

Breaking the Grip of Funded Federal Mandates: Why Wyoming Should Just Say No to Federal Grants-in-Aid

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Executive Summary

On the surface, ever-increasing federal funding may appear to be a win-win for both Wyoming taxpayers and state bureaucracies. But the mandates tied to federal funding increasingly subordinate state and local policies to those determined at the national level, distant from the facts-on-the-ground and the people affected. In fact, the more generous federal funding is, the more such funding creates politically-impenetrable “lock boxes” around expensive programs that prudence or fiscal crises dictate must be cut. This diminishes the accountability and effectiveness of elected state officials, who can plausibly justify their inaction in refusing to make necessary spending cuts. And it guarantees the growth and maintenance of regulatory and service bureaucracies beyond what would be sustainable by state funding alone. An addiction to federal funds thus undermines both state sovereignty and fiscal responsibility, ultimately enervating individual responsibility and threatening personal freedom. Therefore, it is anything but a win-win.

As will be shown, reform is clearly needed to break the velvety grip of federal mandates—the most efficacious one for Wyoming being simply to kick the federal funding habit altogether. Wyoming’s unique ability to supplement state tax revenues with massive cash injections of federal mineral royalties means that legislators can reasonably set their sights on gradually abandoning federal funding and mandates for just about any program. Additionally, the State should consider challenging federal mandates as void under the 10th Amendment when grants-in-aid create incentives that interfere excessively with responsible statewide

policymaking. Simply put, Wyoming has the financial capacity and the constitutional power to assert its sovereignty against funded federal mandates—and it should.

Introduction

Wyoming, as with many states, is enmeshed in a fiscal dynamic in which federal grants-in-aid inflate local demand for government services that bear little or no relation to local priorities or resources, thereby contriving constituencies gratuitously dependent on federal programs. Combined with federal mandates, these grants create pernicious incentives whereby elected state officials come to believe that the political stakes are too high to make necessary cuts in state-funding for federal programs. Federal funding thereby co-opts and subverts local politics to serve putative national interests, at the cost of undermining the protections of federalism from within. Fortunately, Wyoming is well-positioned to free itself from funded federal mandates. This Report explains why and how.

Part I of this Report describes the rapid growth of federal funding to the states and how this bloats state budgets. Part II describes Wyoming's fiscal affairs in greater detail, focusing on the role of federal mineral royalty payments. Part III discusses the budgetary effects of federal funding on the growth of state-funded expenditures. And Part IV discusses the prospects and limits of reform, recommending gradual withdrawal from funded federal mandates, along with a creative new legal strategy that seeks to enforce the principle that neither Congress nor the states have the constitutional power to bargain-away the protections of federalism as consideration for federal grants-in-aid. The Appendix contains detailed statistical analyses supporting the contention that federal funding inflates state spending to serve federal priorities.

1. The Impact of Federal Funding on Wyoming's Sovereignty.

Nearly all state and local governmental services receive funding from the federal government.² This is the direct result of permanent, broad-based federal programs aimed at

supporting the growth and expansion of state and local governmental services. These programs have swollen and metastasized ever since the New Deal. In fact, leaving aside a brief period of dormancy during the Reagan years, such intergovernmental transfers have grown steadily both as a percentage of total state spending (from about 15% in 1952 to about 25% in 2000) and in absolute terms (from just over \$100 billion in 1952 to over \$1.3 trillion in 2004 in constant dollars).³ As increasing amounts of federal dollars have been pumped into state and local coffers, one might expect some relief for state and local taxpayers. Instead, the data show that state and local tax revenues have actually almost doubled, from 5.5 percent in 1948 to 10.1 percent in 2005, while federal tax receipts have risen slightly, from 16.2% to 18.8%.⁴ These counterintuitive facts strongly support the conclusion that “federal funding has permanently inflated the demand for government.”⁵

The growth of federal funding to state and local governments is not benign. Federal funding creates the immediate impression that more local services can be had for the same amount of local tax dollars. This attenuates the perceived connection between the costs and benefits of increased state and local governmental services, thereby generating artificial demand for government, i.e., by playing upon the all too human desire to obtain something for nothing. And as government grows, it fosters more dependency on government while increasingly crowding out the non-governmental sector, further increasing demand for government. Thus, a malign circularity sets in.

Federal funding also enables states to bypass or delay confronting the adverse consequence that they would otherwise face if they were to balloon services unilaterally; for example, an exodus of productive citizens to other states as taxes and fees are increased to pay for increased local services. Thus, one of the great structural protections of federalism—the promotion of fiscal responsibility through policy competition among the states—is either

systematically stifled or distorted. Policy makers are thereby deprived of an essential measure by which to gauge whether demand for (or supply of) government services has overshot economic reality. And the disconnect between fiscal policy and economic reality is likely to be most pronounced in those states that receive more federal dollars than their residents pay in federal taxes, states such as Wyoming.

In short, federal funding gooses demand for state and local government while simultaneously loosening the constraints imposed by federalism on irresponsible policies. In view of the perverse incentive structure this entails, it is no wonder that state and local taxes have grown nationally the way they have despite, ever-increasing amounts of federal support for state and local governments. And a closer look at the dominant types of federal grant programs underscores how federal funding undermines fiscal responsibility and state sovereignty.

The Three Grant Programs that Undermine Fiscal Responsibility and State Sovereignty

The three main types of federal grant programs, to which strings attach, have been described elsewhere as “fully funded, time limited federal grants,” “conditional, capped grants-in-aid,” and “uncapped federal matching grants.”⁶ Fully-funded, time-limited federal grants would seem to be the most innocuous type of federal funding from the perspective of both fiscal responsibility and state sovereignty. This is because they would seem to have only a short term effect. But the reality is that, even if such grants are more like dropping money from a helicopter than the rest, they still artificially inflate demand for government services and this can cause lasting misallocations of state governmental resources when the money drop is targeted to the government payroll. The example used in the literature is the Clinton administration’s “100,000 cops” initiative.⁷ Even though the funding for the initiative was short-term, many state and local governments are still locked-into related expenditures due to pension obligations and organized political pressure not to reduce law enforcement expenditures.

Another common type of federal funding is called “conditional, capped grants-in-aid.”⁸ Most education programs, including No Child Left Behind, are sustained by such funding. In essence, the federal government will offer a discrete amount of money for a specific type of program on the condition that the state matches the federal government’s contribution with state spending. Despite the seemingly fortuitous nature of such largess, such federal funding creates a serious dilemma if the state’s finances later require belt-tightening. This is because any reduction in the state’s matching expenditure will cause the entire federal contribution to be lost. Cutting even \$5 out of state funding for testing, which would otherwise be a 5% reduction of the total budget and a 25% cut in the testing budget, will cause the state to lose its eligibility for the entire \$10 in federal funding. A \$5 cut in state funding thus results in a \$15 reduction in the overall education budget, or a “draconian” 15% budget cut and 75% reduction of the testing budget. To avoid political heat, elected officials would have strong incentives to maintain current levels of funding and raise taxes (illustrating how federal funding tends to permanently inflate demand for government) or find ways to cut \$5 from elsewhere in the education budget (subordinating state policy to federal priorities).

The last type of federal funding is simultaneously the most generous and most pernicious. “Uncapped federal matching grants” match each dollar of state spending in a federal program with a certain amount of federal funding.⁹ The amount of federal funding is determined by a formula and the total amount of federal funding available is not capped. Medicaid is the quintessential example of this kind of program. Depending on the matching formula, called the Federal Medical Assistance Percentage (“FMAP”), the “federal government contributes between 50 and 77 percent of state spending.”¹⁰ As such, Medicaid and other such programs look extremely generous, seemingly stretching the local dollar to new lengths. The FMAP, for instance, is devised to give the poorest states the most federal funding—more than three federal

dollars for every state dollar spent. And federal funding for Medicaid in Wyoming has historically ranged from dollar-for-dollar to nearly a two dollar-for-dollar match; based on a 50% FMAP to a 65% temporarily “enhanced” FMAP.¹¹ But such generosity is a two-edged sword. Even assuming a relatively modest 50% FMAP, cutting one dollar of state funding for Medicaid has the economic impact of taking two dollars away from Medicaid. That presents quite a political hurdle for any elected official to overleap.

In short, all three federal grants-in-aid can reasonably be expected to spawn or ratchet up state spending, effectively resulting in diminished state control over fiscal priorities, such that greater amounts of state resources are progressively focused in federally funded programs rather than in programs that most likely reflect a state’s core functions, unique circumstances or policy preferences. And whenever strings are attached, the more generous and sustained the federal funding, the more captive a state budget is to such funding. In particular, the generosity of uncapped federal matching grants causes states to systematically sacrifice their sovereignty. And during economic downturns, the incentives they create virtually guarantee either that state taxes will be raised or wholly state-funded programs will be cut long before Medicaid or any other similar federal program is touched.¹² And the skewing of budget cutting to wholly state-funded programs will be even more pronounced in poorer states, in which cutting one dollar of state funding for Medicaid can have the economic impact of taking as much as four dollars away.

The question is whether this effect can be verified in Wyoming. Unfortunately, despite appearances, this proved a more challenging question to answer in Wyoming than elsewhere, such as Arizona, which has been similarly studied.¹³ But one of the challenges encountered—the impact of Federal Mineral Royalty Payments on the state’s finances—presents Wyoming with a unique opportunity for reform.

II. **The Challenge and Opportunity Presented by Federal Mineral Royalties.**

Like Arizona and other smaller states, Wyoming is a net beneficiary of federal funding, having received, on average, 10% more federal dollars than its residents have paid in federal taxes since 1981.¹⁴ In fact, the U.S. Census Bureau has listed Wyoming as the number 1 recipient of federal aid in 2006 on a per capita basis.¹⁵ And there is no hint Wyoming's net beneficiary status will change anytime soon: In year 2000 dollars, for example, federal transfer payments have increased 22% between 2000 and 2006 (from \$2.3 billion to \$2.8 billion), while the state's population has only grown about 4%.¹⁶

These statistics are misleading, however, if they are not considered in their full context. This is because they result from the Census Bureau's decision to treat federal mineral royalty payments made under the Mineral Leasing Act of 1920 like federal grants-in-aid, such as Medicaid.¹⁷ But from the perspective of state sovereignty, federal mineral royalty payments are an entirely different animal from federal grants-in-aid, and such conflation of categories is inherently misleading.

The mineral royalties labeled "federal aid" by the Census Bureau represents the State's share of revenues generated from the minerals extracted on what would likely otherwise be private lands, subject to state taxation. This is because Wyoming's federal mineral royalties arise from the federal government's decision to maintain ownership and control over vast swaths of public lands and related mineral rights. In most other states, such public lands and mineral rights were largely transferred into private ownership through private possession and development by virtue of the Homestead Act of 1861 or the General Mining Law of 1872. Given how the federal government dominates Wyoming's public lands and mineral rights, such payments are reasonably seen as "necessary and proper" if Wyoming is to enjoy a semblance of equal footing with other states, which it was guaranteed upon entry into the Union. In a very real sense,

federal royalty payments represent compensation to the residents of Wyoming for mineral rights and lands usurped by the federal government.

