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Fiscal Millstones on the Cities: Revisiting the Problem of Federal Mandates

PIETRO S. NIVOLA

As the fiscal predicament of state and local governments worsens, troubled communities again are contemplating tax increases or cuts in basic service—actions that, either way, risk running more households and businesses out of town.

The fiscal crisis is partly cyclical, inevitably reflecting the national economy's temporary slump. But some of the distress is also structural—that is, related to ongoing financial burdens that public policies have created for local authorities. The structural complications include federal rules and rulings that tie local finances in knots.

To be sure, this is not a new story. Mayors complained about “unfunded mandates” in the early 1990s, when, like now, the U.S. economy was sputtering and local budgetary pressures mounted. Congress eventually responded by passing legislation—the Unfunded Mandates Reform Act of 1995 (UMRA)—that would supposedly constrain the congressional habit of saddling state and city governments with expensive obligations but not providing money to help them comply. How has this mild attempt at self-limitation worked? What additional compensations or corrections might be considered?



The 1995 unfunded mandates bill was part of the House GOP's “Contract with America.”

UNDERFUNDED MANDATES

It would take a book, not a relatively brief article, to list the national commandments that stake a claim on municipal resources, but consider the following sample.

Environmental regulations have

required municipalities to spend tens of billions of dollars building and operating state-of-the-art secondary treatment plants for wastewater. While the price tags of the facilities have escalated sharply since the 1970s, federal contributions to help cover the cost have shriveled. How



essential are these elaborate installations? Since much depends on a city's geographic location, the U.S. Environmental Protection Agency (EPA) might consider granting more waivers.

The Safe Drinking Water Act of 1996 is meant to secure a marked net improvement in the health and safety of city-dwellers. But some of the law's subsequent rules have not passed that test. One EPA standard, for instance, requires that trace amounts of arsenic be eliminated from drinking water. This particular requirement will drain hundreds of millions of dollars from local taxpayers to attain a minimal gain in public health.

More than 80,000 acres of abandoned industrial sites, known as brownfields, blight American cities, costing them billions of dollars in lost property tax revenues. The specter of legal liability over potentially toxic waste on these sites frequently discourages their redevelopment. In some instances, the standards for cleaning up contaminated waste sites are simply unreasonable. Federal courts (like the one that adjudicated a notorious case in New Hampshire, *United States v. Ottati & Goss, Inc.*) should not have to entertain interminable litigation over cleanup projects where the soil is already so safe that it would not even harm someone who might eat samples of it daily over several months.

Environmental policies are hardly the only regulatory activities that foist unexpected workloads onto city governments.

As Washington increasingly delves into education policy, urban public school systems have had to contend with a

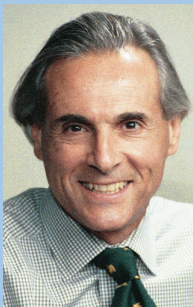
profusion of federal prescriptions. One of them, mandating special educational services for the learning-disabled, has become all but unaffordable. Congress has never come close to funding the authorized federal share of this \$50 billion annual expense. So year after year, the tab falls lopsidedly to the states and localities. The impact on city schools, where the percentages of special-education students are high and the means to support them low, is especially onerous.

CONGRESSIONAL RESTRAINT

The Unfunded Mandates Reform Act introduces greater transparency when legislating mandates that may have adverse fiscal implications for local governments. The Congressional Budget Office (CBO) is asked to calculate the costs of such proposed mandates. When a bill is estimated to exceed \$50 million, any member of Congress can request that it be subjected to an explicit vote. The procedural hurdle is meant to make it less tempting for lawmakers to quietly tuck costly impositions into broad pieces of legislation.

Because at least some categories of bills now are routinely appraised by CBO, and parliamentary challenges can expose them to visible up-or-down votes, in theory UMRA helps deter legislators from casually sponsoring a lot of new proposals priced wildly in excess of \$50 million. And to a notable extent, it has. The CBO reported in May that the number of bills containing intergovernmental mandates (that could be challenged under the law) declined by more than a third between 1996 and 2002.

UMRA is a step in the right direction, but still quite a limited one. Because the act



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defines a “mandate” rather narrowly as an “enforceable duty” that is distinct from a condition for federal aid, huge regulatory programs that are accompanied by dwindling federal co-payments can fly under the radar screen. No sooner was UMRA on the books, for example, than Congress lopped off large sums from previously appropriated federal wastewater treatment grants, leaving local entities to make up the difference. To municipal water systems managers, Congress had violated the spirit, if not the letter, of the mandate reform act. Arcane semantics about whether the action amounted to an unfunded mandate or was technically an “appropriations rescission” of a grant-in-aid must have seemed beside the point.

