

The State of American Federalism 2008–2009: The Presidential Election, the Economic Downturn, and the Consequences for Federalism

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The most consequential developments for American federalism in 2008–2009 were the presidential election and economic recession. After several years when states were the primary innovators on many issues that topped the policy agenda, the economic downturn drew renewed attention to federal policy-making, given the greater resources and capacities of the federal government. Although federalism was not a dominant issue in the presidential campaign, Barack Obama's election and sizable Democratic congressional gains had important implications for federal-state relations by putting federal power in the service of a different set of policy goals, encouraging state experimentation on a different set of policy issues, and producing a greater willingness to respond to state pleas for financial assistance.

The two most consequential developments for American federalism in 2008–2009 were the presidential election and a severe economic recession that began in late 2007 and is expected to last well into 2009. The recession had a clear and predictable centralizing effect. As is generally the case during wars and economic downturns, the public looked primarily to the federal government, with its greater resources and capacities, to ameliorate the economic hardships and prevent the situation from worsening. Federal officials from both parties responded, albeit with varying degrees of enthusiasm, by issuing tax rebates, rescuing banks, mortgage lenders, and auto-makers, and proposing increased federal regulation of various financial institutions. Whereas in the last several years states were the primary innovators on many policy issues that topped the political agenda, the economic downturn and prominence of economic issues in the presidential election drew renewed attention to federal policy-making.

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The consequences for federalism of the 2008 election are more complicated and only starting to fully emerge. Neither of the two major presidential candidates was prone to discuss federalism in an explicit fashion, and in winning the election Barack Obama cannot be said to have espoused a guiding approach to federal-state relations or secured a clear mandate regarding changes in the distribution of federal and state power. Nevertheless, Obama's election and sizeable Democratic congressional gains have had several implications for federalism.

First, federal power will now be put in the service of a different set of policy goals. Among other consequences, the change from Republican to Democratic control has had the predictable effect of favoring expansion of federal regulation in certain policy areas (such as regulation of greenhouse gas emissions) and limiting expansion of federal power in other areas (such as restrictions on state tort suits). Second, unified Democratic control has encouraged state experimentation on a different set of issues than was tolerated during the Bush administration, particularly by permitting state auto emission standards that exceed federal requirements as well as state expansion of coverage through the Children's Health Insurance Program (CHIP). Third, the shift in party control led to a greater willingness of the president and congress to respond to state pleas for additional funding, whether for particular programs such as Medicaid or for general emergency stabilization assistance.

Still to be determined is whether Obama will be guided by a general approach to federal-state relations. Although George W. Bush opened his presidency by professing concern for federalism and state interests, he was notably inattentive to federalism considerations in office—supporting expansion of federal authority even on issues where Republicans had traditionally deferred to state authority such as education, prescription drug coverage, driver's licenses, and welfare policy, and rarely perceiving any tension between his policy priorities and state prerogatives or concerns (Conlan and Dinan 2007). It remains to be seen how Obama will handle situations where his policy priorities are in tension with state interests, and whether he will be any more attentive than his predecessor to federalism concerns in these crucial instances. To date, however, Obama has offered several important professions of respect for states' role in the federal system, most notably in a December 2008 address to governors in Philadelphia and in a February 2009 toast to governors whom he honored by inviting them to the White House for his first presidential state dinner. Moreover, Obama and his cabinet can be expected to be sensitive to the perspective of state and local governments, as a result of the president's experience as an Illinois state legislator and his appointment of current or recent state and local office-holders to head the Departments of Education, Homeland Security, Commerce, and Health and Human Services. These developments suggest at least the possibility of a different approach to federal-state relations (Harkness 2009).

The 2008 Election and Federalism

Presidential elections have traditionally had several implications for federalism. At times, candidates have invoked federalism in an explicit fashion, as when Republican nominee Bob Dole carried a copy of the 10th Amendment and quoted from it during the 1996 campaign. Other candidates have made prominent mention of policies with important intergovernmental components, and in this sense federalism has been raised indirectly, as when the 1992 and 1996 campaigns featured prominent discussion of the federal and state roles in welfare policy. Sometimes election outcomes have produced important changes in federal policies and in ways that had significant implications for federalism. The most prominent example in recent decades was Ronald Reagan's 1980 victory, which placed on the policy agenda and led to the passage of devolutionary measures not given much consideration by the Carter administration.

Federalism in the 2008 Campaign

Although the 2008 general election campaign did not feature much explicit discussion of federalism, the candidates engaged in prominent discussion and criticism of several programs and policies with important intergovernmental dimensions, especially in the Republican primary. Former Arkansas governor Mike Huckabee to some extent and U.S. Representative Ron Paul (R-TX) to a greater extent questioned whether various programs should be undertaken at the federal or state level. Paul was a particularly ardent critic of the federal mandates contained in the REAL ID Act (*Union Leader* 2007), thereby expressing support for the wide-range of federalism and libertarian critiques of this driver's license requirement that Priscilla Regan and Christopher Deering discuss in their article in this issue. Fred Thompson went further than any candidate in 2008, or for that matter any recent presidential election, in making federalism a prominent issue in his short-lived nominating campaign. While in the senate from 1995 to 2003, Thompson often invoked federalism principles when objecting to growth in federal power. In fact, he was so committed to these principles that he was a rare example of an official willing to oppose his own party on core policy issues such as federalization of crime, tort reform, and social issues, because he objected to regulating them at the federal level (Dinan 2004, 45–46, 59–62). Thompson was just as outspoken in his 2008 campaign in defense of federalism principles and opposition to Republican policies that conflicted with them, going so far as to say that the principle of federalism was for him “a lodestar” (Thompson 2007). However, after a period in summer 2007 when polls showed him leading the Republican field, he failed to win a single primary.

Once the general election campaign got under way, neither Obama nor John McCain invoked federalism principles in an explicit fashion with any frequency.

McCain did make occasional reference to his support for decentralization in the course of defending his opposition to a federal same-sex marriage ban and his support for lifting a federal moratorium on offshore drilling. As he explained in each case, “I am a federalist” and therefore supported the capacity of states to decide these sorts of questions (Foust 2008; CNN 2008). For the most part, though, federalism was not raised in a prominent or explicit manner in the general election. Rather, the campaign focused predominantly on the economy (how to respond to the financial downturn that escalated in the fall) and competing tax policies (whether to repeal the Bush tax cuts of 2001 and 2003 and adopt new targeted tax cuts for low and middle-income earners), and with some attention to foreign policy (how quickly to leave Iraq and under what conditions).

The candidates did frequently propose changes in policies with important intergovernmental dimensions, and this led indirectly to discussion about the distribution of federal and state power. At times, the candidates stood together in criticizing federal policies for unduly limiting state discretion or in advocating more federal regulation. A prime example of the former was the candidates’ bipartisan opposition to the Bush administration Environmental Protection Agency (EPA) denial of a Clean Air Act waiver to California to allow it and other states to enact more stringent auto emission standards (Revkin 2008). As an example of the latter, Obama and McCain also stood together—and apart from the Bush administration—in their support for federally mandated limits on greenhouse gas emissions (Bumiller and Broder 2008).

At other times, federalism surfaced indirectly when one of the candidates criticized federal policies on the grounds that they imposed excessive burdens on state governments. On several issues, Obama led the charge against policies that he argued were burdening states with stringent requirements but were funded at inadequate levels. For instance, on education, neither Obama nor McCain attacked the core testing requirements in the No Child Left Behind (NCLB) law that has come in for much criticism from state and local officials. However, Obama did criticize the law, albeit imprecisely, on the ground that it was an “unfunded mandate,” and vowed to increase federal funding for its implementation (Roeder 2008).

At still other times, federalism surfaced indirectly when, in debating competing federal proposals, candidates drew heavily on state policy experiences. This was the case with health care reform especially. The Massachusetts universal health insurance law signed by then-Governor Mitt Romney in 2006 figured prominently in the debate, as supporters of individual mandates pointed to the Massachusetts experience as evidence of the workability of such a requirement. The Obama health care proposal, although differing in important ways from the Massachusetts program, mainly by confining mandates to children, shared a number of features of this state program (Collins et al. 2008). Meanwhile, McCain advanced a

market-based plan that shared some features of the market-based reforms implemented in Indiana and Florida (Buntin 2008). As with so many other federal policies, state experiences with health reform proposals offered a testing ground for competing proposals and illustrated their successes and pitfalls during the course of the presidential campaign.

Consequences of the 2008 Election for Federalism

In winning the popular vote by a 53–46 percent margin and claiming a 365–173 electoral college victory, Obama became the first Democratic candidate since 1976 to win a majority of the popular vote and the first since 1964 to win the Republican strongholds of Virginia and Indiana. Obama not only won the presidential election by a decisive margin and in historic fashion, but he also gained significant support in Congress as a result of Democratic gains in both houses. Democrats gained 21 seats in the House, to move to a 257–178 advantage. Even more important, because it moved them close to a filibuster-proof majority not enjoyed by either party since the late 1970s, Democrats picked up at least seven seats in the Senate to move to a 58–41 advantage, counting the two Democratic-leaning independents and pending the outcome of the disputed Minnesota senate race.

In public addresses since the 2008 election Obama has in several ways signaled a greater attentiveness to federalism principles than was evident during the Bush administration. As president-elect in December 2008 he addressed members of the National Governors Association (NGA) in Philadelphia in the organization's centennial year. Citing Justice Louis Brandeis's oft-quoted dissent in *New State Ice Co. v. Liebmann*, 285 U.S. 262 (1932), Obama celebrated the ability of "a single courageous state" to "serve as a laboratory experimenting with innovative solutions to our economic problems." He went to say: "And that's the spirit of courage and ingenuity and stick-to-it-ness that so many of you embody. That's the spirit that I want to reclaim for the country as a whole. One where states are testing ideas, where Washington is investing in what works, and where you and I are working together in partnership on behalf of the great citizens of this nation" (*Washington Post* 2008). Then, Obama chose to host the governors at the first state dinner of his presidency in February 2009, and in his toast he noted that "You're where the rubber hits the road," and promised that his "goal and aim is to make sure that we are making life easier, and not harder, for you during the time that we're here in Washington" (quoted in Silva 2009).