Furthermore, dollar-for-dollar, the causative relationship between federal royalty payments and state spending along federal priorities cannot approach that of true federal grants-in-aid. Unlike grants-in-aid, federal mineral royalties are fully subject to the Legislature's power of appropriation. Royalty payments, therefore, simply lack the incentive structure that causes matching federal funding for programs like Medicaid to ratchet up total expenditures and to dominate state priorities. And although royalty payments do bear a "helicopter money drop" similarity to "fully funded, time limited federal grants," and undoubtedly sustain significant government growth, they do not involve the federal government in the creation or expansion of state agencies or bureaucracies.

Federal mineral royalty payments just do not present the threat to state sovereignty that is posed by federal grants-in-aid. In this respect, federal royalty payments are quite distinct from federal funding for programs like Medicaid, No Child Left Behind (NCLB) or State Children's Health Insurance Program (SCHIP). But the impact of federal mineral royalty payments remains troubling from a limited government perspective. Federal mineral royalties have historically accounted-for at least one-sixth of the state's budget.¹⁸ During the 2006 fiscal year, for example, the Wyoming Legislative Service reported that the State of Wyoming received over a \$1 billion in federal mineral royalties, including coal lease bonuses, which was closer to one-fifth of Wyoming's total annual expenditures.¹⁹ And the bulk of these royalties have been distributed automatically by state statute to education, transportation and municipal accounts.²⁰ Consequently, in Wyoming, the growth of education, transportation and municipal spending appears substantially, if not largely, attributable to the state's decision to spend federal mineral royalties on "autopilot." Any significant reduction in state spending in such areas will require

reforming the state statutes that direct federal mineral royalty payments to them. This illustrates that state sovereignty is not a silver bullet with which to slay bloated government.

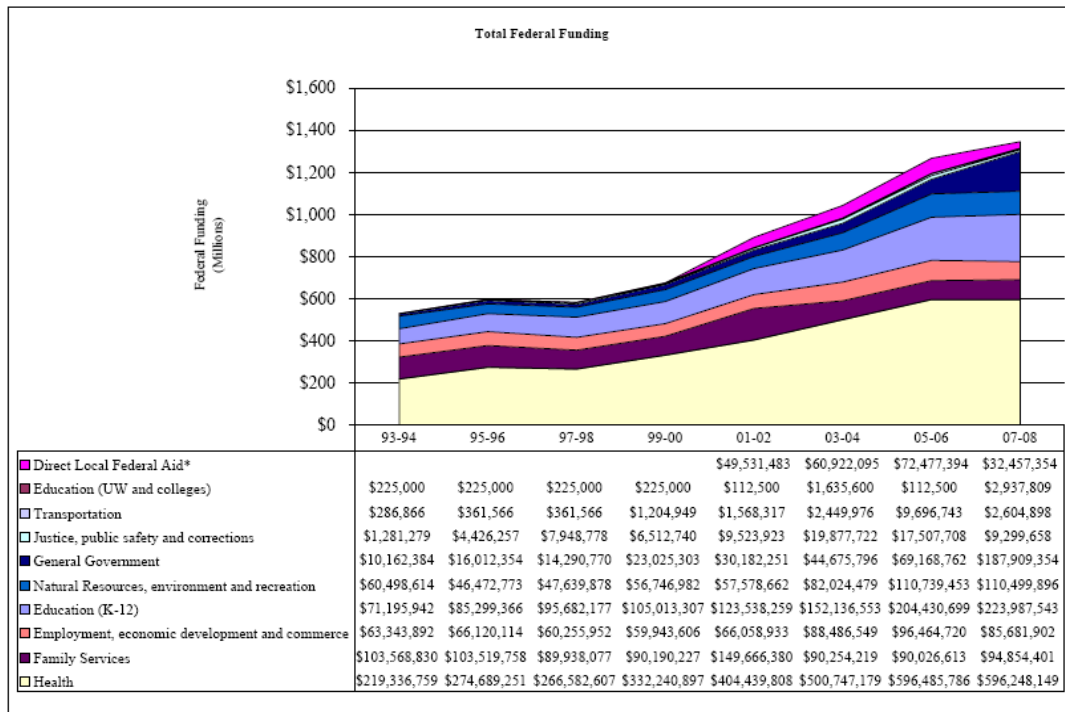
Nevertheless, the availability of federal mineral royalty payments gives Wyoming a unique degree of financial independence to opt out of federal grant-in-aid programs. To the extent state agencies or bureaucracies have been built using federal royalty payments and “autopilot” spending formulas set by state statute, the bottom line is such formulas are not based on federal mandates. The state still retains the power to direct such moneys to its own priorities to vindicate its sovereignty. Simply put, the money exists to create the political will to break the state’s addiction to federal grants. And, as will be discussed in the next section, there is every reason for Wyoming to pursue such independence because the state increasingly dances on the strings attached to federal grants.

III. Federal Grants-in-Aid Have Grown the Size and Scope of State Government in Wyoming.

While the percentage of total annual state expenditures attributable to federal funding might seem to have held relatively steady between 1992 and 2006, averaging about 23% according to National Association of State Budget Officer (“NASBO”) data, this “long view” of the data obscures the recent reversal of a salutary trend.²¹ Between 1992 and 2000, federal funding dropped from nearly 21% of total state expenditures to 14.6%.²² But since 2000, federal funding has grown as a percentage of total state expenditures, from 14.6% to just over 22% in 2006.²³ Combined with the statutory “autopilot” flow of federal mineral royalty payments to segregated education, transportation and municipal funds, which averages one sixth of Wyoming’s total annual expenditures, approximately 40% of Wyoming’s annual expenditures have been made without biennial deliberation or appropriation by the state legislature.²⁴ If this trend continues, less than 60% of the biennial budget will be deliberatively appropriated by the state legislature, whereas federal priorities will determine at least 22% of the budget.

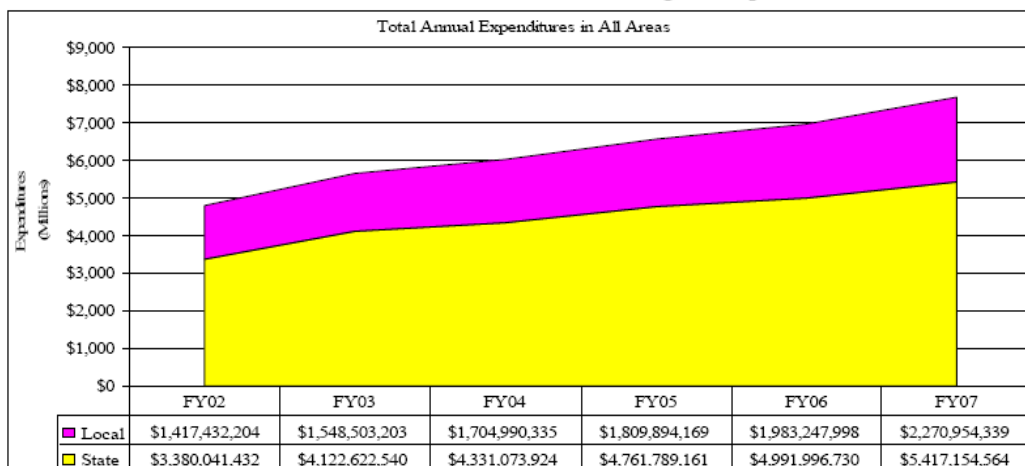
In effect, unless the current trend is reversed, the federal government will enjoy at least a one-third “partnership interest” in determining the biennial budgeting priorities of Wyoming’s state government. Not surprisingly, the federal funding tied to this partnership interest appears to have caused Wyoming’s state government to spend ever more state money by artificially stimulating demand for government services and programs. For example, in 2005, Wyoming was second in the nation in per capita state expenditures.²⁵

There is a strong correlation between annual federal funding and state-funded expenditures. According to NASBO data, between 1993 and 2006, federal grants to the state of Wyoming increased from \$384 million to \$1,366 million nominally, or about 165% in real terms based on year 2000 dollars.²⁶ At the same time, as reported by NASBO, general fund expenditures increased from \$421 million to \$2483 million nominally, or 347% in real terms.²⁷ Data from Wyoming’s Legislative Service confirms a similar growth pattern of lesser magnitude.



(Figure 1; source: Wyoming Legislative Service)

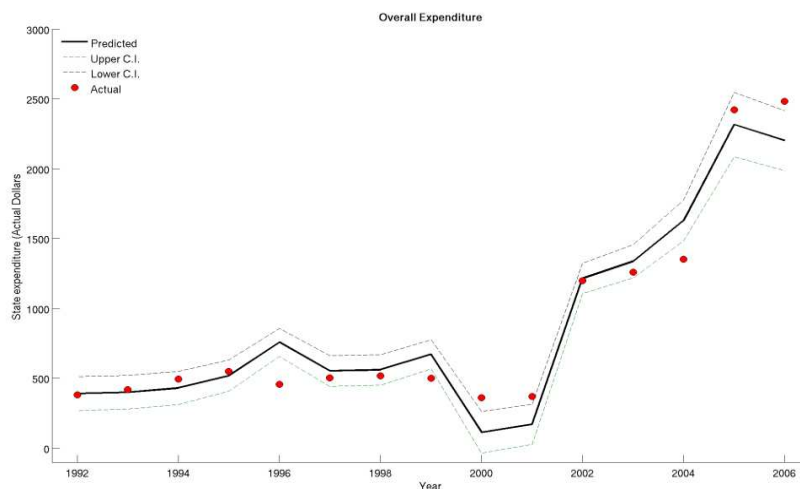
Historical State and Local Government Funding and Expenditures



Legislative Service reports federal funding grew about 150% in nominal terms between 1993 and 2008 (Figure 1).²⁸ And between 2002 and 2007 alone, the Legislative Service reports that state-funded annual expenditures have grown about 50% in nominal terms (Figure 2).²⁹

(Figure 2; source: Wyoming Legislative Service)

Taken together, increased federal funding and increased state expenditures are obviously visually correlated. This is no optical illusion. Statistical analysis, graphically shown in Figure 3 below, confirms that the amount of federal funding strongly predicts the increasing trend in state expenditures.



(Figure 3; source: NASBO data; Appendix)

The Y axis in Figure 3 shows the total amount of state expenditures in millions of dollars and the X axis shows the year of such expenditures. The dots represent actual total amounts of state expenditures reported by NASBO for the specified years. The darkest solid line in Figure 3 shows the total amount of state expenditures one would expect in a given year based on a standard linear statistical model and using NASBO data for total federal funding. This model assumes that state expenditures are determined by and proportional to federal expenditures. The close proximity of the solid line to the dots in Figure 3 as well as the detailed mathematical analysis set out in the Appendix, indicate that such a model accounts for more than 90% of the yearly variations in state expenditures.