Similarly, when Congress enacted the Bush administration’s education reform law—the No Child Left Behind Act (NCLB)—it effectively directed that public schools measure “adequate yearly progress” of students through standardized tests. Hence, the NCLB could compel already lavish state and local spending on public education to increase by multiple billions of dollars. For all practical purposes, these expenditures are more obligatory than optional. But as a technical matter, the provisions of NCLB are conditions-of-aid, not commands and controls, so the legislation sailed through with nary a murmur about whether it squared with UMRA.

The ambit of UMRA is further restricted by exempting the capacious category of law that deals with the civil rights of individuals or groups. So Congress could continue to enact more measures resembling, say, the Americans with Disabilities

Act of 1990, without ever having to examine closely the intergovernmental fiscal ramifications.

At times the most prodigious source of strictures and sanctions on local governments is not Congress or even the federal bureaucracy but plaintiffs obtaining broad decrees from the federal judiciary. Cities have labored under court orders that micromanage racial balances in schools, the capacity of city sewers, the operation of city jails, the instruction of learning disabled kids, the recruitment of police and firefighters, the seating of passengers on public buses, and more. Whatever the merits of these edicts, they have fiscal consequences—and fall entirely outside the purview of UMRA, which affects only legislated mandates. No wonder many local officials contended that the reforms of 1995 had not provided enough relief.

SHIFT AND SHAFT

Maybe a surer way to discourage Washington’s mandate-makers from overloading cities and states with responsibilities they cannot afford would be to embrace a seemingly straightforward proposition: no lower-level government should be obligated to comply with costly demands from a higher-level government unless compensated by the latter.

The logic here is based on a simple principle of fiscal accountability: presumably, when a government is compelled to pay for its dictations out of its own tax collections, it will dictate less, or at least dictate for clear and convincing reasons. If this seems farfetched, notice that sixteen state governments have passed constitutional amendments or statutes purporting to ensure that state



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mandates on municipalities are conditioned on adequate compensation.

This fix has largely failed, however. In the first seven years after Illinois passed a law forbidding uncompensated state-imposed mandates on cities and counties, it was overridden twenty-five times by the state legislature. Fifteen years after Michigan amended its constitution to require that the local costs of major mandates be reimbursed, no reimbursements followed. At the federal level, proposals to make mandate reimbursements compulsory have come before Congress from time to time. They never gain traction.

To a considerable extent, the politics of credit-claiming and blame avoidance explain these outcomes. In a federated governmental structure, top-down tutelage without top-down funding is politically tempting. It affords its practitioners in the upper tiers of government opportunities to claim credit for doing good deeds—cleaning up the environment, enhancing public safety, protecting victims of bias, and so forth—while shifting the inevitable tax increases largely to lower tiers. The temptation to “shift and shaft,” as the game is often called, is all the stronger when the upper tiers of government are running deficits.

A disinclination to compensate for each and every mandated program, however, is based on more than just these calculations. Under certain circumstances compensation would be a mistake. A city that egregiously fouls the atmosphere or rivers beyond its borders should mostly be expected to reduce its pollutants with its own revenues. To hand out a national

remittance in a case of this sort would be to condone the polluter’s apathy or free riding. The “polluter pays” principle would seem to require that, while localities ought not carry an inordinate share of the cost of satisfying a fastidious federal standard, neither should they be succored to attain a modest and feasible one.

Of course, a standard deemed modest and feasible for some localities may still be unsustainable for others. Presumably, compliance costs need to be offset more generously in the disadvantaged communities.

COOPERATIVE FEDERALISM?

Taken to the next notch, therefore, the concept of compensatory payments to local governments graduates to a generalized redistribution of revenues—which is to say, a model of fiscal federation closer to that of Australia, Canada, and Germany. The German system, for instance, pools the proceeds from the nation’s principal taxes (those on personal and corporate income as well as on value added) and then not only allocates the money between the federal and subordinate governments but among the latter in a fashion that moves funds from prosperous to depressed regions. The German constitution recognizes that each level of government has its own competences but also that the states and municipalities have to implement certain federal mandates. The financial affairs of some states and municipalities, however, are a lot weaker than others and so, the argument goes, the weak ones deserve an extra boost.