In the early months of his presidency, Obama took a number of opportunities to revisit Bush administration positions regarding expansion of federal authority, preemption of state policy experimentation, and fiscal support for states, and the outlines of Obama's positions are starting to emerge. First, Obama has permitted

greater state policy experimentation in several areas, including auto emissions standards and children's health programs. Second, Obama has been much more responsive to state fiscal interests, as evidenced most clearly by his support for a massive stimulus package containing significant state aid. Third, and as discussed in the next part of this essay, Obama has put federal power and resources in the service of a different set of policy goals, particularly regarding energy conservation and environmental protection.

Obama reversed Bush administration policy in such a way as to expand state discretion in several areas. In January 2009, he directed the EPA to begin the process of reversing a December 2007 denial of a Clean Air Act waiver to California (Schwartz 2009), and in February 2009, he signed a CHIP (formerly SCHIP) reauthorization measure that Bush vetoed twice in an earlier form in 2007. The Children's Health Insurance Program Reauthorization Act of 2009 (CHIPRA) went even further than the earlier vetoed bills in granting discretion to states to insure legal immigrants immediately rather than waiting five years. Moreover, upon signing the law, Obama directed the Centers for Medicare and Medicaid Services (CMS) to withdraw an August 2007 Bush administration directive preventing states from using federal CHIP funds to cover children in families making above 250 percent of the Federal Poverty Level (FPL). The Obama memo restored states' ability to cover children above this income level, although federal matching funds will be reduced for states choosing for the first time to cover children in families above 300 percent of FPL (Center for Children and Families 2009). In another departure from Bush administration policy, in March 2009 Attorney General Eric Holder announced that the Drug Enforcement Administration would discontinue raids on medical marijuana dispensaries in the thirteen states that have legalized medical marijuana, as long as distributors operate in accord with these state laws (Johnston and Lewis 2009).

It is important not to overstate Obama's support for state experimentation. As James E. Tierney, director of the National State Attorneys General Program at Columbia University, noted after the EPA policy shift was announced: "I don't think we have a hallmark, sweeping view of states' rights here." Rather, Tierney argued, "the Obama administration is going to take these one at a time" and "will be with the states as long as the states fit in with his view of the national interest" (quoted in Schwartz 2009). However, the political dynamics at the start of this administration are aligned so that liberal and progressive causes are in several areas currently being advanced by decentralization of policy authority. Insofar as these sorts of issues remain atop the policy agenda, Obama will continue to be in a position to both advance his party's policy goals and support policy decentralization.

Regarding attentiveness to state fiscal interests, Obama signaled a change from Bush administration policy by promoting and in February 2009 signing a stimulus package containing substantial aid to states in the form of Medicaid payments and

school and infrastructure spending, among other grants. The Bush administration was generally unsympathetic to state government pleas for financial assistance with budget shortfalls. In 2003, Bush only belatedly supported a \$20 billion state aid package that amounted to much less than state officials had sought (Krane 2003, 11, 31–34). Then, in late 2008, the administration generally opposed efforts by congressional Democrats to pass a stimulus package containing aid for state governments (Clarke 2008). However, in his first month in office Obama made a big push for a stimulus package that was responsive in many ways to state pleas for financial assistance.

The key objective of Obama's proposed stimulus plan was to create at least 3 million jobs by the end of 2010 (Romer and Bernstein 2009). The President's strategy in presenting his plans to Congress was to stress the job creation goals and not the details of the plan initially, and he stayed with this message, allowing House Democrats to write much of the initial bill (Weisman and Bendavid 2009). Eventually a compromise conference bill between the House and the Senate was approved, winning three Senate Republican votes and all Democratic Senate votes; but no Republican lawmakers in the House supported the bill and seven House Democrats voted against the bill. Mayors were strongly supportive of the bill, as were a large number of interest groups representing both business and labor interests.

Several Republican governors—Arnold Schwarzenegger (CA), Charlie Crist (FL), Jim Douglas (VT), and Jodi Rell (CT)—supported the final bill, the American Recovery and Reinvestment Act of 2009 (ARRA). Other Republican governors such as Mark Sanford (SC), Bobby Jindal (LA), and Rick Perry (TX) expressed concern that the temporary federal grants will create new and expanded state programs and once federal funding ends, states will be responsible for funding them in the future. In fact, several governors announced plans not to accept the added unemployment insurance benefit funding, on the ground that a provision in the ARRA could require states to make permanent statutory changes regarding unemployment programs and eligibility. Sanford and 2008 Republican vice presidential candidate Sarah Palin (AK) went further in saying they would not commit to accepting the totality of the sizeable fiscal stabilization funds available to their states (Dewan 2009). Another ARRA provision, inserted by Rep. James Clyburn (D-SC) after Sanford vowed not to accept some of the funding, stipulates that if a governor does not apply for ARRA funds the state legislature may override this decision and accept the money on behalf of the state. However, Office of Management and Budget Director Peter Orszag advised that although the Clyburn provision applies to most ARRA funds it does not permit state legislatures to apply for fiscal stabilization funds over a gubernatorial objection (Phillips 2009). In the end, all governors opted to file an initial application for funds by an April 3, 2009 deadline, although in a few instances this merely put off for later the question of exactly which funds they will end up taking.

The ARRA, signed by President Obama in Denver, has a net deficit impact of \$787.24 billion. It provides for approximately 39 percent increase in federal appropriation outlays (\$308.48 billion for discretionary programs), 34 percent increase in direct spending outlays (\$266.96 billion in direct spending programs, including some tax credits) and 27 percent allocated to revenue provisions (\$211.8 in net revenue decline) [Congressional Budget Office (CBO) 2009b].¹

The ARRA's discretionary programs had two goals: to provide one-time increases and lay the basis for long-term growth. The one-time increases include funding for creating jobs or preventing retrenchments of existing jobs and providing fiscal relief to states to offset pro-cyclical measures typical in state budgets (states being forced by constitutional provisions to balance their budgets). Long-term growth was encouraged through investments in infrastructure projects, information technology upgrades, clean energy, energy efficiency and human capital. A state fiscal stabilization block grant is created under the ARRA with a substantial portion targeted to restore displaced education spending in K-12 schools and higher education institutions (National Governors Association 2009). The remaining allocations of the block grant are for public safety, building, repair and modernization of education facilities and other government services. In the case of infrastructure projects the emphasis is to fund "shovel ready projects" for the quickest employment and income generation boost from the additional spending. These include, but are not limited to, highway restoration, repair and construction, transit projects, railroad, air transportation facilities and assistance to shipyards, housing assistance programs, water resource development and other environmental projects (National Conference of State Legislatures 2009). Various energy programs have also received allocations of ARRA discretionary funds.

The fiscal stabilization block grant is distributed to states, for use by 2011, primarily using the state's total population and its population in the age 5–24 years along with various conditions relating to maintenance of effort, performance and reporting. The money is distributed within states using the existing formulae for the relevant programs. The infrastructure and energy funds are partly channeled through existing programs and their respective federal formulas for funding (in some cases the existing formula is modified to target the funds as needed) and also awarded on a competitive basis (National Governors Association 2009). Some ARRA funds are distributed directly to local governments, whether through established formulas or competitive grant processes.

In the direct spending programs the emphasis is to provide a temporary increase in federal matching of state and local spending to help states maintain their Medicaid and other entitlement programs in the face of revenue declines and caseload increases; temporary expansion of benefits in unemployment insurance, various nutrition assistance programs, and child care and early education programs; and expanded coverage of individuals under TANF, as well as creation of

a new emergency contingency fund for TANF with funding till 2010. The defining feature of these direct spending measures is that they hold all states harmless in the FMAP (federal medical assistance percentage) formula. The distribution of funds is slanted towards states that are experiencing particularly poor economic conditions (based on unemployment figures) and towards states that make a greater effort. The key provisions for direct spending added under ARRA are sunset in 2010 (National Conference of State Legislatures 2009, National Governors Association 2009).

The tax provisions of ARRA are targeted at both individuals and businesses (U.S. Senate 2009). The cornerstone of individual tax relief is the “Making Work Pay” (MWP) tax credit, a refundable tax credit for individuals or married couples filing jointly in 2009 and 2010 (the credit is calculated at the rate of 6.2 percent of earned income and phases out at \$75,000 for single individuals or \$150,000 for married couples filing jointly). The MWP credit can be claimed as a reduction in withholding of income tax from their paychecks or as credit on the income tax returns in these two years. Other income support provisions include a temporary increase in the percentage of income that can be claimed as earned income tax credit (EITC), an increase in the income at which the EITC is phased out and suspension of tax on a portion of the unemployment compensation. A variety of time-bound tax credits and tax deductions targeted at selected areas of spending and individuals are also included (first-time homebuyers credit; sales tax deduction for vehicle purchases, tax credits for child care, education spending credits, renewable energy, energy efficiency and advanced energy technology investment credits). Finally, the Act includes tax credits designed to improve the marketability of tax exempt bonds and clean and renewable energy bonds as well as some targeted tax relief measures for businesses.²

The Intergovernmental Policy Mix

In some respects, federal policy making in 2008 and 2009 was characterized by consistency in that the federal government took the lead in enacting legislative responses to the economic downturn. Even before President Obama signed the \$787 billion stimulus package in February 2009, Congress had already enacted statutes giving rebates to taxpayers, helping homeowners, and bailing out financial institutions and easing the credit crunch. Pressure also began to build for greater federal regulation of banks and other financial institutions, including mortgage brokers and insurance companies that have long been regulated by state governments.

