to these problems of national and international scale, a new level of centralization could easily be predicted; after all, the United States had gone through periods of centralization in similar crises in the past—the two world wars, the Great Depression, and the economic and social turmoil of the 1960s. Although the nation’s structure of government, and even its very way of life, suffered several serious shocks this past year, the response and stability of the American federal system has been remarkable. Not only did the federal government work to ameliorate the crises, state and local governments did so as well. Furthermore, state and local governments took the initiative in several issue areas without waiting for decisions by Washington. Rather than a move toward centralization, this past year in American federalism has seen vigorous action by all governments, and a new realization that without the participation of state and local governments, no strategy requiring nationwide efforts will succeed.

HOMELAND SECURITY

To manage the war against Al-Qaeda and other potential terrorist threats, President Bush established the Homeland Security Council and the Office of Homeland Security. The council’s charge is to advise the president on security matters, to develop a comprehensive national strategy to protect against attacks, and to coordinate federal, state, and local counter-terrorism efforts. The Homeland Security Council is composed of the president; the vice-president; the attorney general; the secretaries of Treasury, Defense, Health and Human Services, and Transportation; the directors of the Federal Emergency Management Agency, the Federal Bureau of Investigation, and the Central Intelligence Agency; the assistant to the president for homeland security; and other Cabinet officers and federal officials the president may designate to attend. Conspicuously absent from the council are representatives of state and local government. The Office of Homeland Security (OHS) prepared and delivered by mid-July 2002 The First National Strategy for Homeland Security which identified six critical mission areas: (1) intelligence and warning, (2) border and transportation security, (3) domestic counter terrorism, (4) protecting critical infrastructure, (5) defending against catastrophic terrorism, and (6) emergency preparedness.
and response. OHS was located in the Executive Office of the President, and relied primarily on presidential authority in order to organize and coordinate the 100-plus federal entities with responsibilities related to homeland security. To create a unified command, President Bush proposed legislation to convert OHS to a Cabinet department. The proposal would transfer a number of federal agencies and offices from their existing organizational locations to the new department. Among the units proposed for transfer are the Coast Guard, the Customs Service, Immigration and Naturalization Service (including the Border Patrol), the Animal and Plant Health Inspection Service, and the newly created Transportation Security Administration. The amalgamation of several disparate agencies and offices "would unify authority over major Federal security operations related to our borders, territorial waters, and transportation systems... As a result, the Department would have sole responsibility for managing entry into the United States and protecting our transportation infrastructure." Bush also submitted a request for approximately $38 billion. As of August 2002, congressional approval of the new department had not been obtained.

An effective strategy to protect the nation against new attacks is contingent on the identification of tasks, the assignment of responsibilities, the determination of the means of protection, the mobilization of resources, including paying for new security measures, and the coordination of actions. While the National Strategy for Homeland Security acknowledges that "state and local governments have critical roles to play in homeland security," the primary responsibility of state and local governments mentioned in the document is that of "funding, preparing, and operating the emergency services that would respond in the event of a terrorist attack." The National Strategy views all manmade and natural disasters as local events, and local units are the "first responders" to these events. The National Strategy expressly states that the new department "...cannot and will not create separate and specialized coordinating bodies for every functional area of government. To do so would merely replicate the stovepiped system that exists today and would defeat a main purpose of creating a new Department."

To assist state and local governments in their emergency response role, Bush’s 2003 budget proposed a $3.5 billion First Responder State/Local Preparedness Grant. The new funds would be allocated in thirds to improve communications, direct dollars to state and local first response units, and implement training, planning, technical assistance, and administration. Twenty-five percent of the grant monies would be distributed to states using a 75-25 match rate. The other 75 percent of the funds would be distributed to localities by state governments. Presumably, the grant monies targeted for discretionary spending (25 percent) by the state governments would

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4 President George W. Bush, Message to the Congress of the United States (18 June 2002).
assist states to cover the costs of the specific state government activities mentioned in the National Strategy: coordinate suggested minimum standards for state driver's licenses, enhance market capacity for terrorism insurance, train for prevention of cyber attacks, suppress money laundering, ensure continuity of the judiciary, and review quarantine authorities.6

The Department of Health and Human Services (HHS) in FY2002 announced $1.1 billion in Public Health Grants for Bioterrorism Preparedness. States are allowed to begin spending 20 percent of their total allocation immediately; the remaining 80 percent will become available after HHS has approved a state's bioterrorism plan. Each state is required to devise a plan as to how it will respond to a bioterrorism event, contain outbreaks of infectious diseases, and strengthen its public health capacities by no later than 15 April 2003.7

The proposed Department of Homeland Security builds on an increasingly interconnected relationship between the federal, state, and local governments that has evolved since the early 1950s when the Office of Civil Defense (OCD) was established. Then the threat was nuclear warfare, and the OCD distributed substantial funds to local governments to train personnel and to build emergency operations centers that could withstand the blast effects of nuclear weapons. During the 1960s, the Department of Justice distributed law-enforcement assistance grants to states and localities to improve their capacity to fight crime and to quell urban riots.8 The Stafford Disaster Relief and Emergency Assistance Act (P.L. 93-288) defined the federal government's basic pre-9/11 role in responding to major disasters that are beyond the response capacity of state and local governments. After a disaster is declared, the Federal Emergency Management Agency (FEMA) can reimburse state and local governments for 75 to 100 percent of eligible costs related to response and recovery.9

In the aftermath of the 1995 nerve-gas attack on a Tokyo subway station and the Oklahoma City bombing the same year, President Bill Clinton issued a presidential decision directive (No. 39) listing the responsibilities of federal agencies for combating terrorism. Congress soon passed the Defense Against Weapons of Mass Destruction Act of 1996 for the purpose of providing equipment and training to state and local emergency response units.10 In 1997, Congress set up the Domestic Preparedness Program through which six federal agencies work with state governments and the

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7 Ibid.
10 Ibid.
largest cities in the country to prepare for terrorist events.\textsuperscript{11} The establishment of the Office of Homeland Security in October 2001 and the Transportation Security Administration in 2002 built upon this incremental growth in the intergovernmental capacity to prepare for and respond to disasters and terrorism. It should be pointed out, however, that the new Department of Homeland Security, once it is established, will be more than an incremental step because it "would constitute the largest reorganization of the federal government in fifty years."\textsuperscript{12}

The current campaign to improve the nation's ability to protect against and respond to terrorist attacks exhibits the implementation problems typical of most new public programs.\textsuperscript{13} Confusion about who should protect what was evident in the first months after the September 2001 attacks. Sentries were posted on the cliffs above the Hudson River, newly deputized air marshals were posted aboard some passenger flights, sea marshals were dispatched to board ships entering ports, and NATO pilots flew patrols over the national capital. Governors and mayors bore the direct responsibility for posting the National Guard, deciding which parts of the nation's infrastructure—public and private—would be protected, and for inspecting persons and vehicles in transit.