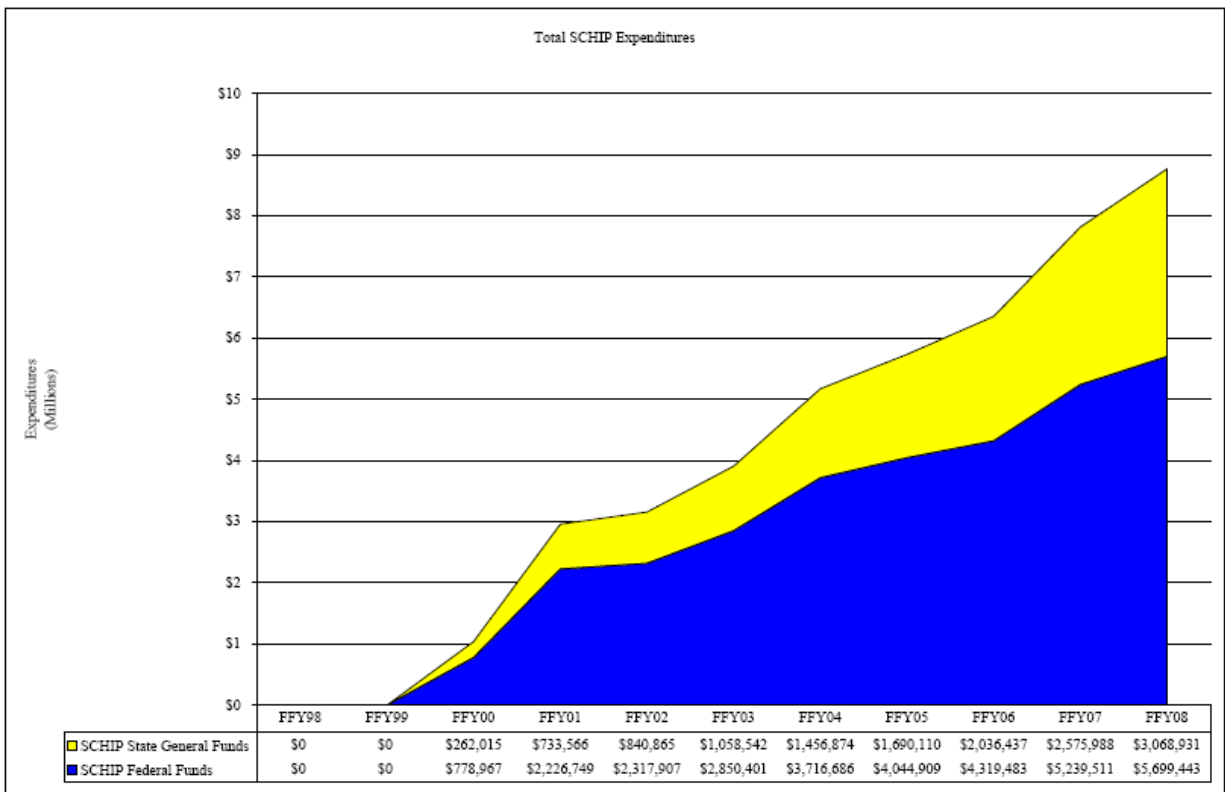
In short, the standard statistical model depicted in Figure 3 confirms the theory that increases in total state expenditures in Arizona are linked to increased federal funding. Although such proof of correlation is not necessarily proof of causation, it confirms that lawmakers increase state expenditures to match federal. the growth of the State Children's Health Insurance Program (“SCHIP”) and Medicaid provides concrete evidence that federal priorities have increasingly dominated those of Wyoming’s state government, ballooning state-funded expenditures on favored federal programs.

A. SCHIP: A Case Study in the Bloating of State Government through Federal Grants-in-Aid.

With respect to testing the hypothesis that federal grants ratchet up state-funded expenditures on federally favored programs, Wyoming’s state’s recent experience with SCHIP presents the best controlled experiment that one could hope to find in political science. Enacted as part of the Balanced Budget Act of 1997, SCHIP sought to expand health insurance coverage for children from families with incomes too high to qualify for Medicaid. And, like Medicaid,

States receive a federal matching grant for participating in their SCHIP programs—with predictable results.

Ever since Wyoming committed state funds to SCHIP in 2000, the state has seen its commitment grow exponentially. According to the Legislative Service, in 2000, the State started SCHIP with an initial expenditure of just over \$250 thousand in state funding (Figure 4).³⁰ This initial expenditure triggered federal matching funds of nearly \$800 thousand—more than three times the state’s initial expenditure.³¹ The next year, in 2001, the State responded by tripling its original expenditure, spending nearly \$800 thousand on SCHIP; which was reciprocated again by nearly triple the amount of federal funding, or nearly \$2.4 million.³² Following the same pattern, by the year 2008, the state was spending more than \$3 million in state revenues on the program and triggering just under \$6 million in federal grants.³³



(Figure 4; source: Wyoming Legislative Service)

The state is now hooked both on federal funding and on SCHIP. Through the ratcheting effect of federal matching grants, state expenditures in support of SCHIP increased 1,071% in just eight years. Statistical analysis of both State Legislative Service and NASBO data, which is shown in Figure 5 below, shows that year on year, state funding grows to match increases in federal funding.³⁴



(Figure 5; source: NASBO data; Appendix)

The Y axis in Figure 5 shows the total amount of state expenditures in millions of dollars and the X axis shows the year of such expenditures. The dots represent actual total amounts of state expenditures for SCHIP reported by NASBO for the specified years. The darkest solid line shows the state SCHIP expenditures one would expect in a given year based on NASBO data for federal SCHIP funding if law makers increased state funding proportionately to match increases in federal funding.. As shown by the close proximity of the solid line to the dots in Figure 5, as well as the detailed mathematical analysis set out in the Appendix, the model fits the data quite

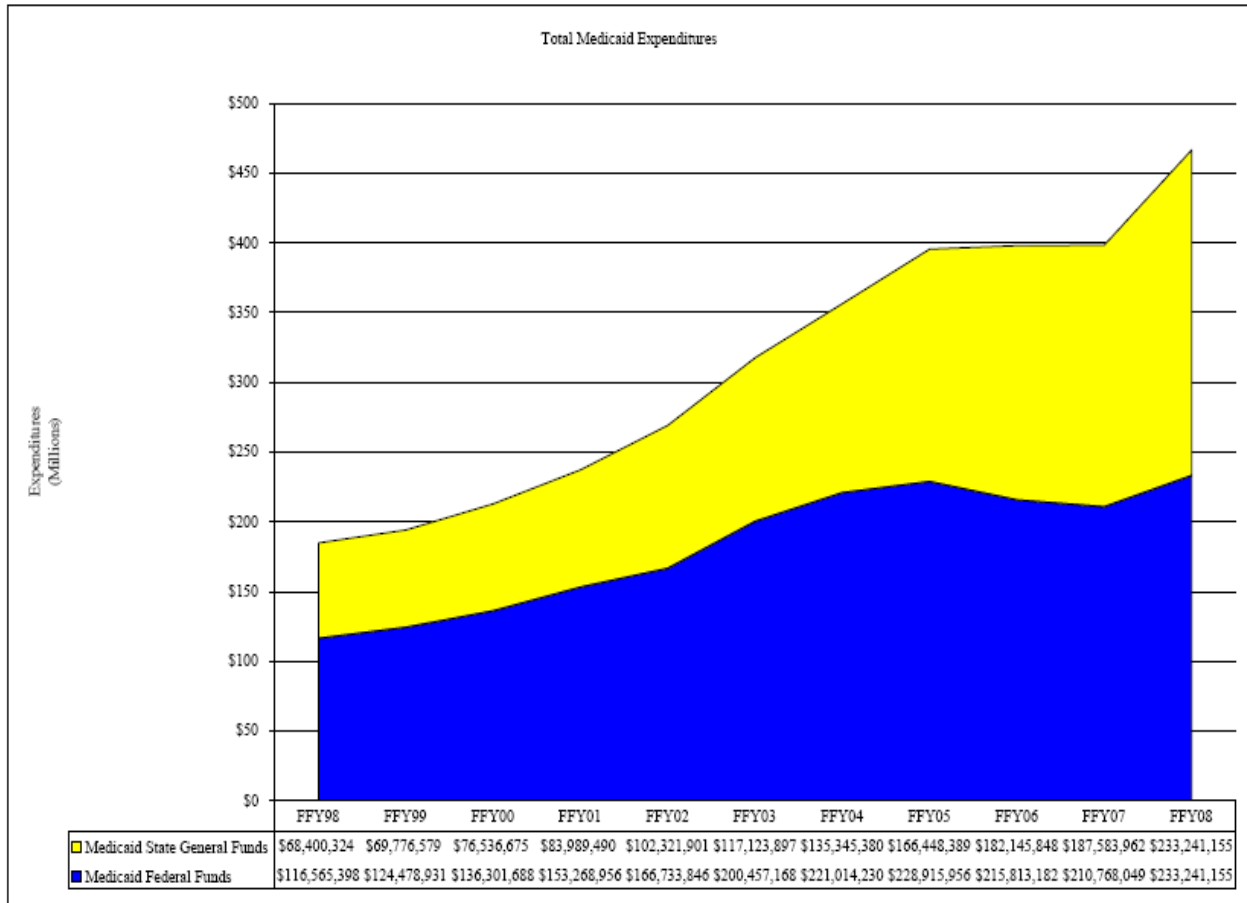
closely. The thin lines on either side of the expected level of state expenditures describe the 95% confidence interval, for the data, assuming deviation from the trend are a result of normally distributed noise (using a standard statistical model).

The trouble yet to come from the fact that state funding to increase proportionately with federal funding on SCHIP is foreshadowed by a closer look at the data. The multiple of matching federal dollars for each state dollar spent on SCHIP has dropped by nearly 50% over eight years, from just over 3 to just under 2 times the state expenditures on the program. In essence, the federal government induced a large state investment in a federally-favored program, created a large and growing constituency for the program, and now is slowly pulling the rug out from underneath state officials. Eventually, this will leave the state with the responsibility to administer a program that probably would not have grown so large or so fast had the federal matching grant multiple been smaller at the outset. The state is now locked into a program by a political reality that denies fiscal reality.

As the unwinding experiment with SCHIP illustrates, windfalls of matching federal grants have aversive consequences. Those consequences include inflated demand for government services and runaway state bureaucracies. And there is perhaps no better example of a runaway state bureaucracy propelled by insatiable demand for government services than that which Medicaid set in motion.