In other respects, federal policy-making was characterized by discontinuity, in that the Obama administration in early 2009 made important changes to Bush administration policies from 2008 and previous years, and with various effects on

state governments. In particular, Obama was more willing than his predecessor to put federal power and resources in the service of policy goals such as promoting a more energy-efficient economy and providing financial assistance to states for particular programs.

The Economic Downturn

It is no surprise that in times of serious economic difficulty, the public looks to the federal government rather than state governments for a response. In the last several years, state governments had been the chief innovators on many policy items that topped the public agenda, including health care and immigration (Dinan 2008). However, the severity of the current recession ensured that the federal government would assume renewed importance in taking steps to shore up numerous economic sectors.

The CBO forecasts that the current recession, which began in late 2007, will last well into 2009 (CBO 2009a). Among the indicators of the severity of the downturn, the unemployment rate dropped from 4.4 percent in the fourth quarter of 2007 to 7.6 percent in the first month of 2009. Non-farm payroll employment declined by nearly 3.6 million jobs during this period. In fact, in January 2009, the economy registered its largest monthly drop in employment since 1974. Real GDP declined at the rate of 2.2 percent during FY 2008, and CBO forecasts only a slow recovery by the end of 2009, and this is expected to continue during FY 2010, with unemployment expected to reach 9 percent or higher in early 2010. The housing market is especially bleak, with further declines expected in national average home prices into 2010 and with the imbalance between the supply and demand for homes predicted to persist.

Congressional responses to this downturn took a number of forms in 2008. In February, Congress and President Bush responded to a slowing economy by putting money directly in the hands of taxpayers. At the center of this \$152 billion Economic Stimulus Act were tax rebate checks of up to \$600 for individuals and \$1200 to couples that were sent out in the spring and summer of the year (Baumann 2008). This was followed by congressional efforts to respond to the rising unemployment rate by extending unemployment benefits in June, then again in November, and finally as part of the February 2009 stimulus package.

In July 2008, Congress sought to respond to the sub-prime mortgage crisis and increasing number of mortgage foreclosures by passing the Housing and Economic Recovery Act. Some \$300 billion was made available to the Federal Housing Administration to help homeowners refinance their loans. The Treasury Department was given authority to bail out Fannie Mae and Freddie Mac. And, in a provision that President Bush initially threatened to veto but eventually opted to accept as part of the broader package, local governments were given

\$4 billion in grants for use in purchasing and then rehabilitating foreclosed houses (Baumann 2008).

In October 2008, after Lehman Brothers collapsed, Merrill Lynch was rescued by Bank of America, and Wachovia was bought by Wells Fargo, Congress approved the Emergency Economic Stabilization Act. The centerpiece of this package was a \$700 billion Troubled Assets Relief Program (TARP) initially designed to authorize the Treasury Secretary to purchase troubled securities in order to open up the credit market and encourage lending (CQ Annual Report 2008, 3270). In a two-stage plan, \$350 billion was made available immediately in October 2008, with the other \$350 billion to be released later upon presidential request and congressional acquiescence, which took place in January 2009.

December 2008 brought calls for a bailout of the domestic auto industry, particularly General Motors and Chrysler. Although the House approved a bailout package, it soon became clear that the measure as drafted could not secure the necessary sixty votes in the Senate, and so the legislation stalled. At that point, President Bush authorized the immediate use of \$13.4 billion in TARP funds to stabilize General Motors and Chrysler, as well as a possible additional \$4 billion in the spring, thereby rendering unnecessary any further congressional action (Sanger et al. 2008).

In each of these areas, it was widely expected that the federal government would be the chief actor, largely because of the national scope of the problems and greater resources and capacities of the federal government. It is true that a number of state governments took action in response to the mortgage foreclosure problem. And of course state officials were tasked with responding to their own budget deficits caused to a great degree by the economic downturn. For the most part, however, the federal government was the primary actor in responding to many of these economic problems, with federal policy-makers undertaking a series of sustained and aggressive interventions. This activity was capped by the February 2009 passage of a stimulus package that the *New York Times* described on the day of its passage as “a striking return of big government” (Herszenhorn 2009). And this was followed by Obama’s unveiling later in the month of his housing plan, a \$275 billion measure whose centerpiece is a \$75 billion investment—drawn from the financial industry bailout funds—that would be dedicated to keeping homeowners in their houses.

Moreover, momentum began to build for still other federal government action regarding additional financial sectors, especially banks, mortgage brokers, and insurance companies, the latter of which have traditionally been regulated primarily by state governments (Ehrenhalt 2008). Bush’s Treasury Secretary Henry Paulson announced a reform blueprint in March 2008 that would have reconfigured the complex system and various agencies responsible for regulating banks (Kettl 2008). During his confirmation hearings, Obama’s Treasury Secretary Timothy Geithner

promised new federal regulations of mortgage brokers, who have long been regulated primarily by the states (Labaton 2009). Some members of Congress also advanced yet another round of proposals for federal regulation of the insurance industry, which Congress has long permitted to be regulated at the state level but has revisited periodically (Calmes 2008). In March 2009, Geithner unveiled a comprehensive plan to tighten federal financial regulation. The plan envisions a new federal authority—an as yet unidentified “systemic risk regulator”—to oversee institutions considered “too big to fail.” He called on congress to empower federal officials to take control of and restructure non-bank financial entities (hedge funds and private equity firms) that are typically designed to operate outside of regulatory structures; they would have to register with the Securities and Exchange Commission and disclose information about their risk management practices. The plan also seeks for the first time to regulate derivative instruments such as credit default swaps, which were seen by financial analysts as contributing significantly to the need for a federal bailout of American International Group (AIG) and Bear Stearns. Geithner also urged broad federal regulation of corporate executive compensation and not only for firms receiving federal bailout money (Andrews 2009).

Energy and the Environment

Regarding energy policy, which promises to shift significantly in the Obama administration, a major battle in the summer of 2008 concerned whether to lift a longstanding federal ban on off-shore oil drilling. Especially once gas prices jumped above \$4 a gallon in July, congressional and presidential candidates and the general public began considering ways to increase domestic energy production. One proposal that attracted public support was ending the longstanding federal offshore drilling moratorium, which applied to all areas except the Gulf Coast of Texas, Louisiana, Mississippi, and Alabama, and a portion of the Alaska coastline. Congress first imposed this moratorium in 1981 and extended it every year since then. President George H. W. Bush supplemented this legislation by issuing an executive order in 1990 that prevented the Interior Department from allowing offshore oil leasing through 2000; this was renewed and extended until 2012 by President Clinton in 1998 (Stolberg 2008). As support for lifting the ban grew in the summer of 2008, President Bush repealed the original 1990 executive order. Then, after much legislative wrangling, with most Republicans opposing the ban and many Democrats seeking ways to retain it in some fashion, Congress chose not to include the legislative moratorium in its FY 2009 Interior Appropriations bill (CQ Annual Report 2008, 3274).

As one would expect, any change in oil drilling policy affecting states not currently permitting drilling is likely to generate significant controversy among

executive and legislative officials in the affected states. Consequently the mere lifting of the ban does not mean that more drilling will actually be undertaken in many instances. Moreover, although in the presidential campaign Obama eventually came around to expressing some support for lifting the ban, as did McCain, he was hardly enthusiastic. And once in office Obama reverted to a position of skepticism about the benefits, as illustrated by Interior Secretary Ken Salazar's announcement in February 2009 that he was delaying a late-hour Bush administration plan to permit new oil leasing off of many of the new coastal areas (LoBianco 2009).

Another summer 2008 congressional battle pitted mostly Democratic supporters of federally mandated limits on greenhouse gas emissions against mostly Republican critics of federal action. In a week-long Senate debate in early June, supporters of federal climate change legislation touted the benefits of relying mostly on a cap-and-trade system to reduce greenhouse gas emissions by two-thirds from current levels by 2050. The measure would have also increased funding and research for renewable energy sources and promoted energy efficiency and conservation. However, needing sixty votes to advance the legislation, only forty-eight senators voted to invoke cloture, thereby stalling the measure (Herszenhorn 2008).

Obama's election and sizeable Democratic Senate gains in the 2008 election increase the likelihood of enacting a federal climate change bill in the 111th Congress. The ARRA contained \$45 billion in spending and tax credits designed to promote energy efficiency and renewable energy sources (Herszenhorn 2009). Moreover, Obama officials continued pushing for federally mandated limits on greenhouse gas emissions. This could be achieved through enactment of a statutory cap-and-trade system (Tankersley 2009). It could also be achieved in part through EPA administrative action to respond to the U.S. Supreme Court's 2007 decision in *Massachusetts v. EPA* by designating carbon dioxide as a pollutant that endangers public health and welfare under the Clean Air Act (Broder 2009). Such a finding by EPA Administrator Lisa Jackson would likely be followed by EPA regulations setting carbon dioxide standards and leading in turn to a series of regulatory and legislative actions geared to meeting these standards.

Health and Welfare

Federal policy-makers provided substantial financial assistance to states for implementation of federal health and welfare programs in 2008–2009, especially through additional funding in the ARRA. The Bush administration also granted one state an unprecedented degree of discretion regarding Medicaid policy-making. Bush administration actions also limited state discretion in several other respects, such as regarding new TANF requirements and adoption of a “provider conscience” rule that the Obama administration moved quickly to withdraw.