As OHS released a series of alerts, state and local officials began to raise questions about their responsibilities and the availability of resources in support of state and local actions. Governor Angus King of Maine spoke for many of his colleagues when he stated that: "We just aren't financially geared up for this level of what really is national defense expenditure... the question is where do you stop with providing security?" Governor Gary Johnson of New Mexico answered by resisting the pressure from OHS for more state commitment to protecting a long list of possible targets. Governor King also raised the issue of precedence related to public protection for some private facilities but not for others: "...if you say yes to one, how do you say no to the next and the next?"\textsuperscript{14}

Governors and mayors also complained about inadequate information sharing or the plain absence of relevant information. The Federal Bureau of Investigation (FBI) took more than a month to set up its post-September 11 national crime database and to post detailed information that local and state police could use as they carried out routine activities such as traffic stops. Sometimes different federal agencies sent conflicting messages to the same state or local office, as exemplified by different directives from the Department of Defense (DOD) and from FEMA about nuclear power plants. In some cases, governors and mayors learned about potential threats

\textsuperscript{11}Winslow, "9/11 and Federalism: Local Government and Civil Defense."
from newscasts, instead of from OHS. Federal investigative agencies required mayors and other state and local officials to fill out lengthy information forms in order to gain clearance before the federal agencies would share information.\textsuperscript{15} In other cases, local officials could not obtain necessary information about emergency preparedness because federal officials did not return phone calls.\textsuperscript{16}

The most serious implementation difficulty was financial. Costs of response were immediate. Major cities such as Boston spent over $100,000 per week on overtime pay for police. Baltimore spent $2.6 million for security in one month. Security expenditures for Baltimore from 11 September to the end of 2001 were projected to be almost $16 million, while Dallas projected $6 million and New Orleans, $10 million.\textsuperscript{17} Cost figures for one-time and continued security expenses are still being calculated, but initial estimates even for a small state like Maine are enormous—one-time costs estimated to be $31 million. In the FY 2002 federal budget, the states were provided with $1.1 billion from HHS through the bioterrorism preparedness grants. In the proposed FY 2003 budget, only $3.5 billion out of the $38 billion was targeted for localities as part of the First Responder grant. The total for all homeland security is less than the new funds ($47 billion) allocated to DOD. The current state government fiscal crisis compounds the burden of providing security.

One of the justifications for the new Department of Homeland Security (HS) is that it will reduce fragmentation in the federal government’s organization, and thus improve overall coordination of security efforts. However, critics of the administration’s proposed organizational structure point to several shortcomings, among which is the disjunct between the priorities of the National Strategy for Homeland Security and the structure of HS.\textsuperscript{18} Once the department is established, its new initiatives will have to avoid a “one-size-fits-all” approach to building intergovernmental and intersectoral partnerships. Patricia A. Dalton, Director, Strategic Issues, U.S. General Accounting Office in testimony to the U.S. House of Representatives cautioned that: “Achieving national preparedness and response goals hinges on the federal government’s ability to form effective partnerships with nonfederal entities. Therefore, federal initiatives should be conceived as national, not federal in nature. Decision makers have to balance the national interest of prevention and preparedness with the unique needs and interests of local communities.”\textsuperscript{19} At the same time, federal

\textsuperscript{15}ibid.
\textsuperscript{18}Daadler, et. al, \textit{Assessing the Department of Homeland Security}, p. iv.
decision-makers face certain risks as they construct intergovernmental and intersectoral partnerships. The history of federal grants contains numerous examples where state and local government interests diverged from federal policy goals. One of the most common grant “games” especially familiar to students of fiscal federalism is the substitution of federal dollars for state and local monies. Another grant “game” is the diversion of federal dollars to alternative activities preferred by state and local entities. From the state and local perspective, new grants and programs in support of homeland security can become new sources of unfunded mandates and federal preemptions.

While much attention has been focused on state and local governments as “first responders,” too little attention has been given to their extensive experience in planning and programming in areas directly related to homeland security. Simply put, state and local governments have long performed many of the primary functions on which an effective national strategy of homeland security will rest. State and local governments have not sat still since 11 September 2001. In the past year, at least 27 states have updated their criminal codes in regard to terrorism, 11 states have added the death penalty as punishment for terrorist acts, and several states have raised their penalties for the use of “hoax weapons.” Other state legal changes include expansions of wire tapping and other forms of interception of communications and information exchange. Many local governments are restructuring their relationships within a regional area to improve coordination, response, and resource sharing. For example, the City of New Orleans and its four surrounding parishes have set up the Metropolitan Safety, Security, and Anti-Terrorism Task Force. In King County, Washington, a new regional disaster plan coordinates across 16 cities, 15 fire districts, 21 water and sewer districts, 12 school districts, and includes private sector representatives. The Front Range Emergency Medical Service and Trauma Advisory Council pulls together all hospitals and rescue units in the six-county metropolitan area of Denver, Colorado. The continuing efforts to develop homeland security plans and programs will be an important test of intergovernmental collaboration in the immediate future. Will the pervasive presence of potential threats prompt officials at all levels of American government to put aside personal and institutional interests, or will these efforts exhibit the “gamesmanship” that has been common to intergovernmental relations?

THE INTERGOVERNMENTAL POLICY MIX

The 107th Congress, characterized during its first session by narrow Republican majorities in the House and Senate, delivered to President Bush

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his initial successes of a major cut in income taxes and the first significant change in federal policy on K-12 education since 1965. The events of 11 September prompted Congress to temporarily abandon its usual partisan deportment. As the general public and elected officials throughout the nation rallied around the president’s call to defend the country against terrorists and “evildoers,” his popularity soared. The quick ejection of the Taliban regime in Afghanistan reinforced Bush’s standing in public opinion polls. As the war against Al-Qaeda terrorism became a world-wide hunt, signs of progress became less obvious, and other events began to alter the political landscape.

The post-September 11 period of “good will” was short-lived. In May 2002, Senator James M. Jeffords (R-VT), in an act of dissatisfaction with Bush’s positions on school choice, missile defense, the direction of the judiciary, and budget priorities, declared himself to be an Independent and began caucusing with the Democrats. Jeffords’ switch in party allegiance gave majority rule in the Senate to the Democrats, thus ending the Republican party’s lock on the main policymaking institutions in Washington, D.C.