An irony of this model is that in its zeal to

shore up local fiscal capabilities by lessening their disparities, it occasions no small degree of intergovernmental strife. The heavily taxed donors, so to say, in Germany's massive revenue-sharing process resent the takers, whose dependency on the system's subventions often seems less deserved (or "cooperative") than parasitic. How is the conflict managed? The German approach, its skeptics say, has been to mollify parties by enlarging the public sector as a whole. Whatever else the growth of government might achieve, one consequence is predictable: the larger the pot of revenue sloshing around, the higher the overall rate of taxation has to be.

The extensive equalization grants or revenue-sharing arrangements of democracies abroad are in essence mechanisms for across-the-board mandate reimbursement—that is, general methods of offsetting the uneven compliance costs that any central government's rules and regulations, rightly or wrongly, lay at the feet of local jurisdictions. Granted, these methods frequently give municipalities in various European countries a fiscal cushion that American municipal governments lack. That may be the good news. The bad news, though, is that expansive sharing of revenue risks sacrificing a basic axiom of sound public finance: namely, fiscal equivalence. The more the expenses of government in a particular community are defrayed by taxable income from somewhere else, the less incentive that community has to operate cost effectively. Simply stated, the concept of fiscal equivalence holds that each jurisdiction should pay its bills

mostly from its own taxable income.

Lest we think that this maxim is mainly of theoretical rather than practical interest, countries that have strayed from it have had unhappy experiences. To take an extreme example, consider the muddled fiscal relations among the strata of government in Italy. In the Italian system, at least until the last decade, the collection and distribution of revenues was progressively centralized on the theory that the national government could thereby overcome inequalities in the tax bases and administrative burdens of subnational units (regions, provinces, and municipalities). The result for many years was that these units neither knew nor cared to know the costs of the services they were obligated to administer. Local overspending and debt swelled, and the irresponsibility was made worse by the willingness of the central government to bail out the most debt-ridden localities.

The public spending and indebtedness problems in Italy became so severe that they were likely to impede that country's participation in the European monetary union. With a series of measures starting in 1990, the Italian government at last succeeded in establishing a degree of discipline. How? The answer, in large part, lay in restoring a semblance of fiscal equivalence: city governments and other local bodies now are expected to meet a more substantial portion of their costs with own-source taxes.

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solution. In reality, it is one with potentially disagreeable side effects. Faltering regions or distressed urban centers should not be left to sink or swim amid a torrent of centrally generated pressures on local agencies and budgets. But neither should relieving these places come at the price of public profligacy.

A better way of bolstering hard-pressed communities would rely not just on defraying the expense of the extra work they are assigned but, more basically, on scaling down some of the assignments. What might nudge this process along?

UMRA-PLUS

In an ideal world, each federal dictum pushing new costs onto local governments would be weighed carefully for whether these exactions serve a compelling national interest. In other words, are major or merely trivial perils to the public health and welfare being addressed? How effectively? At what cost? To be sure, UMRA falls short of such a test, but at least this device accepts the principle that the liabilities Congress imposes on local budgets ought to be independently estimated and publicly displayed. The first order of business, therefore, is to widen UMRA's reach.

Deal with de facto mandates. As noted earlier, distinguishing between pure mandates and “strings” attached to federal aid programs that state and local governments cannot do without often amounts to a distinction without a difference. There should be no blanket dispensation for large congressional grant authorizations that produce plenty of instructions but not appropriations. These acts of Congress should be viewed for what they

really are—in effect, coercive rather than “voluntary” from the standpoint of local authorities—and so ought to fall within UMRA's orbit when reauthorizations are due. Truth-in-advertising could mean that budget-busters such as the Individuals with Disabilities Education Act (otherwise known as the special education law) would stand at least some chance of being accorded the same reasonably systematic and transparent examination that UMRA can trigger for “enforceable duties.”

Revisit the “rights” exclusion. Special education now seems to be one of several federally ordained schemes that are practically deemed a right. But when such programs acquire a status akin to rights, they sometimes cease to be elective activities that Congress is obliged to aid; rather, they become for local officials binding legal warrants that carry no particular federal budgetary responsibility. Indeed, legislation that affirms rights is mostly excluded from UMRA's cost assessments and scrutiny.