Congress and the Centers for Medicare and Medicaid Services (CMS) granted states more discretion and funding regarding Medicaid on several occasions in 2008–2009. CMS issued numerous Medicaid waivers throughout the Bush presidency (Weissert and Weissert 2008), and in December 2008 approved Rhode Island's request for a Global Consumer Choice Compact Waiver that goes even further than previous state waivers in granting considerable flexibility. The waiver, negotiated by Governor Donald Carcieri (R-RI), is unprecedented—a recent Vermont waiver comes closest in character—in setting an overall cap on federal and state spending on Medicaid over a five-year period (Solomon 2008). It also gives Rhode Island officials significant discretion regarding eligibility, coverage, and co-payments (Peoples 2008). Meanwhile, Congress allocated \$87 billion more in Medicaid spending over the next two years and extended through June 2009 moratoriums on seven CMS rules that limited federal reimbursements for a range of Medicaid services and were strongly opposed by state officials.

Regarding TANF, states lost some discretion in 2008 as a result of regulations issued by the Bush Administration's Health and Human Services (HHS) Secretary; but they gained significant funding as a result of the Obama-backed stimulus package in early 2009. HHS has in recent years issued several regulations pursuant to the Deficit Reduction Act of 2005 that have limited state discretion regarding TANF, and in 2008 HHS announced another regulation that governors opposed on this ground. In particular, HHS sought to repeal a 1999 rule giving states "caseload reduction credit for maintenance of effort (MOE) expenditures in excess of what is required by statute" (NGA 2008). States sought to retain the existing rule that was more advantageous to them. States did not make any progress with the Bush administration on this matter. However, they did gain substantial help with additional TANF funding (\$3 billion over two years) in the ARRA, which commits the federal government to cover 80 percent of the cost of assisting each new family enrolled during this period. The ARRA also "modifies the caseload reduction credit states receive toward their TANF work participation," so that a state's "credit will not be reduced for any caseload increases" during this time (Falk 2009).

Still another policy shift due to the change in party control concerned the Bush administration's issuance of a "provider conscience" rule in late 2008 and the Obama administration's move to rescind the rule in early 2009. This HHS regulation requires medical facilities that receive federal funds to honor the religious or moral objections of practitioners who refuse to participate in providing abortion, contraception or other procedures. State officials objected to this regulation in part on the ground that it conflicted with state laws requiring availability of these medical services. In fact, in January 2009 Connecticut Attorney General Richard Blumenthal filed a lawsuit in the U.S. District Court of Connecticut on behalf of his state and six others seeking to block enforcement of the rule (Stein 2009). In February 2009, the Obama administration began

the process of withdrawing the rule, with an eye toward rewriting or repealing it (Levey 2009).

Education

In contrast with other federal policies likely to undergo significant transformation as a result of Obama assuming the presidency, education policy may undergo less momentous changes. The ARRA provided the states with \$13 billion in Title I funding, \$13 billion in Individuals with Disabilities Education Act (IDEA) money, and \$53.6 billion in fiscal stabilization funds, of which \$5 billion will be distributed by the Education Secretary through a new discretionary “Race to the Top” innovation fund (Quaid 2009). And as a condition of accepting fiscal stabilization funds, states must maintain their elementary, secondary, and higher education spending in FY 2009, 2010, and 2011 at least at their FY 2006 levels. However, in the first few months of his administration, Obama and his Education Secretary Arne Duncan announced no major planned changes in the No Child Left Behind Act (NCLB), and this can be seen as consistent with Obama’s campaign statements that called for more funding but largely steered clear of criticizing a law that has generated much opposition from state officials and educators.

Under the Bush administration, reauthorization of NCLB was postponed in 2008 for another year, and neither Congress nor Education Secretary Margaret Spellings made major changes in NCLB requirements. Spellings did announce in July 2008 that she was permitting six states—Florida, Georgia, Indiana, Illinois, Maryland, and Ohio—to participate in a Differentiated Accountability pilot project that she launched earlier in the year. She then added three more states to the pilot program in January 2009: Arkansas, Louisiana, and New York. This project gives participating states more flexibility in distinguishing between the assistance appropriate for schools in need of dramatic improvement as compared with schools that are only narrowly failing to meet NCLB targets (U.S. Department of Education 2009). Spellings also proposed a new rule in April 2008 that was published in October 2008 and requires states by 2013 to calculate graduation rates according to a uniform system (Fagan 2008).

Of particular importance was a May 2008 6th Circuit Court of Appeals announcement that it will rehear *en banc* a two-one panel decision in *Pontiac v. Spellings*, 2008 U.S. App. LEXIS 198 (6th Cir. 2008), which held that NCLB does not give state and local officials “clear notice” of their costs and obligations as a result of accepting federal education funds. U.S. District Judge Bernard Friedman of the Eastern District of Michigan originally ruled in November 2005 for Spellings and against the National Education Association chapters and local school district plaintiffs. A 6th Circuit panel decision in January 2008 reversed and remanded this ruling. The full 6th Circuit announcement that it will rehear the case *en banc* has

the effect of vacating this panel decision and allowing another look at whether NCLB runs afoul of the Supreme Court's spending clause precedents (Derthick 2008).

Although federal policy-making for K-12 education usually attracts most interest, the 2008 reauthorization of the Higher Education Act of 1965 turned attention to the federal role in regulating colleges and universities. Two aspects of the Higher Education Opportunity Act of 2008 (HEOA) are particularly notable for federal-state relations. One notable feature of the Higher Education Act reauthorization, as Robert Lowry discusses in his article in this volume, is the absence of any requirements for reporting of post-secondary student learning outcomes of the sort required of K-12 schools. In fact, the HEOA prohibits the Education Department from directing accreditation agencies to collect data on student learning outcomes. Second, although Congress eventually watered down an even more stringent Maintenance of Effort requirement proposed earlier in the reauthorization process, the law includes several new reporting requirements and directives designed to control student costs (CQ Annual Report 2008, 3272–3273). The Education Department is now required to rank tuition and fees increases at colleges and universities in various categories, to list the schools that post the highest 5 percent of increases, and to require these high-ranking institutions to explain their increases and their efforts to control future costs. Additionally, any state whose higher education spending in a given year falls below that state's average over the last five years will face a penalty. Under the original proposal, which was heavily criticized by state officials, states would have lost a portion of their funding through the Leveraging Educational Assistance Partnership (LEAP) program, which would have been a meaningful penalty. The final version only penalizes states by rendering them ineligible to compete for money from a new College Access Challenge Grant program that has not yet been funded (Khadaroo 2008).

The States

Of particular importance for state politics in 2008 were gubernatorial elections in 11 states, legislative elections in 44 states, and ballot measures regarding contested policy issues in various states. State governments continued to serve as innovators in several policy areas, especially regarding election administration, immigration, the environment, and transportation, albeit not always in such an active or high-profile fashion as in the last several years (Krane 2007). The most important state-level developments this past year were the severe budget shortfalls that forced significant cutbacks in all but a few states.

Elections

Gubernatorial changes in 2008–2009 came more from scandals and appointments than elections. In March 2008, New York Governor Eliot Spitzer resigned after

news reports linked him to a prostitution ring, and he was succeeded by Lieutenant Governor David Paterson, the first African-American to serve in that post. In January 2009, Illinois Governor Rod Blagojevich was impeached and removed from office after U.S. Attorney Patrick Fitzgerald released audio-tapes indicating that he had been trying to sell the senate seat vacated by Barack Obama. Blagojevich became the eighth governor in U.S. history to be impeached and removed, and the first since Arizona Governor Evan Meachem in 1988, and he was succeeded by Lieutenant Governor Patrick Quinn (Associated Press Online 2009). Meanwhile, when President Obama nominated Democratic Arizona Governor Janet Napolitano to serve as Secretary of Homeland Security and she was confirmed in January 2009, Republican Secretary of State Jan Brewer succeeded her, as required by the unusual Arizona gubernatorial succession procedure. Only one governorship changed party control in the November 2008 election, when Missouri elected Democrat Jay Nixon to replace a Republican governor.

Legislative elections held in all but six states in 2008 brought more change in party control of statehouses and in a manner that generally reinforced the two parties' current regional strengths. Democrats continued to make gains in the Northeast, where they won a majority in the Delaware house and a majority in the New York senate, which they have not controlled since 1965. Democrats also made gains in the Midwest, where they secured majorities in the lower houses of the Ohio and Wisconsin legislatures. Meanwhile, Republicans strengthened their position in the South, winning both houses of the Tennessee legislature for the first time since Reconstruction and picking up a majority of seats in the Oklahoma senate for the first time ever. Legislative elections in the West produced mixed results. Democrats picked up a majority in the Nevada senate; but Republicans gained a majority in the Montana senate, pulled even in the Montana house, and gained a majority in the Alaska senate.

As has been the norm in recent years, ballot measures generated some of the most expensive campaigns in 2008 and featured discussion of several controversial policy issues that are debated primarily at the state level but have intergovernmental implications and occasionally challenge federal policy (Ferraiolo 2008). Same-sex marriage bans fared well at the ballot box. In the most expensive campaign in 2008 aside from the presidential election—the two sides together raised over \$83 million—California voters narrowly approved a same-sex marriage ban that overturned a May 2008 California supreme court decision requiring legalization of same-sex marriage (Leff 2009). Florida and Arizona voters also approved constitutional amendments banning same-sex marriage in 2008, bringing to thirty the number of states with same-sex marriage amendments, and leaving four states that legalize same-sex marriage: Massachusetts as a result of a 2003 court ruling, Connecticut by virtue of an October 2008 court ruling, Iowa after an April 2009 court decision, and Vermont through passage of an April 2009 statute to take effect

in September. Meanwhile, Washington in 2008 joined Oregon as only the second state to legalize physician-assisted suicide, in both cases via the initiative process.³

Voting and Election Administration

For much of 2008–2009, states were the main innovators in a range of voting reform and electoral administration issues. As Alec Ewald discusses in his article in this volume, states retain a great deal of discretion about whether to disqualify felons from voting, and several states have taken steps in the last decade to ease longstanding felon disenfranchisement rules. This activity continued in 2008 (ACLU 2008). A number of states made it easier to vote, whether by instituting election-day registration or allowing voting over an extended period prior to election day. Iowa and Montana voters were able for the first time in a presidential election to register and vote on election day, thereby joining the six states that already offer election-day registration, along with North Dakota where no voter registration is required. North Carolina and Ohio voters were able for the first time in a presidential election to register and vote on the same day during an early voting period but not on election day itself. Some of these electoral reforms, particularly the combined same-day registration/early voting reforms, were credited with producing notable turnout gains (McDonald 2008, 5). All told, over 61 percent of individuals eligible to vote actually turned out to vote in the 2008 election, reflecting a slight gain over the already high 2004 rate and marking the highest rate since 1968 (McDonald 2008).