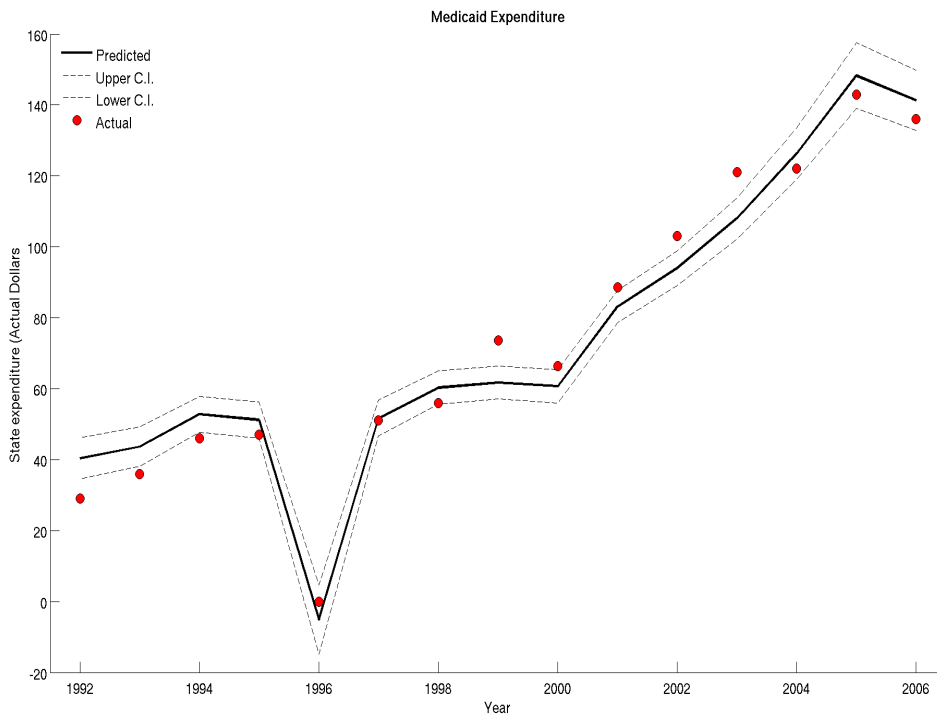
B. Medicaid: The Mother of All Funded Federal Mandates.

According to the Legislative Service, between 1998 until 2008, federal funding for Medicaid grew 100% and state-funding for Medicaid grew over 242% in nominal terms (Figure 6).³⁵ And, in real terms, based on NASBO data, Wyoming saw its federal funding for Medicaid



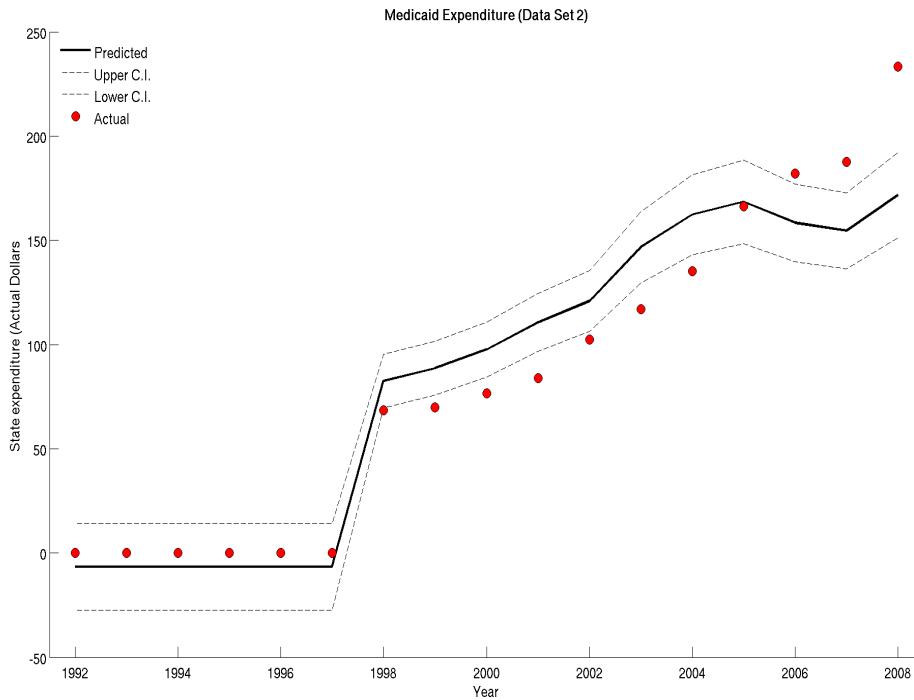
(Figure 6; source: Wyoming Legislative Service)

grow 136% (from \$98 million to \$239 million in year 2000 dollars) and its state-funded Medicaid expenditures grow 248% (from \$33 million to \$115 million in year 2000 dollars) between 1992 and 2006.³⁶ In fact, statistical analyses of both NASBO and Legislative Service data as shown in Figures 7 and 8 confirm that state-funded medical expenditures have increased proportionately with federal funded expenditures since 1992.³⁷



(Figure 7; source: NASBO data; Appendix)

The Y axis in Figure 7 shows the total amount of state expenditures in millions of dollars and the X axis shows the year of such expenditures. The dots represent actual total amounts of state expenditures for Medicaid reported by NASBO for the specified years. The darkest solid line shows the state Medicaid expenditures one would expect in a given year if state expenditures were always increased proportionately to match increases in NASBO data for federal Medicaid funding. As shown by the close proximity of the solid line to the dots in Figure 7, as well as the detailed mathematical analysis set out in the Appendix, the model fits the data quite closely. The same relationship is shown in Figure 8, based on Wyoming Legislative Service data.



(Figure 8; source: Wyoming Legislative Service data; Appendix)

But this long term trend showing that increases in state Medicaid expenditures are strongly determined by increases in federal Medicaid funding does not tell the whole story. Based on NASBO data, combined state and federal medical expenditures on Medicaid in Wyoming have historically ranged between 7% and 16% of total annual state expenditures between 1992 and 2006, with an average of about 8%.³⁸ And state-funded Medicaid expenditures have ranged between 7% and 23% of the state’s general fund expenditures between 1992 and 2006, with an average of about 10%.³⁹ At first glance, this would seem to indicate Wyoming’s Medicaid expenditures are less significant than in states such as Arizona, where Medicaid expenditures have ranged between 15% and 20% of total expenditures during much of same time frame.⁴⁰ Perhaps one might even draw the conclusion from this data that Medicaid does not seriously threaten Wyoming’s sovereignty given that the average of the total budget

spent on Medicaid for all states is now approaching 25%.⁴¹ That conclusion would be completely wrong.

Masked by times of plenty, ever-increasing federal funding has driven Medicaid growth to an unsustainable height. Medicaid's relatively small share of state expenditures at the present date is due almost entirely to a boom period in state spending generated by tax revenues and federal mineral royalties from skyrocketing oil and gas prices, which began in 2001.⁴² As the nation stands on the edge of an economic abyss, it cannot be presumed that the good times will continue to roll. Unfortunately, Wyoming is caught in a fiscal bind because real state spending on Medicaid is now about 50% greater than in 2001, when Medicaid claimed 16% of total state expenditures and nearly 23% of the state's general fund expenditures.⁴³ As revenues drop closer to year 2001 levels, the state will be confronted with a choice between drastically reducing Medicaid spending or slashing spending on all other programs. Undoubtedly, the incentive structure of federal matching funds will pressure the Legislature to cut spending on programs that are fully or predominately state-funded, long before touching the first dollar of Medicaid spending. In short, Medicaid's share of state expenditures threatens to rocket past 2001 levels, incinerating any state priority that stands in the way. Standing still is no longer an option for responsible statesmen.

IV. Reform Options

In the trying times States now face, when public officials need the greatest degree of flexibility in budgeting, the domination of state fiscal policy by federal priorities is irresponsible and dangerous. Restoring respect for state sovereignty and cutting the strings attached to federal funding is now more than a reform. It is a fiscal necessity. But how could it ever be feasible?

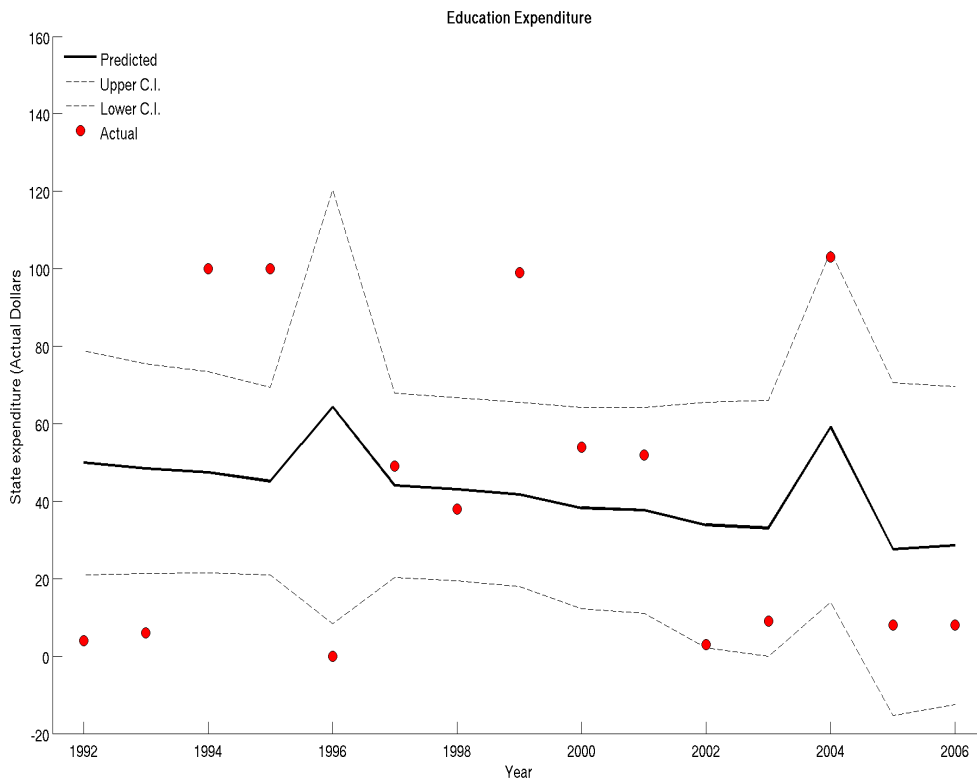
In most states, there is little that can be done at the level of state policy to overcome the pernicious incentive structure created by federal grants-in-aid. Occasionally legislatures in states

such as Arizona have threatened to appropriate federal funding, but these threats have little chance of reducing federal influence on state priorities.⁴⁴ Formalistically “appropriating” federal funding achieves nothing meaningful from the perspective of state sovereignty when the act of accepting such funding still imposes on the state the legal responsibility to implement a federal program.

Instead, for most states, the best reform option entails pursuing substantial reforms at the federal level aimed at amending the U.S. Constitution or the Unfunded Mandates Reform Act (UMRA) to bar both funded and unfunded federal mandates, or, at the very least, to strengthen the UMRA to eliminate loopholes and require funding for administering federal programs.⁴⁵ Those options are also relevant to Wyoming and should be considered. But the history of education spending in Wyoming confirms that it is uniquely positioned to opt-out of federal programs altogether based on the financial independence made possible by its receipt of federal mineral royalty payments. And there remains the possibility of mounting a creative new legal challenge to enforce federalism limits on Congress’ Spending Power.