The collapse of Enron ushered in a wave of corporate scandals and bankruptcies that shocked investors and the stock market. The administration’s lack of quick action against corporate “terrorists,” compared to the speed of its action against the Taliban half a world away, raised doubts about the competence of the president’s economic team. Bush’s personal and political ties to some discredited corporate executives resurrected charges that the Republicans are the party of big business. Democrats, however, could not gain much traction with this charge because many Democrats also had close ties to the same corporations. The public pressured Washington to arrest the CEOs and close the accounting and legal loopholes that made possible the looting of some firms. Bush, who campaigned for the presidency as a businessman, was forced to get tough on CEOs, some of whom had been his most important contributors.24

The costs of the war against Al-Qaeda increased federal expenditures significantly. At the same time, the economy still struggling to recover from the collapse of the dot.com bubble caused a decline in federal revenues, as did the previously enacted tax cuts. The corporate scandals pushed the stock market down farther, threatening the Federal Reserve’s efforts to boost the economy. Within the short span of a single year, the federal budget went from surpluses “as far as the eye could see” ($227 billion in July 2001) to burgeoning deficits ($192 billion in July 2002).

Although the government in Washington was divided slimly along party lines, a fair amount of agreement was achieved across party lines in several policy areas. The president and Congress discovered that state governments

had serious differences with the directions proposed for several federal policies. State challenges of Bush administration plans were especially troublesome because the dissenting voices were often Republican.

**Education**

The No Child Left Behind Act of 2001 passed with overwhelming majorities in both chambers on 8 January 2002. During his presidential campaign Bush promised to make the education of every child his number-one priority, and his basic strategy sought the adoption of performance testing in the nation’s public schools. The reauthorization of the 1965 Elementary and Secondary Education Act (ESEA) presented the administration with the opportunity to make good on the president’s promise. Negotiating compromises with Senate Democrats, in particular Senator Edward Kennedy (D-MA), Bush achieved his first domestic victory since the Democrats gained their one-vote majority in the Senate. Not a mere reauthorization of ESEA, the new law transformed federal education policy from one of a broad-based distributive but supplemental program of federal dollars to a policy based on performance standards and backed up by penalties for failure to achieve the standards. The key provisions include:

1. **testing**—establishes annual assessments for grades 3 through 8 in reading and mathematics, and authorizes $490 million in FY2002 (and similar sums to FY2007) to aid states with the cost of testing;

2. **accountability**—establishes Adequate Yearly Progress (AYP) benchmarks which the states must reach with 100 percent proficiency in equal increments over 12 years;

3. **transferability**—permits states and localities to use up to 50 percent of non-Title I monies for purposes they designate such as teacher training, bilingual education, after-school programs, and technology, and also grants parents the right to transfer their children out of failing schools to other public schools or receive federal aid for private tutoring;

4. **flexibility**—gives seven states and 150 local education agencies a waiver from the U.S. Department of Education so that these jurisdictions may consolidate specified programs.25

President Bush, in his comments after the two houses agreed to the final draft, stated: “The conference agreement will ensure that no child in America is left behind through historic education reforms based on real accountability, unprecedented flexibility for states and school districts, greater local control, more options for parents and more funding for what works.”26

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Not every one was pleased with the legislation. The Heritage Foundation called the measure a "mixed bag... [of] small steps to reform," and stated that while the new law's provision to hold schools accountable for low test scores was a positive step, the right of parents to transfer their children was still inadequate.27 Some supporters of performance-based education were unsatisfied by the House Republicans' rejection of efforts to increase funding for special education from $6.3 billion to $21 billion over six years. The lack of additional funding for the growing costs of special education amounted to the federal government's turning away from its long-standing support for educational services to children with disabilities. Officials in a number of states were especially angered over the law's imposition of what some labeled as the "Texas model" of testing on all the states, even those with their own well-developed procedures. Senator Chuck Hagel (R-NE) felt that the lack of discretion on the design of state testing systems would impose a cumbersome federal mandate that would override the successful testing program in his state. Hagel, one of three Republican votes against the legislation, lamented that "this bill federalizes our education system more than it's ever been federalized. I fail to see why the federal bureaucracy should override a state when a state has an accountable, workable testing system that, in fact, accomplishes the objective." Hagel was especially frustrated because he had managed to gain bipartisan Senate approval to fully fund the congressional commitment to meet the 40 percent of education services costs established in the 1975 Individuals with Disabilities Education Act.28

The No Child Left Behind Act of 2001 is, in the White House's words, "the most sweeping reform of the Elementary and Secondary Education since it was enacted in 1965." In terms of its basic policy direction of performance-based education and in its 49 percent increase in funding over FY 2000, the new law is, without a doubt, a major revision of federal policy. The mandated single model for performance testing constitutes a direct order that has the potential to constrain state government discretion over how testing systems will be designed and operated. Some states, such as North Carolina, have testing procedures more sophisticated than the "Texas model," but under the new federal rules, they may not be able to retain them. Other states such as Kentucky test students across more subjects than reading and math, but different subjects are tested in different school years, so Kentucky may have to add what officials there see as unnecessary additional tests.29

The future success of the new federal education policy hinges not just on the testing requirement, but also on the parental choice feature. If

27 Ibid.
schools are found to be underperforming, but parents cannot find substitute
schools into which to place their children, the new policy will be stymied.
Upon passage of the final legislation, educators in many states expressed
doubts about the viability of the school-choice option. Education officials
in states as diverse as California, Massachusetts, and New York pointed out
that their states already permit school choice, but in many metropolitan
school districts, there are no empty spaces in many of the schools. If schools
are overcrowded, the parental right to transfer is meaningless. In rural
states such as Wyoming, "two-thirds of the schools," according to the
legislative liaison for the state Department of Education, "are in
communities where there is no choice."30
For some, the U.S. Supreme Court's decision in *Zelman v. Simmons-Harris*31
has a greater potential for altering the nature of public schooling than the
No Child Left Behind Act. The case pitted defenders of one of Thomas
Jefferson's most important legacies and one of the civil institutions that has
made America a pluralist nation against those who contend that public
schools have failed in their obligation to educate all children, in particular,
the poorest of the poor who are trapped in the worst of the inner city schools.
Cleveland, Ohio, established a program giving low-income parents vouchers
of $2,250 per child to move their children from sub-par inner city schools
to private schools of the parents' choice, including private religious schools.
The Court ruled that Cleveland's voucher program is constitutional because,
on its face, it is neutral; the aid is designed to assist parents educate their
children, the aid is not designed to assist a religion. The *Wall Street Journal*
was so elated by the Court ruling that it declared in an editorial "free at last,
private school choice is free at last."32
The *Zelman* ruling may be good news in those states where voucher
experiments have been underway for some years and have had to contend
with opposition based on the establishment clause of the First Amendment
to the U.S. Constitution. However, the ruling may not be good news for
voucher advocates for several reasons, some related to state laws and likely
state action. First, the Supreme Court decision will run into a relic from the
Know Nothing era of the 1850s. This period was the height of the hysteria
against the newly arriving immigrant Irish, mostly Roman Catholic, and the
Know Nothing party whipped up xenophobic sentiments in support of laws
to ban Catholics from holding public office, dismiss Irish workers from state
jobs, and to ensure that state dollars "shall never be appropriated to any
religious sect for the maintenance exclusively of its own schools." In the
1880s, James G. Blaine, a Speaker of the U.S. House of Representatives,
campaigned for the presidency on a platform urging Congress to adopt a

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30Diana Jean Schemo, "Officials Say School Choice Often Just Isn't an Option," *New York Times*, 22
December 2001 (Netscape version).
32Dick Herman, "A Lament For Public Schools," *Nebraska State Paper*, 30 July 2002;
constitutional amendment forbidding the use of tax dollars for religious schools. While the proposal never succeeded in Congress, many states did pass these so-called "Blaine amendments," and today thirty-seven states still have them in their constitution. Thus, the fight over vouchers will have to be carried to the state courts. Florida's court recently upheld that state's constitutional prohibition against vouchers.