States also retain a good deal of discretion over when to hold their presidential nominating contests, and in 2008 Michigan and Florida became entangled in a major controversy when they held their primaries in January, prior to the Democratic National Committee's (DNC) scheduling window. Hillary Clinton defeated Obama handily in Florida and won a majority of the vote in a Michigan race where Obama's name did not even appear on the ballot, at his request. Consequently, it was in Clinton's interest to press for relaxation of DNC rules to permit full representation of the Michigan and Florida delegations at the Democratic National Convention. By contrast, Obama supporters had a clear interest in enforcing party rules, because doing so would help him clinch the nomination. The DNC Rules and Bylaws Committee met in May 2008 and awarded the Michigan and Florida delegates half-votes, which was not enough to give Clinton the upper hand in the nominating contest, and she conceded soon afterward. Then at the convention in August 2008, Obama as the presumptive nominee allowed the entire Michigan and Florida delegations to enjoy full voting privileges. The resolution of this latest controversy between states and national parties demonstrates once again that although the national parties hold the dominant position in a strict legal sense, states have generally been able to challenge national party scheduling rules and prevail in the end (Busch 2008, 545–546).

State legislatures also retain full discretion over how to award their electoral votes, with two states currently permitting a split in their electoral votes and four states taking the lead in adopting a scheme designed to circumvent the electoral college. Maine (since 1969) and Nebraska (since 1992) have adopted a congressional district plan, where candidates win an electoral vote for each congressional district in which they win a plurality, even if another candidate wins a plurality in the state as a whole. The 2008 election marked the first time that either state actually split its electoral votes, when Obama claimed one of Nebraska's five electoral votes. Meanwhile, by the end of 2008, New Jersey, Maryland, Hawaii, and Illinois (which together award fifty electoral votes) had all approved legislation adopting a National Popular Vote (NPV) plan, whereby participating states form an interstate compact and agree to allocate their electoral votes to the winner of a plurality of the popular votes cast in the entire country. The plan is set to take effect once NPV legislation is enacted in states awarding at least 270 electoral votes, the minimum required to win the presidency.

Immigration Policy

States and localities in 2008–2009 continued to adopt immigration-related measures, as Lina Newton and Brian Adams discuss in their article for this volume, in part because federal law provides many openings for states to exercise regulatory power in this area. State legislatures in 2008 considered 1,305 immigrant-related bills, and a total of 205 laws were enacted in 41 states. This level of state activism on immigration measures is slightly below the level in 2007, when 240 laws were enacted. But it far exceeds the more modest levels of activity as recently as 2005 and 2006 (NCSL 2008c). South Carolina, Utah, and Missouri enacted the most significant immigration statutes in 2008, relying on a mix of employer sanctions, benefit limits, and bans on local sanctuary policies, among other provisions (NCSL 2008d).

Even more important in 2008–2009 than continued passage of state and local immigration measures were federal court decisions regarding legal challenges to these measures. Federal courts have issued mixed rulings to date on whether these measures are preempted by federal law, and this pattern continued this past year. Most important, a 9th Circuit Court of Appeals panel in September 2008 in *CPLC v. Napolitano*, No. 07-17274 (9th Cir. 2008) upheld the Legal Arizona Workers Act of 2007, which requires employers to use the federal government's E-Verify database to check the legal status of prospective workers and threatens businesses that hire illegal workers with the loss of their licenses. In rejecting a facial challenge to the state law, the court rejected claims that it was preempted by the federal Immigration Reform and Control Act of 1986 and Illegal Immigration Reform and Immigrant Responsibility Act of 1996. This 9th Circuit ruling followed a similar

ruling by a U.S. District Court Judge for the Eastern District Missouri in February 2008 rejecting a preemption challenge to a city ordinance that also sanctioned employers for hiring illegal workers (*Gray v. City of Valley Park* [E.D. Mo. 2008]). However, opponents of state and local immigration measures also won a partial victory in June 2008 when a U.S. District Court Judge for the Western District of Oklahoma enjoined enforcement of a portion of a 2007 Oklahoma law requiring employers doing business with the state to use the E-Verify system.

Environmental Policy

State and local activism also continued in 2008–2009 regarding environmental protection, in part through passage of additional legislation and regional cooperation. In October 2008 President Bush signed the Great Lakes-St. Lawrence River Basin Water Compact, whereby eight states agreed to collectively manage these water sources and not divert them outside of the region (Walters 2008). Several states enacted statutes limiting greenhouse gas emissions or requiring greater use of renewable energy sources (Prah 2008). Of particular importance was the inaugural auction of carbon emission allowances held in September 2008 by the ten Northeastern states that now make up the Regional Greenhouse Gas Initiative (RGGI) (Arrandale 2008). The RGGI is one of three regional climate change initiatives, along with the Midwestern Regional Greenhouse Gas Reduction Accord (comprised of six states and one Canadian province) and the Western Climate Initiative (comprised of seven states and four Canadian provinces) (Scheppach 2008). Moreover, as Kirsten Engel argues in her article in this volume, state and local activism on climate change can be expected to persist even if the federal government should enact a comprehensive climate change policy.

State activism on environmental policy also took the form of filing federal lawsuits intended at times to preserve state autonomy and designed at other times to force more extensive federal regulation. In a move that drew sustained attention throughout 2008, California and a number of other states sued EPA Administrator Stephen Johnson for denying in December 2007 a Clean Air Act waiver request to permit these states to set auto-emissions requirements in excess of federal standards. The D.C. Circuit Court of Appeals did not rule on the case during the year, and the suit took on less practical importance once President Obama in January 2009 ordered the EPA to revisit this issue and begin the process of approving the waiver request (Broder and Baker 2009). Additionally, twelve states and two cities followed up on a major Supreme Court ruling in *Massachusetts v. EPA*, 127 S.Ct. 1438 (2007) by filing a similar lawsuit in the D.C. Circuit Court charging the EPA with failing to rely on the Clean Air Act to limit greenhouse gas emissions from oil refineries. Finally, in a case with implications across the country, in January 2009 a U.S. District Court Judge for the Western District of

North Carolina sided with North Carolina Attorney General Roy Cooper in his challenge to the Tennessee Valley Authority for not moving quickly enough to limit emissions from coal-fired power plants in the southeast region (Rawlins 2009).

Transportation Policy

The viability of the federal highway trust fund (FHTF) has been at the heart of the debate on funding for transportation.⁴ In September of 2008, the resources in the FHTF were so low that Congress was forced to transfer \$8 billion in general revenues to the fund to prevent transportation projects from shutting down (Barkin 2008). While this most recent crisis is largely a result of the economic downturn, Americans driving less and using more fuel-efficient cars, the long-term problem is that the federal gas tax that is the main source of revenues for the trust fund has not been raised since 1993 and the tax is levied on the volume of gasoline not its value. State and local governments have been much more innovative in their use of the gas tax. Several states have indexed their gas tax rates to inflation and others use a value base or make periodic increases in the tax.⁵

Innovative financing of transportation projects, which includes public leveraging of federal grants to borrow money in private financial markets, public-private partnerships (PPP) and tolling of highways, has been widely used by state and local governments under the aegis of the federal Transportation Infrastructure Financing Innovation Act (TIFIA) (Poole 2009a). Given the exigencies of the economic situation and the virtual drying up of private investment opportunities, public-private partnerships (PPPs) are likely to flourish. Public infrastructure investment has been increasingly attractive to private businesses (as well as public pension funds) since it is a relatively risk-free long-term investment. TIFIA has allowed cash-strapped states and municipalities to use innovative contracts with private businesses to build and/or operate transportation facilities (and other infrastructure projects). Under the PPP arrangements, typically the private partner builds and operates the project (typically a toll facility) and receives the right to collect the revenues from the project as well as subsidized financing in the form of tax exempt municipal bonds. A spectrum of alternative PPP arrangements currently exists ranging from long term concessions/leases on existing toll facilities to contracts where the private firm designs, builds, operates and maintains the facility (DBO&M contracts are for a pre-specified time period and sometimes include private financing). In all these cases the facility is either transferred back to the government entity or sold to a private firm at the end of the contract period. There were several PPP projects initiated across the country in the past year; one of the larger ones is the North Tarrant Express project in the Fort Worth area.⁶ PPPs were also used for four new toll bridge projects located in various states

(Virginia, New York-New Jersey, Washington and Alaska)—all funded with full or partial private funds in exchange for in one case a perpetual franchise, in two cases a long term concession with tolling, and in the fourth case a toll facility under an Urban Partnership (Poole 2009b).