A. K-12 Education in Wyoming: Proof of the Feasibility of Opting Out.

When it comes to education spending, federal grants-in-aid cause most other states, like Arizona, to appropriate ever more state funds to implement dubious federal programs like NCLB and to satiate artificially increased public demand for government services. Wyoming is different. Although increasing amounts of federal money are spent on education, there is no apparent statistical correlation between federal funding for K-12 education in Wyoming and general fund appropriations for K-12 education (Figure 9).⁴⁶

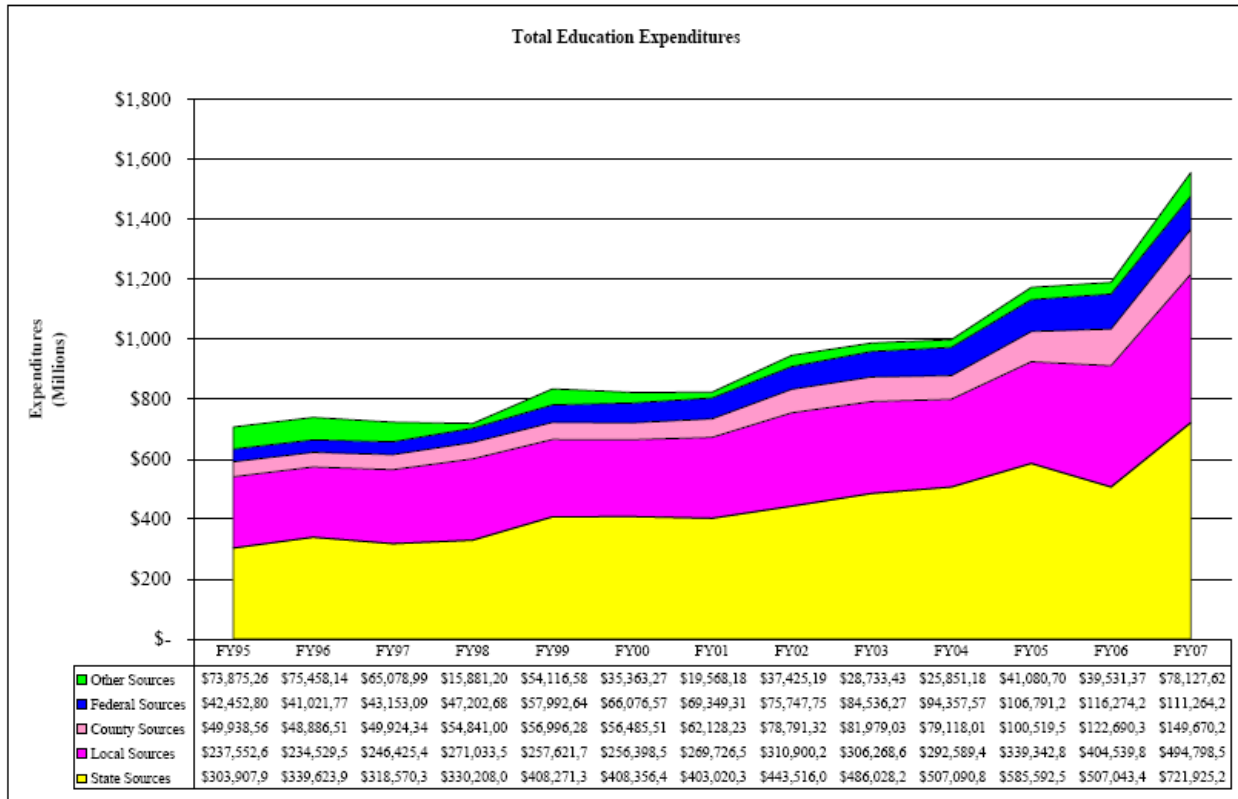


(Figure 9; source: NASBO data; Appendix)

The Y axis in Figure 9 shows the total amount of state expenditures in millions of dollars and the X axis shows the year of such expenditures. The dots represent actual total amounts of state expenditures for K-12 education reported by NASBO for the specified years. The darkest solid line shows the state education expenditures one would expect in a given year based on NASBO data for federal K-12 education funding if increases in federal funding linearly determined the increases in state expenditures. The dashed lined indicate the 95% confidence intervals for this prediction using a standard statistical model. As shown by the scatter-shot appearance of the dots in Figure 9, as well as the detailed mathematical analysis set out in the Appendix, the model does not fit the data very well—at least in Wyoming.

In fact, the state’s receipt of federal grants from No Child Left Behind declined about 5% between 2004 and 2007, from \$75.5 million to \$72 million.⁴⁷ Furthermore, in both real and

nominal terms, federal funding has trended downward as a percentage of total annual state spending on primary and secondary education both before and after the 2001 revenue boom, based on NASBO data.⁴⁸ And Wyoming’s Legislative Service reports that federal funding makes up a smaller percentage of the total amount of state and local education spending in 2007 than in 1995 (Figure 10).⁴⁹



(Figure 10; source: Wyoming Legislative Service)

The declining share of federally-funded education expenditures over extended periods of time combined with the lack of statistical correlation between federal educational funding and state expenditures suggests Wyoming’s education spending is largely autonomous from federal influence. Wyoming has demonstrated the ability to minimize the increasing federalization of a traditionally local and state concern—possibly avoiding or positioning itself to avoid many of the “unpleasant and somewhat bizarre” policy choices required by NCLB and other federal programs.⁵⁰ This does not mean Wyoming’s total spending on K-12 education has declined

either nominally or in real terms. Clearly, it has not. But to the extent that the education bureaucracy is overgrown in Wyoming, it appears essentially home-grown. And this naturally raises the question, how did Wyoming avoid becoming addicted to federal funds?

Although political courage is one possibility, as indicated previously, the best explanation is federal mineral royalty payments. Wyoming's educational establishment automatically receives huge amounts of money from federal mineral royalties. It has the ability to replace lost federal grants with money derived from those royalties. Accordingly, it appears that federal mineral royalty payments have made it politically possible for Wyoming both to avoid and to wean itself off federal education funding, along with the strings attached to such funding. There is no reason such autonomy should be restricted to the education establishment, when the unsustainably spiraling cost of programs like SCHIP and Medicaid is so apparent.

Wyoming is in a unique position to cut state spending and opt out of federal programs by redirecting the flow of federal mineral royalties to replace lost federal matching grants. As discussed previously, the existing statutory framework causes federal mineral royalties to bypass the general fund and flow on "autopilot" to designated fund accounts (such as K-12 education) without further legislative deliberation. This framework should be reformed. Specifically, when state agencies reduce their spending on a program that receives matching federal grants-in-aid, a new or amended statutory framework should automatically redirect the flow of royalties to neutralize the loss of federal grants-in-aid. For example, if \$1 million cut from state SCHIP expenditures were to trigger a loss of \$2.5 million in federal grants-in-aid, then the reformed statutory framework would immediately divert \$2.5 million in federal mineral royalties to SCHIP to replace the lost federal grants-in-aid. This would minimize the political withdrawal symptoms associated with cutting back on state SCHIP expenditures, with federal royalty payments serving as public policy methadone that could empower Wyoming to gradually wean itself from its

federal funding habit. Wyoming, its agencies and subdivisions, would be freer to engage in cost-cutting without the sort of political calculus federal grants-in-aid would otherwise force into the equation. This would enable the state to opt-out of one-size-fits-all federal programs in favor of local solutions for local problems.

As foreshadowed in the preceding example, vindicating state sovereignty through the “methadone method” should start with the relatively painless choice of breaking the State’s growing addiction to SCHIP and kicking the No Child Left Behind habit altogether. Together, this would require diverting fewer than \$80 million dollars of federal mineral royalties to substitute for the lost matching federal grants. The State would then be well-positioned politically to break the grip of federal dependency, either to restructure programs to better serve local priorities or to downsize them to fit fiscal reality.

B. Challenging the Power to Bargain-Away Federalism.

It is natural to wonder where Congress found the power to manipulate state priorities and policies through federal grants-in-aid.⁵¹ Such wonderment may arise from the belief that the U.S. Constitution grants only enumerated powers to the federal government, reserving all others to the states and the People. But that perfectly legitimate understanding is unfortunately anachronistic. In fact, courts have interpreted Congress’ spending power so broadly as to give it nearly complete authority to spend federal money on whatever Congress believes promotes the general welfare.⁵² And the notion that Congress’ spending authority is an effective unbounded “plenary power” underpins case law that analogizes Congress’ dealings with the States to something like freewheeling contract negotiations. Under such prevailing and unfortunately well-settled precedent, courts will usually tolerate just about any condition Congress places on a State’s acceptance of federal money, so long as the State’s acceptance is knowing and voluntary, based

on the theory that the States are the best judge of when Congress has overstepped the bounds of federalism.⁵³

But the contract analogy used to justify the strings that are attached to federal grants-in-aid is invalid. There are bargains Congress simply has no constitutional power to strike with the States. For example, the Supreme Court has held, “where Congress exceeds its authority relative to the States . . . the departure cannot be ratified by the ‘consent’ of state officials.”⁵⁴ Likewise, there are limits to the idea that the States are the best judge of whether Congress has overstepped the bounds of federalism *because those boundaries are meant to restrain the States too*.⁵⁵ For example, few would argue that the States have the power to relinquish their seats in the House of Representatives in exchange for federal-grants-in-aid. Nor does Congress have the power to condition federal grants-in-aid on the stipulation that States relinquish their seats in the House of Representatives. Fewer still would argue that Congress could give federal money to the States on the stipulation that they organize a new branch of the federal government. And no one would dispute that Congress lacks the power to condition federal grants-in-aid on the States agreeing to implement a federal program that violates the first eight amendments of the Bill of Rights. But what if Congress conditions federal grants-in-aid on the basis of the states relinquishing powers that have traditionally defined states as distinct sovereign entities within our system of federalism? An analogy to contract law should not save such a Faustian bargain from being struck down.

The law of contract, after all, voids fully consensual agreements that have an illegal objective because neither party to the agreement has the lawful power to request, offer or perform what is promised.⁵⁶ Likewise, it makes no sense to presume any state has the constitutional power to act as the People’s representative in bargaining away the very structural protections meant, in part, to protect the People from their state. Neither the States nor Congress

have the power to dismantle federalism altogether or piece-by-piece merely by consent or mutual agreement. Therefore, applying the contract analogy that has (thus far) shielded funded federal mandates from constitutional challenge by the States, should lead to the conclusion that the U.S. Constitution voids even fully consensual, fully-funded federal mandates, which have the purpose or practical effect of undermining the attributes of state sovereignty that underpin federalism.⁵⁷

Federalism is not an end-in-itself.⁵⁸ It is not meant merely to protect states from an encroaching federal government. The 10th Amendment reserves power to the States *or the People*. And, most fundamentally, federalism is meant to secure individual liberty against the encroachments of *both federal and state* governments by diffusing and checking governmental power.⁵⁹ As evidenced by the preceding sections, such structural protection is clearly needed against fully-funded federal mandates and their dependency-inducing impact on state government.

In sum, rather than attempting to argue that state sovereignty somehow empowers the States to scotch deals knowingly reached with the federal government (which has never proved persuasive in a court of law), Wyoming should consider challenging the worst mandates from the perspective of protecting individual liberty through principles of federalism. This, of course, requires the blunt and, optimally, humbling admission that neither the States nor Congress ever had the constitutional power to bargain-away the protections of federalism.