Even if states move forward with vouchers, several questions will have to be answered before vouchers fulfill the promises made by their advocates. The Cleveland vouchers at $2,250 appear to be generous, but not many private schools set their tuition so low. One question is: will states appropriate enough money or tax credits to cover the average cost of private education, especially when states are suffering from fiscal stress? Second, as with the transferability feature in the new federal education law, if alternative private schools are not available, will vouchers be meaningless? Third, if vouchers become popular, will states without an income tax be forced to enact one in order to cover the additional costs of permitting some parents to exercise choice? Fourth, will vouchers designed to allow parents in the inner-city let their children escape under-performing schools provoke other parents to demand a broader system of direct financing based on tax credits? Fifth, will private schools that accept students bearing vouchers be required to meet a long list of regulations (e.g., non-discrimination in hiring and public access to their records) not now applied to these schools?

Welfare Reform

The 1996 Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) was scheduled for re-authorization in 2002. A key component of the 1996 act was the Temporary Assistance for Needy Families (TANF) program, a new federal block grant that replaced the long-standing Aid to Families with Dependent Children (AFDC) entitlement. Enacted after a bitter partisan struggle, the law touted by President Clinton as the means "to end welfare as we know it" has been judged by most in Washington to have been a success. Isabel Sawhill of the Brookings Institution described the results of TANF with these words: "Almost all of the data is moving in the right direction: caseloads are down, employment up, poverty rates down, particularly among children and minority children."

TANF, compared to AFDC, imposed work requirements on welfare recipients and placed a 60-month lifetime limit on the period for which a family could receive cash assistance. States had to enforce the work requirements and time limits, and states also had to spend their own funds up to a level specified in federal policy [known as "maintenance of
effort"funds]. Furthermore, federal policy directed states to increase, on an annual basis, the percentage of TANF participants who work. A target of 50 percent of all welfare families was set, and states that did not achieve this target could be penalized with loss of federal funds. TANF did grant considerable administrative discretion to state governments in matters such as which families could be excluded from work requirements and time limits as well as what family assets would be included in the computation of a family's income. States also were allowed considerable flexibility over the types of services provided to TANF families.

Bush's proposal for welfare re-authorization, entitled "Working Toward Independence," was announced on 26 February 2002. In essence, the plan would ratchet up the work requirements from 30 to 40 hours a week, raise the participation rate from 50 to 70 percent, phase out a case-load reduction requirement, continue funding at the current $4.6 billion, and re-program some of the money into two new funds intended to encourage new activities related to family formation, healthy marriages, and the reduction of out-of-wedlock births. In keeping with public opinion favorable to increased assistance for children in poverty, Bush proposed that child well-being be the primary purpose of the re-authorized program, rather than its former goal of moving welfare recipients from dependency to self-sufficiency.36

To the surprise of the White House, governors from both political parties strongly opposed the president's plan. The National Governors' Association (NGA), which had played an influential role in designing the 1996 act, argued that the paramount focus of TANF ought to be on work, but that increasing the hourly work requirement for some families was unrealistic in a time of rising unemployment and a recessionary economy. Because many of the easiest persons to help had already left the welfare rolls, the governors demanded more discretion over what activities—job training, education, drug abuse treatment—would fulfill the work requirements. Many governors believed that the proposed increase in the participation rate would force states to place welfare recipients in "make work" jobs, often with public or non-profit organizations, rather than preparing people to qualify for private sector jobs.37

Jesse Ventura, Minnesota's independent governor, issued a public statement in May 2002 that captured the governors' disappointment with the Bush administration's welfare-reform proposals:

In 1996, the federal government ended 60 years of failed welfare policy that trapped families in dependency... The 1996 law scrapped the federally centralized welfare system in favor of broad flexibility so states could come up with their own welfare programs. It was a move that had bipartisan support, was smart public policy and worked... The reason is simple: state

flexibility. But now the Bush administration is having second thoughts about empowering the states. The administration's proposal would return us to a federally prescribed system. It would impose rules on how states work with each family, forcing a "one size fits all" model for a system that for the past six years has produced individualized systems that have been successful in states across the country. 36

The debate between the governors and the White House gives the appearance of being fought out over money and programmatic details, but if one looks past the arguments over specific details, what one sees is a classic intergovernmental battle. Although legislative action on the re-authorization of TANF has yet to be completed, the bills in the House and the Senate contain most of the president's proposals. Despite a steady stream of gubernatorial testimony against Bush's position, the likelihood is that he will succeed in raising the performance bar on the administration of TANF by the states.

Health Care

Once again, health care is the biggest policy headache for federal and state officials. A decade ago the Clinton administration's plan for reforming the health-care system failed to win public approval. In place of comprehensive reform, federal and state policymakers did support managed care approaches as a means to provide medical services broadly while controlling price increases. Although managed care temporarily slowed inflation in health-care costs, these costs are now rising at rate equivalent to those that provoked a crisis in the early 1990s. The Center for Studying Health System Change reports that "overall, health care spending per privately insured person increased 7.2 percent in 2000—the largest year-to-year increase since 1990." 39 The usual suspects are once again pushing up health costs. As a proportion of overall spending increases, hospital outpatient costs accounted for 31 percent, prescription drugs, 29 percent, and physicians, 28 percent. 40

Both private and public health programs are under severe fiscal strain. Health insurance premiums in 2001 rose 11 percent, the highest increase since 1993, and the projection for 2002 is 13 percent. The current year is the sixth year in a row in which health costs have climbed with the consequence that cost increases have been outrunning increases in insurance premiums, in some cases by as much as 30 percent. During the recent economic expansion, employers absorbed these increases, but with the current economic downturn, employers are beginning to pass these increases to employees. Similarly, self-employed persons find themselves receiving substantially higher health insurance bills, which has prompted

40 Ibid.
some families to enroll their children in S-CHIP, the State Children’s Health Insurance Program that covers children in families with annual incomes of no more than twice the federal poverty level (approximately $34,000).  