Another innovative measure that got some traction in state policy was the use of mileage-based road user fees. In February 2009 U.S. Transportation Secretary Ray LaHood promoted the idea of taxing drivers based on vehicle miles traveled (VMT) as a way to earn revenue for the FHRTF. However, White House press secretary Robert Gibbs clarified that a VMT tax will not be the policy of the Obama Administration (Caruso 2009). Several congressionally directed transportation commissions have supported this idea as a way to supplement the gas tax along with various other options (National Surface Transportation Policy and Revenue Study Commission 2008; National Surface and Transportation Infrastructure Financing Commission 2009). The VMT tax is the same as a mileage-based road user fee or a road charge. At least two states (Oregon and Washington) have pilot tested this method of raising revenue and there is a national pilot study underway at the University of Iowa that was initiated by funding from the 2005 federal highway authorization bill. While road charges have a significant initial set up cost and a relatively higher administration cost than the gas tax, they are likely to be very effective in reducing congestion. Since the technology exists for implementing road charges, differentiated by time-of-day and location, this method is likely to be tested in more states (Transportation Research Board 2006). However, most experts involved with transportation think that a VMT tax will not replace the gas tax for at least ten to fifteen years.

Housing Policy

The sub-prime mortgage crisis and rising home foreclosure rates led a number of states to impose stricter regulations on mortgage brokers and enact measures assisting homeowners facing foreclosures (Pew Center on the States and Pew Health and Human Services Program 2008; Pew Center on the States 2008). NCSL reports that twenty-nine states passed sixty-six laws in 2008 regulating mortgage licensing and cracking down on mortgage fraud (Prah 2008; NCSL 2008b). A number of states also took steps to help homeowners prevent foreclosures, whether by offering mortgage refinancing assistance or short-term loans (Tax Policy Center 2008). In addition, state attorneys general sued several lenders for engaging in predatory lending practices and forced legal settlements in which companies agreed to help homeowners facing foreclosure. The largest settlement was reached in October 2008 between eleven state attorneys general and Countrywide Financial, where the company agreed to offer \$8.4 billion in loan assistance (Morgenson 2008).

State Budgets

The most important story at the state level in 2008–2009 was that many states faced significant budget shortfalls. Though the states were able to close these gaps by drawing down reserves and implementing cuts to their fiscal 2009 budgets, the gap reopened in the first half of the 2009 fiscal year. In its fall 2008 Fiscal Survey of the States, the National Association of State Budget Officers (NASBO 2008) estimated a collective midyear shortfall of \$30 billion. The Center on Budget and Policy Priorities (CBPP) and NGA report budget deficits in forty-six states in the fiscal year 2009 with a total reported deficit of \$99 billion for fiscal year 2009, if states take no further action. State deficits are expected to grow during fiscal years 2010 and 2011 and are estimated to be approximately \$325 billion for these two years combined (McNichols and Lav 2009). It should be noted that the data on government deficits typically lag behind key economic indicators; unemployment is already 7.6 percent and is expected to rise to 9 percent, worsening the state and local fiscal situation. An important question raised by these developments, which Robert Ward and Lucy Dadayan address in their article in this issue, concerns the extent to which short-term budget deficits will convert into long-term problems of fiscal sustainability with growing mismatches between revenue and expenditure.

Forty-nine states are required constitutionally or statutorily to maintain a balanced budget from one fiscal year to the next. States are generally prohibited from using deficit financing (e.g., general obligation bond issues) to close operational shortfalls (NCSL 1999). Furthermore, they have no monetary policy tools at their disposal. Therefore, they must rely on fiscal measures—i.e., drawing down the general fund balance and rainy day reserves, raising taxes and fees, reducing operational spending—to close budgetary gaps. Following the recession and consequent state budget crises since the 1980s many states built substantial reserves to buffer against future downturns. But the current downturn has been so severe that most states have already depleted their reserves. With few remaining options, states have begun to enact sometimes drastic cuts to agency budgets and social programs. Some states are also raising taxes or enacting new taxes (the range of such measures is described below). Unlike states (and localities), the federal government has the authority to issue new debt during economic slowdowns, which it can then use to stimulate lending and consumption, as was done through the ARRA.

There is some variation in the intensity with which states are hit by the current economic recession. Apart from the current economic downturn (including the sub-prime mortgage problem and home foreclosures) and the resulting loss of tax revenue, there are also multiple causes for state budget shortfalls. State budget shortfalls are in part a product of pre-existing long-term and short-term causes and decisions taken at the state level. This also includes growing personnel costs as a

result of increases in state hiring in recent years, increased costs for state pensions, and increased health care costs for state employees. State budget shortfalls are also a product of federal policies and federal decisions. These include federal cuts in grants other than Medicaid, loss of tax revenues due to the internet tax moratorium (state taxes on internet service providers for sales in their jurisdiction), and the restrictions on state taxation of remote sales (purchases made by a state's residents in another state). Additionally, the tax policy changes made as part of the 2001 and 2003 federal tax legislation had negative effects on state revenues.⁷ Broader economic phenomena have also caused imbalances in state and local fiscal systems—increased demand for public services (including quality improvements) and reduced share of taxable items in domestic production (manufacturing base shrinking relative to services) and wealth (real property share decreasing relative to intangible personal property) (Tannenwald 2001).

A survey conducted by the CBPP (McNichols and Lav 2009; Johnson et al. 2009) shows that in response to the current economic recession, states have cut or proposed cuts in various categories of spending: on public health; programs for the elderly and disabled; K-12 education; post-secondary/higher education; and state workforce programs. A growing number of governors have called for across-the-board budget cuts ranging from 1 to 10 percent. Additionally, as Thomas Gais demonstrates in his article for this issue, the state budget shortfalls and recession have the potential to lead to a continuing reduction in money spent by states on certain social welfare programs and, combined with the ARRA, this could imply a diminished fiscal (though not administrative) role for states and localities in the U.S. social welfare system.

Along with spending cuts, states have proposed increases in taxes and fees. The tax policy measures include closing loopholes in their existing tax code; restructuring tax credits and tax rebate policies; increasing tax rates on goods and services, tobacco/cigarettes, alcohol and more broadly increasing state sales tax base and tax rates; and increasing corporation taxes (particularly noteworthy in this respect is Delaware—a corporation friendly state). A number of states have changed their tax code to avoid the negative effects of federal tax changes on their tax revenues. These fiscal measures are all pro-cyclical because they reduce individual and business income, which in turn reduces consumption and investment. However, as pointed out by economists, tax increases have a smaller pro-cyclical effect than decreases in public spending, primarily because a dollar of tax and fee increases reduces private spending by less than a dollar because, along with consumption, it also reduces private saving. By contrast, a dollar of public spending decline reduces aggregate spending by a dollar. Most states have exhausted their budget stabilization funds (rainy day funds)—a counter cyclical fiscal tool available to state and local governments. State budget shortfalls are likely to have several long-term consequences for state and local governments, including

widespread problems in meeting state (pension and non-pension retirement benefits) long-term liabilities as evident in the large shortfalls forecasted in state pension funds.⁸

The market for municipal bonds stayed afloat in 2008 despite successive crises that hampered issuers' access to credit. The market registered extreme changes in the volume of bonds issued in 2008 as compared to 2007 (Scarchilli 2009). By the end of 2008 the municipal bond market continued to function, but supply far exceeded demand and only the best credits were finding investors. Yields were up substantially—in October 2008, yields for AAA rated bonds had risen by 90 to 125 basis points, while medium quality yields were up 150 to 200 basis points (NLC and NACo 2008).⁹ By this time, variable rate bond issues had nearly ceased, institutional buyers and hedge funds had mostly dropped out of the market, and retail investors became the drivers of market activity. Also, by the year's end, with the exception of Berkshire Hathaway, no municipal bond insurer had a full AAA rating (Although insurers have not failed to pay on bond defaults, confidence in the industry remains low) (NLC and NACo 2008).

After bottoming out in December 2008, municipal bond market conditions improved somewhat in the first two months of 2009; by mid-February, yield ratios between municipal bonds and U.S. Treasuries stabilized around 100 percent on notes with maturities through ten years and municipal yields are expected to increasingly correspond with Treasuries (Funk 2009). The number of municipal defaults remains "extremely low" (Albano 2009). Municipal issuers, particularly those with the highest credit ratings, have still successfully borrowed money, though until recently they have been forced to accept unfavorably high yields. The bond market responded favorably to the passage of the ARRA that allows state and local governments to use the aid for infrastructure projects versus issuing new debt (Bullock 2009; Funk 2009). However, these federal funds are a short-term increase in capital finance for state and local governments and this raises concerns about how to use these funds optimally from a state's budgetary perspective and about the additional operational funds needed as projects are constructed, creating a burden on cash-strapped governments. The actual distribution of these funds to local governments and its effects on the municipal bond market will depend on decisions made by state legislatures.

The municipal bond market conditions that continue to pose major challenges to bond issuers are: (1) the fall of the municipal bond insurance industry and difficulties in getting credit enhancements resulting in higher cost of municipal debt; (2) the failure of auctions of auction rate securities (ARS) and the evaporation of demand for variable rate bonds requires major restructuring of these types of municipal debt resulting in much higher costs of borrowing than the initial bond issue; (3) the retreat of institutional investors and hedge funds from the market, leaving only the retail investor to drive demand and creating a situation

of excess supply of municipal bonds resulting in higher yields on new issues (higher cost of borrowing); and (4) the weakening fiscal condition of state and local governments creates concerns about credit quality and the possibility of high profile credit defaults resulting in further loss of buyer confidence.¹⁰

Federalism and the Courts

The U.S. Supreme Court in 2008–2009 did not issue any notable rulings concerning the extent of congressional power, although it agreed in January 2009 to hear a challenge to a pre-clearance provision of the Voting Rights Act that was extended once again in the 2006 reauthorization of that law. The Court's main contributions to federalism in 2008–2009 came in decisions regarding state power. For the most part, the Court upheld state authority in these rulings. However, in a key capital punishment decision the Court limited state discretion regarding offenses that can trigger the death penalty. Additionally, in a major gun-control case concerning a District of Columbia law, the Court raised the possibility that it would incorporate the 2nd Amendment into the due process clause of the 14th Amendment and thereby apply its guarantees to state and local governments.