Conclusion

The 10th Amendment to the U.S. Constitution was meant to ensure that all governmental powers not among the enumerated powers of the federal government would be retained exclusively by the States or the People. It enshrines a system of federalism, a system of dual sovereignty between the states and federal government—not as an end in itself, but to preserve liberty. For federalism to work, the States must retain their autonomy to act as a check on federal

power—whether they want to or not. This is because when states become dependent on federal funding, they cannot oppose unwise federal policies or abuses of federal power; much less serve their citizens effectively in terms of local priorities. Consequently, the preservation of liberty gets short shrift.

Fortunately, despite the bloating impact federal funds have had on the size and scope of Wyoming's state government and the threat of dependency posed by new federal programs such as SCHIP, Wyoming has the financial capacity to opt-out of federal programs mandated by federal grants-in-aid. Ironically, that capacity originates from the compensation Wyoming receives for the federal government's usurpation of its public lands and mineral rights. Federal mineral royalty payments make it politically possible for Wyoming to just say no to funded federal mandates. And the humble admission that there is no constitutional power to bargain away the attributes of state sovereignty in consideration of federal grants-in-aid just might permanently liberate Wyoming from the worst federal mandates.

Appendix: Statistical Analysis of Wyoming State Expenditures

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Summary

Two reports on Wyoming state and federal expenditures were examined in order to assess a causal relationship between the level of federal funding and the amount of state expenditures. A stochastic linear model was used to assess the strength of the dependency of state general fund expenditures on federally funded expenditures. For Medicaid and SCHIP spending, the analysis of both datasets revealed that more than 80% of the variation in state expenditures was dependent on variation in federal funding. The scarcity of data points in the second dataset precluded analysis of trends in other variables. Using the first dataset, further analyses revealed that more than 93% of the variation in overall state expenditures was linearly dependent on federal expenditures. In contrast, no significant relationship was found between the state and federal educational expenditures as reported in the first dataset. Based on the size of the median residuals, in standardized units, calculated from this data, federal funding appears to be a more reliable predictor of state expenditures than is state expenditures of federal funding.

Methods

Two sets of conflicting data reporting federal and Wyoming state expenditures were examined. The first dataset was provided by the National Association of State Budget Officers (Dataset 1). The second dataset was provided by the Wyoming state legislative service office (Dataset 2). In particular, four items from the budget were considered: State Children's Health Insurance Program (SCHIP), Medicaid, primary and secondary education, and overall state and federal expenditures.

A stochastic linear model was used to assess the strength of the dependency of state general fund expenditures on federal funding. The small number of data points in both datasets precluded the use of nonlinear models to explain the data. Missing or averaged data points

limited the utility of Dataset 2 and only observations relating to Medicaid and SCHIP expenditures were examined. All revenues and expenditures were analyzed using nominal (actual) dollars.

General approach

The linear model used to assess the dependency of state general fund expenditures on federal funding had the general form:



Where Y_{SF} indicates the predicted level of state expenditures, FF indicates the amount of federal funds, α_0 , and α_1 are parameters determined by minimizing the error function:



Where SF indicates the vector containing actual state funding levels and Y_{SF} is the vector of predicted SF values. In other words, the parameters were determined by minimizing the difference between predicted and the actual SF values using ordinary least squares. The random noise component, ϵ , represents the residuals and given by:



The residuals ϵ are assumed to be independent, identically distributed (i.i.d.) and to follow a normal (Gaussian) distribution with a zero mean. Once the values of α_0 , α_1 , and ϵ , were obtained from least squares, the percent of the variance in actual state expenditure captured by the model was quantified using the coefficient of variation (R^2) statistic, adjusted for sample size effects. The predictive reliability of the parameters (i.e., the probability that state expenditures estimated from the model are wrong) was assessed based on an ANOVA table constructed from the linear model, as is standard for this methodology. In addition, a multilinear regression was used to assess the significance of interactions between all variables in the first dataset:



Where Y_{SF} indicates overall predicted state expenditures. Parameters b_0 , b_1 , b_2 , and b_3 are determined by minimization of least squares error, and ϵ is, as before, a random noise component. The parameters, b_i , denote the partial effects of individual *FF* items on overall *SF*. In other words, the parameters b_i represent the change in *SF* per \$1 of one of the *FF* items (e.g., Medicaid) when all other *FF* items (e.g., SCHIP and education) are held constant.

In addition to assessing the strength of the causal relationship of *FF* on *SF*, linear models were used to examine two alternative hypotheses: the ability of *SF* to predict *FF*, and the ability of year on year growth in *FF* to predict year on year growth in *SF*. The magnitude of the median residual (in standardized units), that is median of the (normalized) error term that cannot be explained by the linear model, was used as a qualitative surrogate compare whether *SF* was a more reliable predictor of *FF* or the converse. Scarcity of data points precluded more detailed approaches.

Results

Using the estimated parameters, along with federal funds (*FF*) as inputs, predicted state expenditures (Y_{SF}), and the corresponding 95% confidence intervals were calculated (see Figures below). Alongside these predicted levels of state expenditure are plotted the actual state expenditures (*SF*). Trends in overall, Medicaid, SCHIP, and educational expenditures are detailed below.

Overall Expenditures

Overall *FF* explains 94% (adjusted for sample size) of the overall *SF*. Once the linear trend is subtracted out, the median residual (in standardized units) for a model where overall *FF* is used to predict overall *SF* was 8.92. In contrast, if a linear model is constructed where *SF* is used to predict *FF*, the median residual was 10.33. This implies that for this model and limited dataset, overall *FF* is a more reliable predictor of overall *SF* than the converse. Overall expenditure from dataset 2 was not analyzed owing to scarce data.

A similar stochastic linear model to assess the effect of yearly growth (that is, successive yearly differences) in overall *FF* on yearly growth in overall *SF* explained substantially less of the variation in overall *SF* growth (64%) compared to the model with absolute dollar amounts.

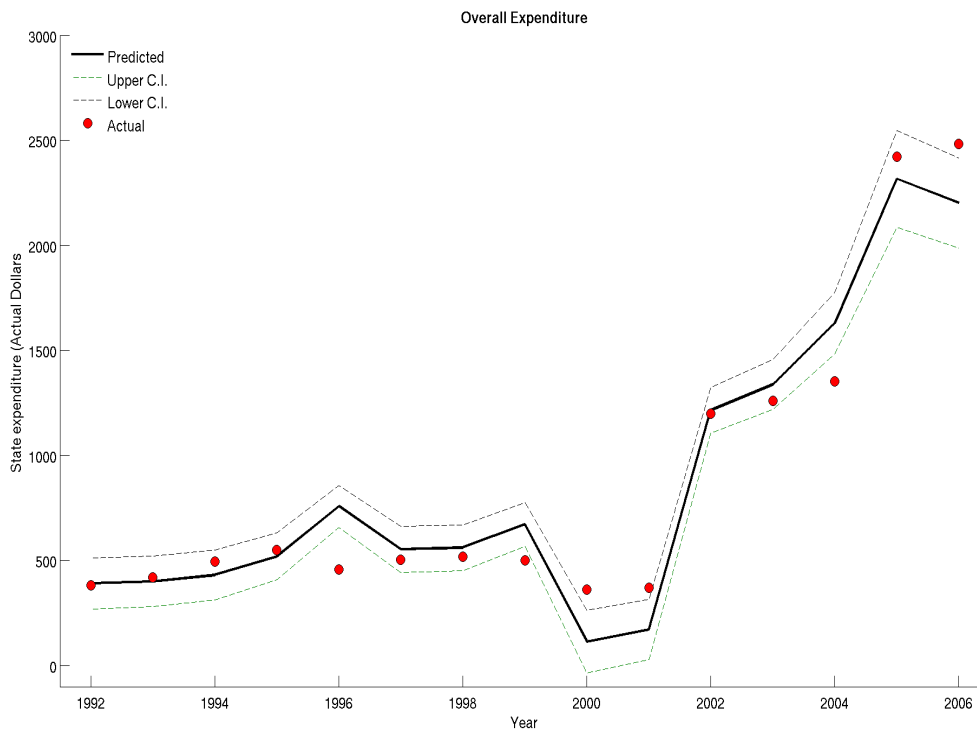


Figure 1: Overall State Expenditures as predicted by Federal Funds. *FF* explains 94% (adjusted for sample size) of overall *SF* (solid red circles). *SF* reported in millions of actual dollars. 95% confidence intervals are shown as dashed lines on either side of the solid line indicating predicted state expenditures (Y_{SF}). Offset (a_0) = -315.93 ± 92.82 . Change in overall *SF* per \$1 *FF* (a_1) = 1.84 ± 0.12 . The probability that a_0 and a_1 would be outside of these ranges is less than 0.01. Source: NASBO.

Medicaid Expenditures

In dataset 1, Medicaid *FF* explained 94% (adjusted for sample size) of the Medicaid *SF* (Figure 2). Similarly, for dataset 2, Medicaid *FF* explained a large proportion of Medicaid *SF* (89.63%, adjusted for sample size). Linear model that relates Medicaid *FF* to Medicaid *SF* left unexplained residuals with a median value of 4.18 (in standardized units), whereas the median residual magnitude (in standardized units) was 6.14 when Medicaid-related *SF* was used to predict Medicaid-related *FF*. As is noted above, this is an indicator that Medicaid *FF* is a more reliable predictor of Medicaid *SF* than the opposite.

90% of the variation in yearly growth in Medicaid *SF* was predicted by the yearly growth in Medicaid *FF* using a similar linear model.

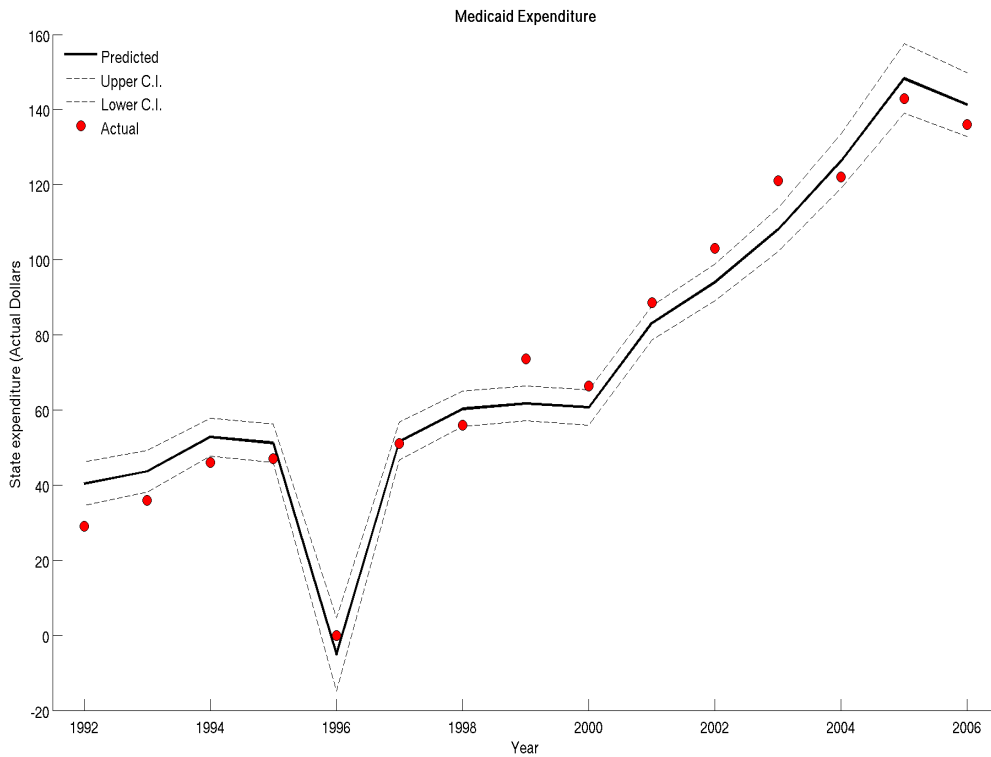


Figure 2: State Medicaid Expenditures as Predicted by Federal Medicaid Funds. Medicaid *FF* explains 96.52% (adjusted for sample size) of the Medicaid *SF* (solid red circles). *SF* reported in millions of actual dollars. 95% confidence intervals are shown as dashed lines on either side of the solid line indicating predicted state Medicaid expenditures (Y_{SF}). Offset (a_0) = -5.15 ± 4.53 . Change in *SF* per \$1 *FF* (a_1) = 0.54 ± 0.03 . The probability that a_0 would be outside the above range is 0.28, that a_1 would be outside the above range is less than 0.001. Source: NASBO