Medicaid, the nation’s major health and long-term care program for the needy, covers more than 44 million people, is the largest federal grant program with about $207 billion outlays in FY 2000, and provides 42 percent of all federal dollars to the states. The program is administered by state governments which have discretion over several features of the health services provided. States payments for Medicaid expenditures combine state dollars with federal “matching” funds based on the state’s per capita income compared to the national average for the preceding three years. Wealthier states receive a match of 50 percent, while the poorest states receive an 83 percent match. In 2001, state Medicaid spending rose 10.6 percent, and estimates of the increase for 2002 put it at 13.3 percent. For 2002, state Medicaid outlays are almost 21 percent of total state spending, compared to 17.8 percent in 1992. These escalating expenditures have forced 47 states to reduce them in 2002 or propose reductions for 2003. Examples of the actions taken or proposed include (1) reductions in drug costs, provider reimbursement rates, optional benefits, grants to rural hospitals, or eligibility, (2) increases in cost-sharing requirements, fraud and abuse efforts, or estate recovery, (3) contracting for services or multi-agency purchasing agreements, (4) implementing disease management, and (5) deferral of planned expansions or program enforcements. States are also moving to direct additional revenues toward Medicaid, including the reallocation of tobacco funds, increasing taxes on hospitals and cigarettes, initiating quality insurance fees on nursing homes, and drawing down the maximum permitted federal funds. 

Unlike the bipartisan support in Congress for President Bush’s education and welfare proposals, there is a lack of agreement on how to solve the looming health-care crisis. The stunning defeat of the Clinton universal health care proposal makes even the most ardent advocates of this strategy reluctant to try again. Consequently, current policy proposals are incremental in nature. Bush, for example, has put forward several ideas, among the most widely discussed are $89 billion in tax credits to assist the uninsured purchase coverage, reform of medical malpractice insurance, tax exemptions for care givers, a patient bill of rights, and new funding of $190 billion to improve Medicare, which would include a prescription drug benefit.

Bush also proposed to increase rebates to the states by adjusting the
formula for calculating the Medicaid drug rebate; this proposal would have saved about $9.5 billion over five years, but it died in Congress. Other parts of Bush's health-care reform plan worsen the states' Medicaid financial crisis by cutting approximately $9 billion dollars over five years. As unemployment has risen in recent months, more individuals qualify for Medicaid, thus driving up state expenditures. The National Governors' Association, along with the National Conference of State Legislatures (NCSL), the U.S. Conference of Mayors (USCM), and the National Association of Counties (NACo), have objected to the administration's reduction in Medicaid matching funds. NCSL termed the administration's proposal to cap Medicaid expenditures as "fundamentally changing the relationship between the states and the federal government by inappropriately transforming a full partnership into a limited partnership, and shifting both costs and responsibilities to state governments."\(^{46}\) Officials representing state and local governments are supporting a bipartisan coalition in Congress, led by Senators Ben Nelson (D-NE) and Susan Clark (R-ME), which has introduced legislation to create a temporary increase in the Medicaid FMAP (Federal Medical Assistance Percentage) matching rate and hold harmless provision so no state would see its FMAP percentages reduced. The defeat of the prescription drug proposal before the August 2002 recess reflects the general lack of consensus in Washington over how to solve the health-care crisis.

Unfortunately, this deep division in the nation's capital leaves the states with no solution to the inexorable growth in health-care expenditures. Each political party holds fast to its preferred solution—the Republicans favor market mechanisms, while the Democrats prefer enlarging public programs. This standoff does nothing to address the runaway cost of prescription drugs which has increased at a whopping average rate of 19.7 percent in the last two years.\(^{47}\) States are not waiting for the gridlock in Washington to be broken; instead, over half the states have created or expanded their own programs to assist senior citizens pay for prescription drugs. For example, eight states have direct subsidy programs covering nearly three million people. Ten states are using tobacco-settlement money to pay part of the costs for prescription drugs. California and Florida passed laws limiting the prices pharmacies can charge senior citizens, while Michigan and Missouri enacted tax credits to help offset drug prices. Other states have set up buyers' clubs or purchasing cooperatives to help low-income elderly people gain discounts on drugs, and a few states are considering forming a group to jointly negotiate discounts from pharmaceutical companies.\(^{48}\) These varied actions by the states to reduce the costs of prescription drugs


\(^{47}\)"Toner and Stolberg, "Decade after Health Care Crisis, Soaring Costs Bring New Strains."

to the elderly offer a classic example of states performing their dual roles of "laboratories of democracy" and "workhorses of democracy."

THE STATES

As of 30 June 2002, there were 87,900 governmental jurisdictions in the United States, of which 87,849 were units of local government. The 50 states encompass 38,971 general-purpose local governments, which include 3,034 counties, 19,431 municipalities, and 16,096 townships. Special purpose governments number 48,878, of which 19,522 are school districts. Over the last 50 years, the number of counties has decreased by 18, townships have declined in number by four percent, while there are now 16 percent more municipal governments. The number of special purpose governments has changed substantially since 1952. Where once 67,355 school districts functioned, the count has dropped by 80 percent to 13,522. Special purpose governments have nearly tripled in number from 12,340 to 35,356. Almost 91 percent of the non-school special districts perform a single function—the most common of which are natural resources (19.9 percent), fire protection (16.2 percent), housing and community development (9.7 percent), water supply (9.7 percent), and sewerage (5.7 percent). Other functions include activities such as airports, cemeteries, highways, health, hospitals, libraries, parks and recreation, and other utilities.49

In 1998-1999 state and local governments had revenues from their own sources of $1,163.4 billion, of which $815.3 billion were taxes (70 percent). The principal tax levies of state governments were the general sales tax (32.67 percent), individual income taxes (34.55 percent), selective sales taxes (15 percent), motor vehicle and other taxes (9.1 percent), and corporate income taxes (6.2 percent).50 A variety of charges, miscellaneous general revenues, liquor store revenues, utility fees, and insurance trust revenues constituted the remainder of state government fiscal sources. It is noteworthy that the interest earnings of state governments ($32.1 billion) exceeded the amount levied on corporate incomes ($30.8 billion).51 By 2001, state taxes grew to $559.8 billion, an increase of nearly 12 percent. The relative importance of the various types of taxes shifted in two important directions: (1) individual income taxes in 2001 increased to 37 percent of total state taxes, and (2) other state taxes declined—general sales taxes (32.1 percent), selective sales taxes (14.1 percent), corporate income taxes (5.7 percent), and motor vehicle and other taxes (8.7 percent).52

State government spending in 2000 on traditional functions continued to be substantial and widespread, as it had been through most of the 1990s.