Federal Power

Another year went by without the Roberts Court handing down an important decision concerning the limits of congressional power pursuant to the commerce clause, 10th Amendment, 11th Amendment, or enforcement clause of the 14th Amendment. The Rehnquist Court relied on these various provisions to issue numerous decisions from 1992 to 2002 limiting congressional power and then from 2003 to 2005 pulling back from the implications of several of these earlier decisions. However, aside from several 11th Amendment state sovereign immunity rulings in the 2005–2006 term (*U.S. v. Georgia*, 126 S. Ct. 877 [2006], *Central Virginia Community College v. Katz*, 126 S. Ct. 990 [2006]), members of the Roberts Court, and particularly the Chief Justice and Justice Sam Alito, have not taken the opportunity to indicate whether they are more inclined to support the 1992–2002 line of congress-restrictive rulings or the several deferential rulings issued in 2003–2005. The cases decided in 2008–2009, at least as of March 2009, did not give any further indication along these lines.

The Court did agree to place on its 2008–2009 docket a Voting Rights Act case that could produce an important ruling concerning the reach of congressional power. *Northwest Austin Municipal Utility District Number One v. Mukasey* presents the questions of whether a Texas municipal utility district covered by Section 5 of the Voting Rights Act of 1965 can bail out of the pre-clearance provision recently reauthorized in 2006 for another 25 years and whether this provision exceeds congressional power under the enforcement clauses of the 14th and

15th Amendments. A three-judge federal district court ruled against the municipal utility district in May 2008; but the Supreme Court agreed in January 2009 to hear an appeal. The Court could decide to avoid the constitutional question altogether by granting the district an exemption from the pre-clearance provision, which requires all covered jurisdictions to get approval either from the Justice Department or a three-judge district court before making any changes in voting regulations. But if the Court takes up the constitutional question, this could provide insight into the current meaning of the “congruent and proportional” test announced in *Boerne v. Flores*, 521 U.S. 507 (1997) and applied in subsequent cases to invalidate congressional acts whose sanctions are not narrowly tailored to remedying state and local violations of constitutional rights.

State and Local Power

The Supreme Court between April 2008 and March 2009 issued a number of rulings regarding the extent of state and local power, with the Justices generally sustaining state and local authority. In fact, several Justices took the opportunity in majority opinions to discuss the benefits of deferring to states in areas of traditional state sovereignty and the risks of intruding on state policy discretion.

None of these 2008–2009 cases had more potential fiscal consequences for state governments than *Department of Revenue of Kentucky v. Davis*, 128 S.Ct. 1801 (2008), which posed the question of whether states can grant income tax exemptions to residents who hold in-state municipal bonds but not to resident holders of out-of-state bonds. In a seven-two decision from which Justices Alito and Anthony Kennedy dissented, the Court relied on a recent holding in *United Haulers Association v. Oneida-Kerkimer Solid Waste Management Authority*, 127 S.Ct. 1786 (2007) in finding no dormant commerce clause violation in this sort of differential tax policy currently in place in forty-two states (Associated Press 2008).

Baze v. Rees, 128 S.Ct. 1520 (2008) was another consequential decision, in that it upheld the lethal injection protocol used by at least thirty of the thirty-six death-penalty states and thereby allowed executions to resume after a several-month period when the Court’s consideration of the case resulted in an effective moratorium on capital punishment. In sustaining Kentucky’s lethal drug protocol by a seven-two margin, all of the Justices but Ruth Bader Ginsburg and David Souter rejected the plaintiff’s contention that the proper standard for finding an 8th Amendment violation should be whether a death penalty procedure poses an “unnecessary risk” of pain. In his Opinion for the Court, Chief Justice Roberts concluded that “a condemned prisoner cannot successfully challenge a State’s method of execution merely by showing a slightly or marginally safer alternative.” Adopting such a standard, Roberts wrote, “would threaten to transform courts into

boards of inquiry charged with determining ‘best practices’ for executions, with each ruling supplanted by another round of litigation touting a new and improved methodology” and “would substantially intrude on the role of state legislatures in implementing their execution procedures.” Instead, the Court concluded that the proper standard for adjudicating death penalty challenges is to require petitioners to identify an “alternative procedure” that would be “feasible, readily implemented, and in fact significantly reduce a substantial risk of severe pain.” Even this standard was too intrusive and ill-grounded for Justices Clarence Thomas and Antonin Scalia, who argued in a concurrence in favor of a standard whereby “a method of execution violates the Eighth Amendment only if it is deliberately designed to inflict pain.” Nevertheless, the “substantial risk of serious pain” standard prevailed, and the ruling had the immediate effect of restarting executions in most death-penalty states.

In *Crawford v. Marion County Election Board*, 128 S.Ct. 1610 (2008), in another ruling that declined to overturn a state policy, the Court upheld Indiana’s requirement that voters provide government-issued photo identification. In a six-three ruling from which Justices Ginsburg, Souter, and Stephen Breyer dissented, the Court rejected a facial (as opposed to an as-applied) challenge to the Indiana law, on the ground that the policy was “amply justified by the valid interest in protecting ‘the integrity and reliability of the electoral process.’” Indiana is one of seven states now requiring voters to produce photo identification; another seventeen states currently require some form of voter identification but not necessarily a photo ID (NCSL 2008a).

The Court also declined to invalidate state policies in several criminal procedure cases. In *Oregon v. Ice*, No. 07-901 (2009), the Court continued the task begun in *Apprendi v. New Jersey*, 530 U.S. 466 (2000), and continued in *Blakely v. Washington*, 542 U.S. 296 (2004), of determining which questions and facts regarding punishment must be determined by juries rather than by judges. The issue in the instant case was whether Oregon, along with several other states, ran afoul of the 6th Amendment jury-trial guarantee by directing judges to make a finding of fact that would determine whether to impose sentences on the same defendant consecutively rather than concurrently. In a five-four ruling, with Roberts, Alito, Thomas, and Scalia dissenting, Justice Ginsburg’s majority opinion held that “in light of historical practice and the authority of States over administration of their criminal justice systems, . . . the Sixth Amendment does not exclude Oregon’s choice” to allow this determination to be made by a judge rather than a jury. In reaching this conclusion, Ginsburg took note of “States’ interest in the development of their penal systems, and their historic dominion in this area,” and she argued that “the authority of States over the administration of their criminal justice systems lies at the core of their sovereign status.” Meanwhile, in *Indiana v. Edwards*, No. 07-208 (2009) the Court held, by a seven-two margin, with

Scalia and Thomas dissenting, that the 6th Amendment right to counsel does not prevent a state from limiting a mentally incompetent defendant's ability to represent himself at trial.

In a 1st Amendment case that continued a string of recent challenges to state laws regarding union organizing and dues, the Court also upheld state authority in *Ysursa v. Pocatello Education Association*, 128 S.Ct. 1093 (2009). At issue was the legitimacy of an Idaho law prohibiting local public employees from authorizing payroll deductions for union political activities (as opposed to payroll deductions for union dues, which are permitted). In a six-three decision from which Breyer, Stevens and Souter dissented, the Court sustained the state law against a free-speech challenge.

In each of these cases, the Court opted against relying on federal constitutional provisions to invalidate state statutes; in two other cases in 2008–2009 the Court declined to invoke the preemption doctrine to limit state tort suits. In *Altria Group v. Good*, 129 S.Ct. 538 (2008), the Court ruled that lawsuits filed by smokers of “light” cigarettes against cigarette makers under the Maine Unfair Trade Practices Act are not preempted by the Federal Cigarette Labeling and Advertising Act, as amended in 1969. The Court had in several recent cases relied on the preemption doctrine to limit state tort claims, including by limiting suits brought against manufacturers of medical devices (*Riegel v. Medtronic*, 128 S.Ct. 999 [2008]). However, in a five-four ruling from which Roberts, Alito, Thomas, and Scalia dissented, the Court relied on *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504 (1992), in concluding that state tort claims against cigarette manufacturers are not preempted if they are “predicated on the duty not to deceive.” In *Wyeth v. Levine*, No. 06-1249 (2009), in a six-three ruling from which Roberts, Alito, and Scalia dissented, the Court declined to rely on preemption doctrine to prohibit state tort suits against drug manufacturers for failure to warn of the risks associated with such drugs.

Although the Court generally deferred to state authority in 2008–2009 cases, in one important ruling in *Kennedy v. Louisiana*, 128 S.Ct. 2641 (2008), the Court limited state discretion regarding the crimes punishable by death. The Court has in recent years prevented states from executing mentally retarded individuals, *Atkins v. Virginia*, 536 U.S. 304 (2002), and individuals who commit offenses while under the age of eighteen, *Roper v. Simmons*, 543 U.S. 551 (2005). And in an earlier decision, *Coker v. Georgia*, 433 U.S. 584 (1977), the Court banned imposition of the death penalty for the crime of raping an adult woman. But the Court had not clearly barred states from imposing the death penalty for the crime of raping a child, and Louisiana in 1995 enacted such a statute, with five other states following suit in subsequent years. In *Kennedy v. Louisiana*, the Court heard a challenge to the Louisiana statute. In a five-four ruling, with Roberts, Alito, Scalia, and Thomas dissenting, the Court concluded that “there is a national consensus against capital

punishment for the crime of child rape,” and therefore Louisiana’s law was in violation of the 8th Amendment ban on cruel-and-unusual punishment.

The Court also limited state authority in *Chamber of Commerce of United States v. Brown* 128 S.Ct. 2408 (2008), when it struck down a California law prohibiting corporations that receive state grants from using these funds to influence union-organizing campaigns. In a seven-two ruling, with Ginsburg and Breyer dissenting, the Court held that although this state policy is not expressly preempted by the National Labor Relations Act, Congress intended to preempt laws of this sort that regulate within “a zone protected and reserved for market freedom.”