But perhaps such legislation should be included. When a rights-based measure is at bottom a congressionally mandated benefit program, its off-budget costs probably ought to be “scored” much like any on-budget federal initiative. Congress in the end may craft its social policies in whatever style it sees fit. But to enact these policies without, at a minimum, exposing their bottom line to local taxpayers is simply too commodious.

LEGAL ISSUES

If the stack of regulations that mayors protest consisted only of congressional mandates and rules from federal bureaus, it would be less vexing than it actually has

been. In fact, the pile includes a lot of requirements resulting from lawsuits. Many, maybe even most, of these serve socially beneficial purposes and should not be choked off. But something seems amiss with the wheels of a legal system that also ushers into the federal courts plaintiffs who complain that, say, a strength test is discriminatory because it requires applicants for a city fire department to simulate the real world by carrying a heavy weight through an obstacle course.

It is not too much to say that the public managers of many city “street-level bureaucracies” in the United States go to work each day with an ominous sense of being perpetually at risk of legal run-ins they cannot readily prevent or minimize, no matter how honestly they try. Inasmuch as the vagaries of federal litigation (or perceived trajectories thereof) have contributed to this atmosphere, it could be lifted somewhat if all three branches of the national government made a few changes. “See you in court” is the prospect that national laws almost inevitably raise when, among other complexities, legislation delineates unmet social needs or wants as actionable deprivations of rights, or when its wording is potentially open-ended, or when it deliberately deputizes private litigators for the purpose of enforcement. To expect the American political process to shed every such source of disputation is wishful thinking, but surely at least a couple could get better attention.

Clarify legislative interpretation. What precisely does it mean to mandate “safe and complete” inspections for asbestos fibers in school buildings? At what point

do incidents of alleged bias amount to a “pattern of practice”? Which “related services” qualify as “appropriate” in special education? Exactly how must a municipal workplace accommodate an employee who makes a case that he or she is “substantially” limited from engaging in a “major life activity”? Federal laws that can form the basis for some sweeping mandates contain this sort of language, which is bait for lawsuits. Too frequently they buck to the judiciary responsibility for ironing out the ambiguities.

There may come a time when the courts will simply decline to take in so much of Congress’s laundry. But short of that, the legislative and judicial branches could bridge more of the gaps between their respective deliberations. Steadier lines of communication would enable “judges to alert legislators to statutory drafting problems identified in the course of adjudication,” as Chief Justice William H. Rehnquist suggested in his 1992 year-end report. The conversation might even regularly remind both institutions that flinging open the courthouse doors to litigants, and emboldening them to extract broad remedies on the basis of pliant statutory expressions, is legislating from the bench—that is, by proxy.

Diminish double jeopardy. The executive, too, can help turn down some of the litigious heat on state and local governments. Many U.S. regulatory statutes, in sharp contrast to those of most other advanced countries, encourage individuals or organizations to sue local authorities over questions of compliance, even when a competent federal enforcement agency exists and its labors ought to suffice. The double-

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barreled approach to enforcement—coming from agencies and private plaintiffs—can subject local officials to repetitive legal wrangles, especially when the terms of federal statutes are vague and officials are unsure of what is required of them. Adjustments are in order. Pruning the payment of legal fees or the fee-shifting provisions for citizens’ suits under certain conditions may be one option. Another is that executive agencies need not make a habit of joining these suits. Federal administrators, like their local counterparts, increasingly worry when, in the words of a former EPA chief, “Litigation is essentially setting the priorities.” Surely, this distortion is not lessened when federal prosecutors pile on.

CONCLUSION

Amid economic woes and deepening deficits, city governments presently have their hands full paying big, unanticipated bills—for essentials like homeland security. Every time the terrorist threat alert is elevated to orange, Los Angeles

spends at least an additional \$1 million a week, New York an extra \$5 million a week. These cities and quite a few others could use some added assistance under the circumstances. An infusion of cash may be helpful in the short run. But going forward, policymakers at the national level should lend a hand by disencumbering local budgets, not just by shoveling money at them.

Eight years ago, Congress began putting in place some procedural safeguards against lawmaking that unduly burdens state and local governments. The scope of those prudential procedures now needs to be broadened. In addition, municipal governments, in this county more than almost any other, are frequently the target of legal challenges invoking national law. Not a few awkward federal mandates ultimately emanate from this continual resort to the courts. More moderation of that practice, too, might be desirable, perhaps along the lines suggested in these pages. **B**

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