50 The percentages were computed as a proportion of total state taxes of $499.94 billion.
Education accounted for $346.8 billion (31.9 percent), public welfare consumed $239.0 billion (22.04 percent), health and hospitals required $74.6 billion (6.87 percent), and highways cost $74.2 billion (6.84 percent). The national economic expansion following the recession in 1991-1992 allowed state governments to increase their spending by 28 percent, after adjusting for inflation and population growth. From 1990 to 1999, 39 states increased expenditures by 25 percent or more. The economic boom not only sustained the rising spending, but it also permitted states to roll back taxes by nearly $36 billion.

An unusual convergence of events, some would say good luck, made it possible for state governments to increase real spending and decrease taxes. The economy rebounded after the financial services recession of the early 1990s on a wave of growing worker productivity and the explosion in information technology, telecommunications, and “dot.com” businesses. State revenues advanced in real terms as taxable incomes grew even faster than the economy. At the same time, states benefitted from the federal government’s action to reform welfare by converting the AFDC entitlement to the TANF block grant. Efforts to contain health-care costs using managed care approaches yielded some savings as did a temporary drop in the pace of Medicaid enrollment. Topping off this good fortune for the states was the tobacco settlement with its windfall of $264 billion over 25 years.

Red Ink Floods the States

In February 2001, the Cato Institute described state governments as in “...the midst of the longest sustained run of net state tax cutting in American history,” but by January 2002, 46 states had revenues below projections, 30 states had expenditures over budget, 39 states had enacted budget cuts or rollbacks, 26 had dipped into their reserves, and 30 states used various other measures to balance budgets that had become flooded with red ink. Seldom has fiscal growth been followed so swiftly by fiscal decline. In March 2002, the National Association of State Budget Officers (NASBO) estimated the budget shortfalls for the current fiscal year to be close to $40 billion, or 7.8 percent of estimated total general-fund revenues. By April 2002, the National Conference of State Legislatures reported that “at least 40 states and the District of Columbia were being forced this year to make emergency cuts in their budgets totaling $27 billion.” By July 2002, the National...
Governors' Association reported that 45 states had revenue shortfalls over last year totaling $50 billion.\(^6\)\(^1\)

Projected FY 2002 shortfalls were estimated to range from $12 million in South Dakota to $4.5 billion in California. As a percentage of FY 2000 general fund expenditures, 2002 projected shortfalls ranged from a low of 0.4 percent in New Mexico to a high of 28.3 percent in Alaska.\(^6\)\(^2\) One report had California's budget deficit at $23.6 billion, or one-third of the state's entire budget.\(^6\)\(^3\) State governments responded to the budget-busting "deficit deluge" with standard short-term measures and "creative accounting." Spending cuts targeted higher education, aid to local governments, parks, prisons, and K-12 funds. "Rainy day" reserves were drawn down, trust funds were swept into the general fund, and debt financing using bonds was substituted for "pay-as-you-go" financing of capital projects. States desperate to balance their budgets resorted to bookkeeping gimmicks and ruses such as artificially inflating revenue estimates, delaying payments of already appropriated funds, budgeting appropriations at a level below forecasts, and delaying or suspending tax refunds.\(^6\)\(^4\)

As expected, most of the effort to balance state budgets has fallen on the expenditure side of the ledger. Some states, however, have been willing to raise taxes, typically cigarette and other sin taxes. Many states are increasing the fees charged for services ranging from state park entrance fees to motor vehicle licenses to college tuition. Other states have rolled back some portion of recently enacted tax cuts or tax rebates. Ironically, many state officials who supported the national effort to abolish estate taxes have voted to preserve their state's inheritance tax.\(^6\)\(^5\) The tobacco-settlement money in some states has been "securitized" in order to produce short-term revenues. "Securitization" is a technique by which a state government sells bonds that give investors a claim on future installments of the state's tobacco-settlement funds in return for a lower, one-time payment that can be used immediately by the state government. As of June 2002, 12 states had adopted this extreme form of deficit financing.\(^6\)\(^6\)

Budget cuts, closure of public facilities, increased taxes, and various accounting gimmicks have not dammed the tide of red ink. Arturo Perez, a NCSL policy analyst, stated that the situation in Tennessee was described to him as: "We cut the fat in the first year. We cut to the bone last year. And

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\(^6\)\(^3\) Rosenbaum, "States' Vast Budget Gaps Bring Higher Fees and Emergency Cuts."

\(^6\)\(^4\) See, for example, Kevin Carey, Liz McNichol, and Iris J. Lav, *State Responses to Tight Fiscal Conditions: Short-Term Fixes May Backfire If the Economy Does Not Soon Recover; Cyclical Downturn Masks Structural Problems in Some States* (Washington, DC: Center on Budget and Policy Priorities, August 2001).


what we are going to do this year is kind of unanswered."\textsuperscript{67} Forecasts for FY 2003 project even more red ink.

\textit{Causes of the State Fiscal Crisis}

Less than two years ago, governors and state legislators contemplated the joys of tax relief, but now state officials face the pain of paying bills without sufficient funds. How could this fiscal crisis emerge so quickly and apparently with little warning? Don Boyd, Director, Fiscal Studies Program, Nelson A. Rockefeller Institute of Government, points to the stock market decline as "the number one culprit."\textsuperscript{68} Each year of "irrational exuberance" in the stock market drove the proportion of state income taxes derived from capital gains and stock options higher and higher, but in 2001 this revenue source dropped precipitously—in some cases as much as 36 percent. Unlike other recent economic downturns, 2001 was especially abrupt, thus bursting the states' revenue bubble.\textsuperscript{69}

Terrorism also contributed to the burgeoning fiscal crisis. Because decisions about what to protect and how to do it are still being made, it is nearly impossible to estimate state and local costs for improved security. Some early numbers are instructive. A January 2002 survey conducted by the U.S. Conference of Mayors found that city officials expected to spend an additional \$2.6 billion on security between 11 September 2001 and the end of 2002. These costs are over and above expected and planned security spending, with the per city average of extra security costs estimated at \$1.84 million. "Tightening security in the aftermath of September 11 threatens to break the bank for many city budgets," New Orleans Mayor Marc Morial, the USCM president, stated.\textsuperscript{70} Although federal funds were approved, but not yet delivered, to help states and localities with security costs, nevertheless, the general slowdown in several sectors of the economy following the attacks resulted in reduced revenues. From 1 October 2000 to 31 March 2002, municipal sales taxes were 3 percent below projections, tourist taxes 9 percent below, and income taxes 10 percent below. The only good news was that property taxes in 2001 were up 5 percent over 2000.\textsuperscript{71}

Rapidly rising health-care costs, especially for Medicaid, contributed strongly to the states' fiscal woes. One in seven Americans is covered by Medicaid which pays for, among other items, 40 percent of births and 50 percent of nursing home bills. Although federal dollars cover on average 57 percent of state costs, state spending is accelerating into double-digit annual increases—13 percent in 2001.\textsuperscript{72} Medicaid accounts for an average

\textsuperscript{68}As quoted in Lemov, "Deficit Deluge," pp. 20-24.
\textsuperscript{69}Ibid.
of 20 percent of state budgets, and the return of unrestrained inflation in health care means that Medicaid and other health expenditures will continue to grow faster than state revenues. With few signs of additional aid from Washington, D.C., Medicaid expenditures threaten to swallow up monies from other fundamental state functions such as higher education, transportation, and aid to local governments.