Finally, although the landmark 2nd Amendment ruling, *District of Columbia v. Heller*, 128 S.Ct. 2783 (2008), does not currently apply to state and local governments, the Court did not rule out the possibility that this holding would be applied in future cases to limit state authority to enact gun-control measures. At issue in *Heller* were a D.C. ban on handguns and trigger-lock requirement on all guns in a home. In a five-four ruling, with Stevens, Ginsburg, Breyer, and Souter dissenting, the Court undertook its most comprehensive review of the meaning of the 2nd Amendment to date and concluded that “the District’s ban on handgun possession in the home violates the Second Amendment, as does its prohibition against rendering any lawful firearm in the home operable for the purpose of immediate self-defense.” Justice Scalia’s Opinion for the Court did not make clear whether the 2nd Amendment should be understood as incorporated into the due process clause of the 14th Amendment, in which case it would restrict state and local governments as well as D.C. and the federal government. As Scalia noted, “incorporation” was “a question not presented by this case.” However, Scalia gave no reason why the 2nd Amendment would not join the vast majority of bill of rights provisions that now apply against state governments, and so it remains possible that the *Heller* ruling will be interpreted in a future case to limit state authority to restrict gun possession (Stern 2008).

Conclusion

Changes in the balance of federal and state power throughout U.S. history have been achieved in various ways. Constitutional amendments have at times been responsible for limiting or, more often, authorizing expansion of federal power. Supreme Court rulings have at times been an important vehicle for restraining federal power and at other times legitimated or accelerated centralization of power. Presidential directives and congressional statutes have occasionally had devolutionary effects but have more often expanded federal power vis-à-vis the states. At times also, changes in the balance of federal and state power have been generated by external events that have generally empowered the

federal government. On still other occasions, transformations of the federal system have come about as a result of changes in public support for entrusting federal or state governments with authority in particular policy areas.

No constitutional amendments were enacted in 2008–2009, and the Supreme Court issued few decisions this past year altering the balance of federal and state power. Rather, the main changes in federalism this past year were a result of the economic recession and 2008 election. The former development had the predictable effect of empowering the federal government, with its greater resources and capabilities than state governments, to mount a series of aggressive responses to ameliorate economic conditions. The latter development brought a change in party control of the presidency and led to presidential directives and congressional statutes that put federal power in the service of a different set of policy goals, encouraged state discretion in a different set of areas, and provided more financial assistance to states than in recent years.

Both of these developments had clear and immediate implications for federalism. However, in each case the long-term consequences remain to be determined and will depend to a great degree on choices and decisions yet to be made by federal, state, and local officials and the general public.

The long-term consequences for federalism of the recession depend in part on the severity and length of the economic downturn, but also on the degree to which the resulting federal intervention is sustained or rather recedes in the recession's aftermath. As long as unemployment remains high, economic growth low, and the banking system and housing market in disarray, then substantial federal relief and increased federal regulation of various financial sectors will be sustained. This is fully in keeping with patterns from previous economic downturns. The more important question, to which historical precedents provide mixed answers, concerns what happens once the recession ends. On one hand, there will be significant pressures to sustain federal involvement at the same levels as during the economic downturn. On the other hand, the heightened federal intervention in banking and other financial sectors, along with the substantial boost in federal aid to states, might well be treated as a temporary state of affairs that will recede along with the economic downturn.

State and local governmental behavior will have a lot to do with determining the answer to this question: will state and local officials at the end of the recession choose to lobby for the increased funding levels to be treated as a baseline, or will they opt to view them instead as emergency stabilization grants? And how will federal policy-makers respond to state lobbying on these matters? Federal officials will face similar questions in terms of whether to view continued intervention in the financial industry as necessary to prevent future reoccurrences of the current problems or whether to view the current intervention merely as an emergency step.

As for the continuing consequences for federalism of the 2008 election, this will depend to a great degree on how President Obama handles situations where his policy preferences are in tension with state prerogatives. On a number of issues, there will be little conflict between Obama's policy preferences and state interests, as was the case with his support for state experimentation with auto emission standards and CHIP coverage in excess of federal standards. As long as these sorts of issues remain atop the policy agenda, a Democratic president and congress can be counted on to permit state discretion, just as a Republican president and congress were willing to permit states to exercise discretion in ways consistent with their policy interests (such as limiting or providing alternative delivery of Medicaid services).

On other issues, Obama is bound to encounter tensions between his policy preferences and state prerogatives, and it is in his resolution of these conflicts that his approach to federalism questions will be most clearly illuminated and his commitment to honoring state prerogatives most challenged. Such tensions will emerge in various policy areas but may be particularly pressing in climate change policy, where local, state, and regional actors have for several years been the key innovators, and where the president and congress in their deliberations about a proposed federal cap-and-trade policy will have to decide how much regulatory authority sub-national governments will be allowed to continue exercising. On this issue, as on various others, Obama, like his predecessors, will face a tension between pursuing his policy interests and honoring state prerogatives. Most presidents have ended up pursuing their policy preferences in such situations, although some have perceived such a tension and altered their policies to a greater extent than others. Obama will undoubtedly have opportunities as his administration unfolds to resolve these conflicts and in a way that will permit a more conclusive judgment about the long-term consequences of the 2008 election for federalism and the degree to which he might represent a departure from previous presidents in this regard.

Notes

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1. Discretionary spending programs require congressional appropriation authority for federal agencies to incur obligations and spend the money for specified purposes. Examples include national defense, education and environmental programs. Direct spending is authorized by statutes (entitlement spending and tax relief provisions) or by contracts and other forms of obligations (mostly comprised of interest on federal debt obligations). Direct spending does not require congressional appropriation for the federal agencies to spend the money. Examples of entitlement spending include benefits

- paid to persons or entities of government that meet eligibility requirements (specified in the authorizing legislation) for Medicaid, Medicare and Food stamps.
2. Some tax relief measures included in ARRA for businesses are the continuation in 2009 of the temporary accelerated depreciation at 50 percent of the cost of depreciable property (enacted in 2008); additional relief in the form of extension of carry back period for losses from two to five years; the exclusion of a certain proportion of gains made by small businesses in sales of business stock (if held for more than five years); delayed recognition for cancelled debt income for some businesses; and incentives to all businesses that hire unemployed veterans and disconnected youth.
 3. Other social, political, and fiscal reform measures had mixed success at the ballot box. Massachusetts voters approved an initiative decriminalizing marijuana possession and Michigan became the thirteenth state to adopt a medical marijuana measure. An affirmative action ban was approved by Nebraska voters but defeated in Colorado. Anti-abortion measures were defeated in California, Colorado, and South Dakota. California voters approved a redistricting reform initiative that entrusts the drawing of district lines for state legislative—but not congressional races—to a citizens' commission. Of the six ballot measures seeking to permit investment of public funds in the stock market, the only one to pass was a Nebraska measure voted on in May; all of the November measures failed. Meanwhile, Minnesota voters approved the only explicit tax increase when they approved a boost in the sales tax to pay for arts and the environment; other measures of this sort were all rejected. Massachusetts voters rejected an initiative to eliminate the individual income tax.
 4. The federal trust fund receives its revenue from the gas tax of 18.4 cents per gallon and provides 45 percent of highway funding (the remainder coming from a variety of state and local sources including a state gas tax).
 5. Texas is considering a proposal to index the state's gas tax to the inflation rate and the legislature is also weighing the options to levy local taxes and fees to build road and rail projects in the same legislation (Wear 2009). In California sales taxes are applied to gasoline sales and the state sales tax was recently increased by a penny per dollar spent (*Washington Post* 2009). Massachusetts' gas tax is set to rise by 19 cents a gallon to become the highest state gas tax in the nation (42.5 cents). The state may also increase tolls along major turnpikes and transportation fees to promote fuel efficient vehicle use (Johnson 2009). Several other states are considering increasing their gas tax—Iowa and Oregon, among others.
 6. The North Tarrant Express project in the Fort Worth area is worth \$2 billion (Texas Department of Transportation spends about this much annually on all road construction projects). In this project, Texas has agreed to invest up to \$600 million of its gas tax money with a team of domestic and international private firms NTE Mobility Partners (NTEMP), also included in this partnership is the Dallas Police and Fire Pension System as an equity partner. The project has been approved for federal private-activity bond and TIFIA funding. The contract is for NTEMP to design, construct and maintain the project for fifty-two years. In return for their effort NTEMP will collect the bulk of the managed lane toll revenue. The state of Texas will still own the improved roadway (Houghton 2009).

7. In particular, the federal tax cuts under Economic Growth and Taxpayer Relief Reconciliation Act (EGTRRA) and Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) have affected state and local revenues in several ways: (1) the primary effect is through reductions in federal grants in aid; (2) An equally important effect is via the links that exist between federal and state income tax codes; (3) Lowering of the federal tax rates and restrictions placed on itemized deductions, or the failure to limit the applicability of the Alternative Minimum Tax, reduces the federal tax savings for itemizers and thus affects the state and local government ability to tax their richer populations; (4) Finally, the elimination of the federal estate and gift tax (along with potential elimination of state level estate taxes) under EGTRA and JGTRA would create a big loophole for avoidance of federal and state income taxes. See CTJ (2001) and Aron-Dine (2008).
8. New Jersey has one of the larger shortfalls in its pension fund: \$60 billion (McNichols 2008). But, this problem exists in various other state pension funds (Walsh 2008).
9. A basis point is equal to 0.01 percent.
10. Fitch Ratings recently downgraded California's Economic Recovery bonds (WSJ DN 2009). Moody's Investors Service and Standard & Poor's warned that they might downgrade California's general obligation bond rating, (White and Bu 2009).

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