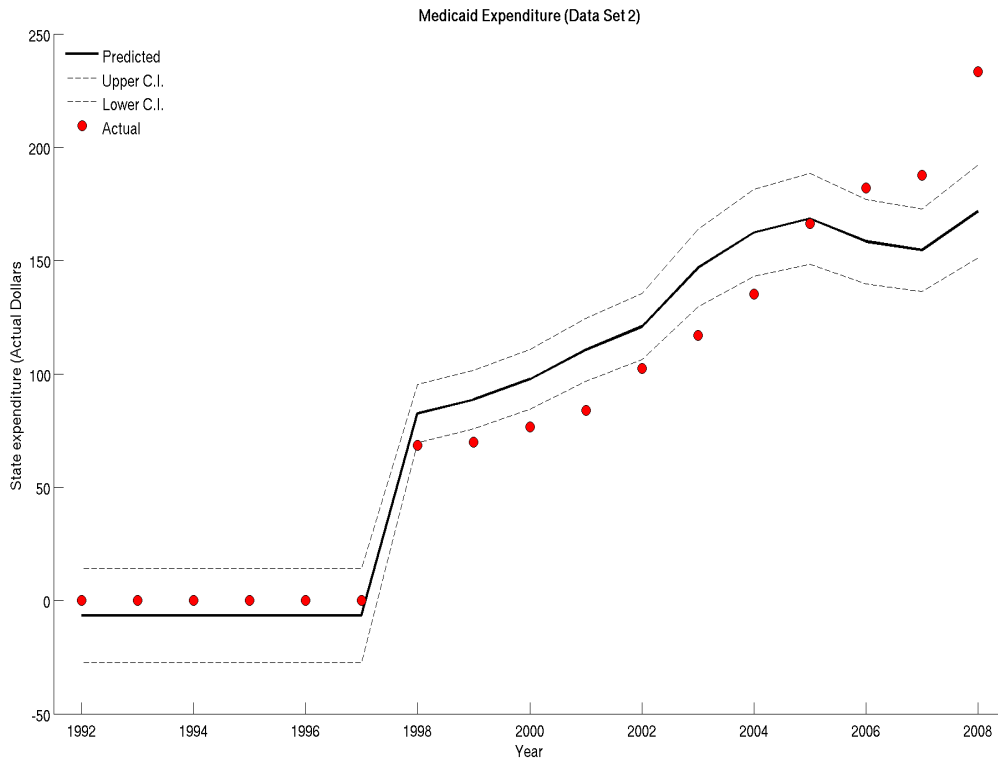


Figure 3: State Medicaid Expenditures as Predicted by Federal Medicaid Funds (Dataset 2). Medicaid *FF* explains 89.63% (adjusted for sample size) of the Medicaid *SF* (solid red circles). Medicaid *SF* reported in millions actual dollars. 95% confidence intervals are shown as dashed lines on either side of the solid line indicating predicted state Medicaid expenditures (Y_{SF}). Offset (a_0) = -6.61 ± 9.76 . Change in GF per \$1 IFF (a_1) = 0.76 ± 0.07 . The probability that a_0 would be outside the above range is 0.50, that a_1 would be outside the above range is less than 0.001. Source: Wyoming State Legislative Services Office.

SCHIP Expenditures

In dataset 1, SCHIP *FF* explained 81.86% of the SCHIP *SF* (Figure 4). Similarly, for dataset 2, SCHIP *FF* explained a substantial proportion of the variance in SCHIP *SF* (95.39%; Figure 5). The median magnitude of the residuals (in standardized units) for the model using SCHIP *FF* to predict SCHIP *SF* was 0.06. In contrast, the median magnitude of residuals (in standardized units) for the model using SCHIP *SF* to predict SCHIP *FF* was 0.37, implying that using SCHIP *FF* as a predictor of SCHIP *SF* is marginally more reliable than a model using the opposite dependency on this dataset.

A model of yearly growth in SCHIP *FF* to predict yearly growth in SCHIP *SF* captured only 10% of the variation in the growth of SCHIP *SF*.

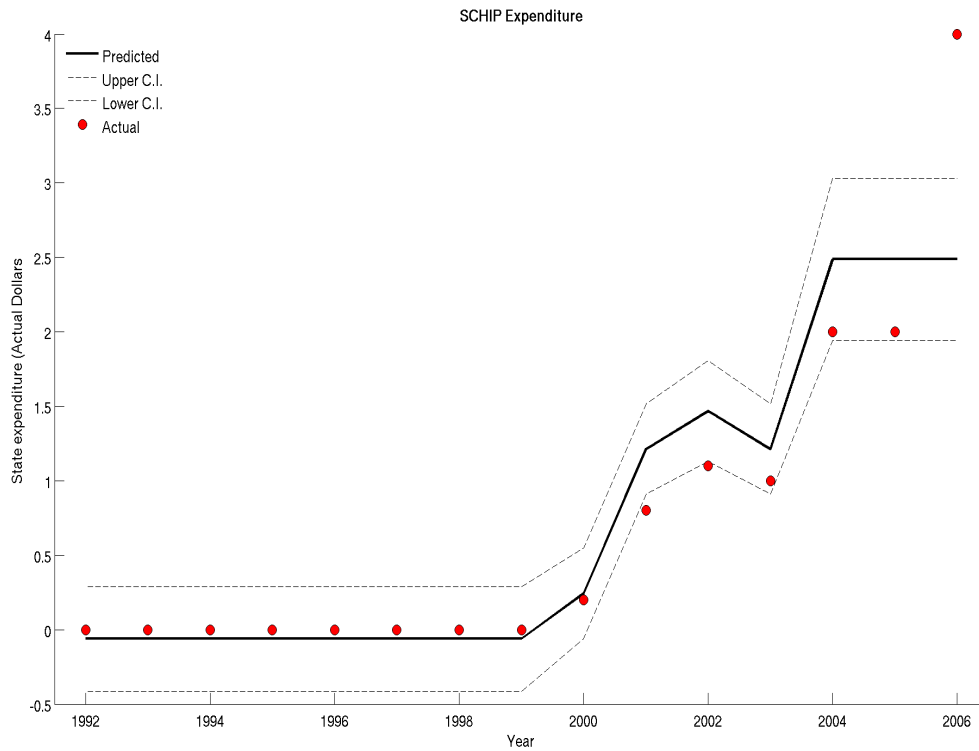


Figure 4: State SCHIP Expenditures as Predicted by SCHIP Federal Funding (Dataset 1). SCHIP *FF* explains 81.86% (adjusted for sample size) of SCHIP *SF* (solid red circles, millions of actual dollars). 95% confidence intervals are shown as dashed lines on either side of the solid line indicating predicted state SCHIP expenditures (Y_{SF}). Offset (a_0) = -0.06 ± 0.16 . Change in *SF* per \$1 *FF* (a_1) = 0.51 ± 0.06 . The probability that a_0 would be outside the above range is 0.71, that a_1 would be outside the above range is less than 0.001. Source: NASBO.

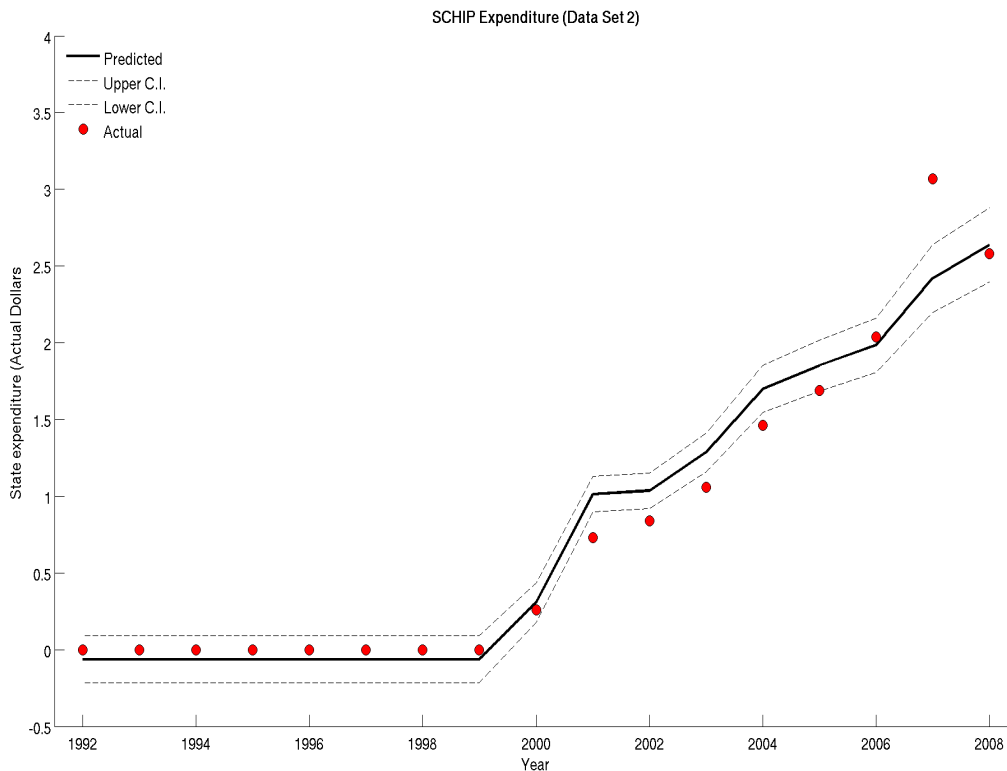


Figure 5: State SCHIP Expenditures as Predicted by SCHIP Federal Funding (Dataset 2). SCHIP *FF* explains 95.39% (adjusted for sample size) of SCHIP *SF* (solid red circles, millions of actual dollars). 95% confidence intervals are shown as dashed lines and predicted SCHIP *SF* (Y_{SF}) is the solid line. Offset (a_0) = -0.06 ± 0.16 . Change in *SF* per \$1 *FF* (a_1) = 0.51 ± 0.06 . The probability that a_0 would be outside the above range is 0.71, that a_1 would be outside the above range is less than 0.001. Source: Wyoming State Legislative Services Office.