A longer list of other pressures on state budgets would also include smaller returns on state pension investments, lower payouts of tobacco-settlement money due to a decline in the consumption of cigarettes, and the four-fold increase in criminal justice expenditures since 1980. But one of the most frustrating sources of fiscal problems as far as state officials are concerned are federal policy actions as well as inaction by the president and Congress on matters important to the states. In particular, the phase-out of the federal estate tax and the immediate federal tax deduction for new equipment purchases have the potential to force states to forego billions of dollars of revenue in the near future. The Economic Growth and Tax Relief Act of 2001 included a repeal of the federal estate tax by 2010, but the state tax credit to which state inheritance taxes are linked will be eliminated by 2005. The potential revenue loss has been estimated at approximately $21 billion, and every state but Oklahoma could be affected. Instead of the previous practice of allowing businesses to depreciate capital purchases over several years, the 2001 economic stimulus legislation granted businesses an immediate deduction of up to 30 percent. Similar to the federal-state tie between the estate tax credit and state inheritance taxes, states have used federal depreciation rules as part of state business-tax calculations. Consequently, the change in federal depreciation policy will force states to also give businesses this “instant” deduction, and thus states will lose revenue. The good news is that it is possible for states to avoid these losses by passing legislation that “decouples” their tax systems from these specific federal changes. About a dozen states have already acted to do so.

The states themselves have contributed to the fiscal pain they are suffering, principally through the reduction of state taxes. Into 2001, when the effects of the stock market downturn were already evident, states continued to enact tax cuts. The Great Lakes states, for example, passed large tax cuts totaling almost $1.8 billion, and the cuts caused a decline in state revenue collections for FY 2001. In 2001, Wisconsin reduced its revenues by 5.1 percent; Delaware, Maine, and Minnesota lowered revenues

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by over 3 percent; New York decreased revenues by almost $1 billion; and California trimmed revenues by a little over $1 billion.

At a more fundamental level, the states have yet to address the primary structural weaknesses in their budgets. The first structural weakness is on the demand side. Health-care costs, as noted previously, are growing faster than revenues, and now consume, if one includes all state health-care expenditures, almost 30 percent of state budgets. If the aging of the population is driving up health-care costs, then the "baby boom echo" combined with immigration, legal and illegal, is pushing up education costs. States cannot expect Washington, D.C., to rescue them from the relentless demand for education and health care, so the states have to tackle the second structural problem, which is on the supply side. The long-term shift of the economy from manufacturing to services has left state revenue structures collecting monies from a deteriorating base. The exemption of goods and services purchased via electronic commerce only exacerbates this weakness. Reform of state revenues will not be easy in the current political-economic climate.

Federalism Without Washington

States, singly or in combination, can choose to pursue policies different from that of the federal government. It is common for one or more states to take the initiative on some issue or problem, and for state action to become the precursor of federal action. The most compelling example in recent years is the agreement reached by 40 states with the tobacco industry. Daniel J. Elazar called this type of state government policy activity "federalism without Washington," which he described as "...unnoticed in discussion of the place of the states in the federal system is the growing routinization of interstate relationships that are not routed through Washington and that act as a counterbalance to federal activity." 79

Interstate activism has been on the upswing, and this year states pushed forward on several policy fronts, some of which directly challenge the federal government. The states have been especially assertive in three policy areas all related to their relationships with the corporate world: (1) actions prompted by losses states suffered in the stock market, (2) battles over energy policy, and (3) the federal government's continued push to deregulate. Each of these policy areas has prompted several states to take new and often surprisingly strong stands.

During the past year, public pension funds have lost more than $1 billion because of corporate malfeasance. The nation's largest pension fund, the California Public Employees Retirement System (Calpers), lost $565 million

on the collapse of Worldcom's stock. The losses in other states' pension funds are equally staggering: New York—$300 million; Wisconsin—$36.3 million; Michigan—$116 million; Iowa—$33 million. These losses are in addition to previous-year losses. The total amount that vanished from public pension funds from January 2000 to June 2002 has been estimated at $370 billion, or 14 percent of fund assets.\textsuperscript{81}

Given these figures, it is hardly a surprise that numerous states have gone to court not just to recoup their losses, but also to change the rules governing corporate behavior. Michael L. Fitzgerald, the Iowa treasurer, called the situation "a crisis." He went on to say: "I'm outraged. We have invested in the American marketplace and we have lost confidence. There is now no trust in people who are running these businesses. No trust in them at all. Institutional investors need to pick up the mantle of litigation. Who's watching these guys at the top? They are proving to be bald-faced liars." Tom Herndon, the executive director of the Florida State Board of Administration, stated, "The time is over for the chief executive to sit in his multimillion-dollar mansion in Aspen and laugh at all the shareholders who have lost their life savings. These people ought to be punished, and the institutional investors ought to be one of the parties to take up the cry." Given these sentiments, it is no surprise that Florida's pension fund has filed over 200 lawsuits against Enron, Alliance Capital, and several Wall Street firms.\textsuperscript{82}

Officials in California, New York, and North Carolina went so far as to announce that they would start withholding business from Wall Street firms that do not make changes to limit conflict of interest between their activities in investment banking and stock analysis. Firms that agree to the changes will be allowed to compete for various financial actions such as bond sales conducted by these states. "Those who don't will go into the penalty box," stated Philip Angelides, the treasurer of California.\textsuperscript{83}

Another area of interstate activism is the movement by state governments to counteract the continuing deregulation trend by Washington. The Bush administration's plans to loosen federal regulations in policy areas such as antitrust, banking, appliance efficiency, consumer safety, energy, environment, health care, and telecommunications have prompted numerous states to express their opposition by going to court. State officials see federal deregulation as undercutting state statutes and rules that are more stringent than new federal ones. The current round of state lawsuits is not unlike the one that occurred during the Reagan administration when efforts to relax federal rules prompted state attorneys general to band together to try to stop Washington's deregulatory activity.\textsuperscript{84}

\textsuperscript{81}Leslie Wayne, "Irate Over All the Scandals, Pension Funds Go to Court," \textit{New York Times}, 28 June 2002 (Netscape version).
\textsuperscript{82}Ibid.
A particularly long-running and bitter feud has developed between California and the Bush administration over several interrelated policies: electricity, energy, global warming, and air pollution. In each of these policy areas, California has adopted stances at odds with Washington. California's dissatisfaction with decisions by the Federal Energy Regulatory Commission (FERC) on electricity deregulation continues to fester. FERC and California spent the last year dueling over details such as the time period that power sales transactions should be subject to refunds because of overcharging as well as the duration of the temporary price restraints FERC imposed in June 2001. The uncovering of company documents demonstrating that the Enron corporation had gamed the electricity market during the power crisis of 2000 and 2001 exacerbated the tension between California and FERC, and the state increased pressure on FERC to open an inquiry into what actually transpired in the energy market. The "smoking gun" internal memos undercut the commission's earlier position on the virtues of the free market, and forced FERC to reverse course. The commission ordered nearly 150 power marketers, independent electricity generators, and energy traders to turn over a long list of company documents so that FERC could launch an investigation into the full extent of electricity price manipulation. Once the damaging memos became public, other states joined California's campaign against Enron.

California's troubles with federal electricity deregulation were not its only differences with the Bush administration. California's Democratic governor, along with Democratic officials in ten other states, attacked Bush's decision not to act to limit "greenhouse gas" emissions. One motive behind this maneuver was the opportunity to score political points after new studies again demonstrated the reality of global warming. But California's challenge of federal environmental policy also has roots in the size and strength of the environmental interest groups in the state that have made California the "center of the environmental regulatory universe," according to a spokesperson from General Motors. Environmentalists have been frustrated for years by their inability to pass federal legislation to increase fuel standards and to control automobile emissions. A bipartisan coalition of primarily midwestern members of Congress has blocked pro-environment initiatives; consequently, environmental groups targeted the nation's largest automobile market for a lobbying campaign to require new reductions in tailpipe emissions for cars and light trucks (including the highly popular sport utility vehicles). Success on this proposal prompted Governor Gray Davis and other officials to pressure the president on global warming.

For the details of electricity deregulation in California, see the article by Mary Timney in this issue of Publius; Kincaid, "The State of U.S. Federalism, 2000-2001," 54-57.


Four features of this current round of state-federal scuffling over regulatory policy are important to note. First, a number of the changes in federal regulations are the result of changes enacted by Congress, a good example is the 1999 Financial Modernization Act.\textsuperscript{88} Second, some state action reflects dissatisfaction with federal inaction in a policy area. An example is telemarketing where at least seven states have passed “Do Not Call” laws that “require telephone solicitors to avoid calling consumers who list their objections to such calls on a registry.”\textsuperscript{89} Third, state action to fill perceived voids in federal policy is not partisan; both Democratic and Republican officials are engaged in lawsuits against the federal government. Fourth, some federal officials have reached out to the states, but the general perception by state officials is that too few have.\textsuperscript{90}

An important consequence of this current battle over regulatory policy is a shift by national interest groups to lobby in state capitals. The American Association of Retired Persons (AARP), for example, recently completed building a network of 50 state offices to facilitate its lobbying activities in every state.\textsuperscript{91} Lobbyists registered in state capitals are so numerous that a recent study computed a ratio of five lobbyists to every state legislator. This same study found that in 2000, spending by registered lobbying groups in 34 states totaled $570 million, an increase of 91 percent from 1995.\textsuperscript{92}

State-federal tension, of course, is a normal feature of American federalism. So also is state government use of “police powers” to protect the health, safety, and welfare of citizens and to exercise state authority to regulate intrastate commerce and some aspects of interstate commerce. State government activism aimed at corporate malfeasance is not new; after all, state governments were in the forefront of the Populist battles with railroads and banks during the late 1800s. But today’s increased interstate activism derives from an important intergovernmental shift in where private enterprise seeks to gain advantage. For much of the twentieth century, business groups opposed federal government regulation in part because businesses could more easily influence state government actions. The rise of consumer protection and environmental interest groups challenged private enterprise’s dominance in the states, and these groups were able to transform state laws and regulations so that in many instances state standards exceeded federal ones. During the 1990s, many corporations and industries decided that a single national standard was preferable to 50 different state standards, and so reversed their stance on federal regulation in an effort to constrain state regulatory actions. Consequently, many state governments find themselves being urged by their residents to challenge federal policy

\textsuperscript{89}Labaton, "States Seek to Counter U.S. Deregulation."
\textsuperscript{90}ibid.
in areas as diverse as bank customer privacy, global warming, patent rights related to generic drugs, and predatory lending. State officials are being pressured by their constituents to use "police powers" to protect citizens by imposing regulations tougher than federal ones. Globalization of economic competition and the development of technologies that make possible nearly instantaneous transmission of commercial activity add to the intergovernmental tension over regulatory policy. The legitimate use of state "police power" clashes with the necessity of business to operate within a global marketplace characterized by reasonably uniform rules, some of which originate in international bodies such as the World Trade Organization.

The matrix of American federalism facilitates shifts in the locus of interest group activity with its consequent impact on the nature of public policy. This intergovernmental movement also can change the character of each state's policy interests and its stance toward federal policy. Efforts to provide industries with economies of scale by establishing a single national standard for a particular activity or product are not new, as the long campaign to adopt a single standard for buildings and construction attests. However as the campaign for uniform building codes also demonstrates, state (and local) governments will insist on pursuing what they perceive as their own best interest. Today's high level of interstate activism may not be a particularly well routinized form of "federalism without Washington," but it certainly is the "counterbalance to federal activity" that Elazar anticipated in his explanation of this feature of American federalism.

CONCLUSION

In November and December 2000, U.S. federalism suffered through a protracted, extra innings contest to determine the forty-third president. While the bitter battle over the legality of certain ballots in the state of Florida was certainly harmful to the electoral process and to the U.S. Supreme Court, nevertheless, it did not destroy the electoral process nor did it undermine the legitimacy of the new administration. But few knew that this political shock to American government would be followed soon afterward by a more terrible one to the whole of society. The 11 September 2001 terrorist attack on two symbols of American power—the Pentagon and the World Trade Center—thrust the country into an unwanted war with a distant and not well understood foe. The scramble to organize a response against a loose coalition of individuals with sufficient resources to commit mayhem resulted in a remarkable outpouring of patriotism as well as a new realization that government—national, state, and local—does provide solutions to many types of problems. Where once presidential candidates derided government as the problem, citizens suddenly saw the benefits of government in the form of firefighters, police officers, rescue teams, and

public health specialists. From the “first responders” at “Ground Zero,” to
the National Guard standing watch at vital facilities such as water treatment
plants, to the president and Congress uniting, if only temporarily, to devise
and execute national plans for homeland security, all elements of the
American federal system not only survived the attack, but demonstrated
the capacity and energy the system can marshal in a time of urgency.