Education Expenditures

Sufficient and reliable data on secondary and primary education expenditures was not available from dataset 2. As with overall expenditures, all analysis on primary and secondary education spending was done using dataset 1. Unlike the previous variables, education *FF* explained only 6.04% (adjusted for sample size) of education *SF* (Figure 6). The lack of a linear relationship was also observed in the relation of yearly growth of education *FF* and yearly growth in education *SF* (explaining only 2% of the variance).

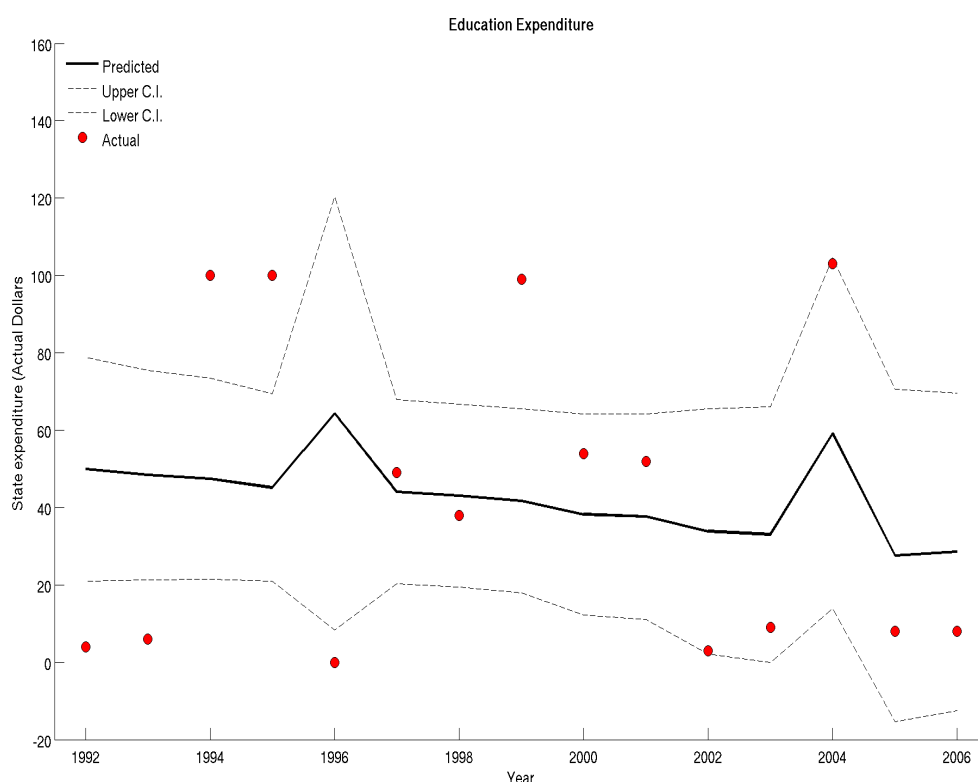


Figure 6: State Education Expenditures as Predicted by Education Federal Funding (Dataset 1). Education FF explains only 6.04% (adjusted for sample size) of the education SF (solid red circles, millions of actual dollars). 95% confidence intervals are shown as dashed lines and predicted education SF (Y_{SF}) is the solid line. Offset (a_0) = 64.31 ± 25.93 . Change in SF per \$1 FF (a_1) = -0.40 ± 0.44 . Because the explanatory power is very low (6%), the estimate of the change (a_1) is not reliable. The probability that a_0 would be outside the above range is 0.03, that a_1 would be outside the above range is less than 0.38.

Overall Trends in State Expenditures

A last linear model was estimated for predicting overall SF from individual (Medicaid, SCHIP, and Education) FF items using dataset 1. Together, individual FF items explained 76.88% of the overall SF . This is approximately 18% less than the explanatory power of overall FF (above). Figure 7 displays predicted overall SF with $\pm 95\%$ confidence intervals. See caption for the b coefficients, which measure the contribution of individual FF items to overall SF (so-called beta coefficient \pm standard error).

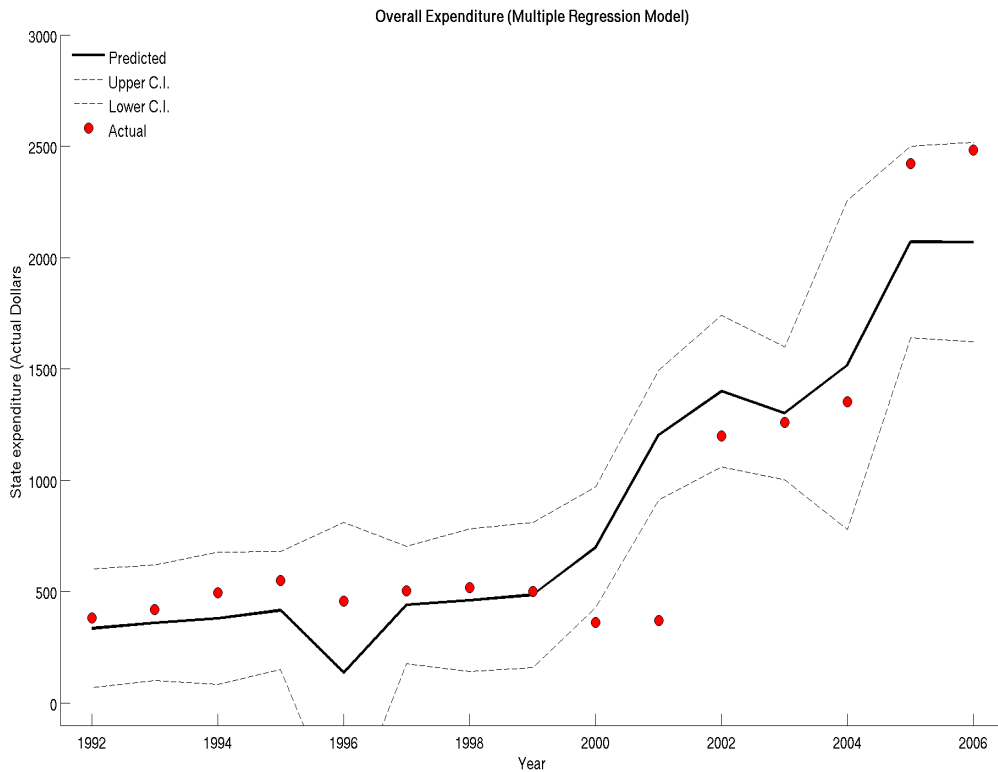


Figure 7: Overall State Expenditures as Predicted by Individual Federal Funding Items (Medicaid, SCHIP, education). Individual *FF* items explain 76.88% (adjusted for sample size) of the overall *SF* (solid red circles, millions of actual dollars). 95% confidence intervals are shown as dashed lines and predicted overall *SF* (Y_{SF}) is the solid line. Offset (b_0) = 137.16 ± 305.95 (the probability that b_0 would be outside the above range is 0.66). Change in overall *SF* per \$1 Medicaid *FF* (b_1) = 0.10 ± 4.05 (the probability that b_1 would be outside this range is 0.98). Change in overall *SF* per \$1 SCHIP *FF* (b_2) = 253.96 ± 126.09 (the probability that b_1 would be outside this range is 0.07). Change in overall *SF* per \$1 education *FF* (b_3) = 6.11 ± 4.99 (the probability that b_1 would be outside this range is 0.25).

Discussion

By construction, the linear models described above can be interpreted as effectively capturing any linear causal relation between dependent and independent variables (i.e., between state and federal expenditure). Thus, the R^2 value obtained from each model indicates the relative variance accounted for by a linear causal relation, and the remaining variance (i.e. $1 - R^2$) may represent the lack of causality, or alternatively, the insufficiency of the linearity assumption. However, given the sample size, it is not feasible to pursue any nonlinear models. From a causal perspective, α_0 represents the trend of state expenditures independent of federal funding while α_1 can be interpreted as the proportion of state expenditures related to federal

funding. When two variables are significantly related, further information about the direction of causation can be inferred by investigating the characteristics of the residuals. In this paper we used the median residual magnitude (in standard units) as a means to infer the reliability of two models with the same coefficient of variation, but different dependencies. By this rule, federal funds were found to be a more reliable measure of state expenditures, than the converse. However, a complete causal relation requires detailed consideration of relevant facts such as is found in the accompanying text.

1 J.D.; Director, Center for Constitutional Government, Goldwater Institute. This Report is not a publication of the Goldwater Institute, nor should the contents of this Report be attributed to the Goldwater Institute. The statements, opinions and conclusions expressed herein are solely those of the Author writing in a personal capacity.

2 USA Spending.gov, "Assistance Spent in Wyoming (FY 2007)," http://www.usaspending.gov/faads/faads.php?fiscal_year=2006&principal_place_state_code=56&sortby=f&datatype=T&reptype=p&database=faads&detail=0&submit=GO (last visited August 17, 2008).

3 Benjamin Barr, *Arizona's Struggle for Sovereignty: The Consequences of Federal Mandates*, Goldwater Institute PR-224, June 3, 2008, p. 3 (Graph 1) (The data for Graph 1 reportedly come from the Census of Governments, <http://www.census.gov/govs/www/statetechdoc2004.html#sources>. The data through 1995 reportedly were culled from their treatment in Susan B. Carter, ed., *Historical Statistics of the United States: Earliest Times to the Present*, Millennial Edition, Cambridge University Press, 2006, Volume 5: Governance and International Relations, sets Ea348-Ea352).

4 Office of Management and Budget, Historical Table 15.1 (FY 2007).

5 Edward M. Gramlich, "Federalism and Federal Deficit Reduction," *National Tax Journal*, No. 40, 1987, p. 299; Shama Gamkhar, *Federal Intergovernmental Grants and the States*, Northampton, Mass.: Edward Elgar, 2002; Aaron Wildavsky, "Fruitcake Federalism or Birthday Cake Federalism," in David Schleicher and Brendon Sedlow, eds., *Federalism and Political Culture*, New Brunswick, N.J.: Transaction Publishers, 1998, p. 55; Edward M. Gramlich, "Intergovernmental Grants: A Review of the Empirical Literature," in Wallace Oates, ed., *The Political Economy of Fiscal Federalism*, Lexington, Mass: Lexington-Heath, 1977, p. 219.

6 Barr, *supra* note 3, at 4-5.

7 *Id.* at 5.

8 *Id.*

9 *Id.*

10 *Id.*

11 Federal Register, Vol. 72, No. 228, November 28, 2007, available at <http://aspe.hhs.gov/health/fmapp09.pdf> (last visited August 17, 2008).

12 Barr, *supra* note 3, at 4.

13 *See id., inter alia*. In the course of investigating Wyoming's fiscal data, the Author discovered some discrepancies between state budget, federal funding and state expenditure data maintained by the National Association of State Budget Officers (NASBO) and the Wyoming Legislative Service. For example, based on the series set that appears to develop in specific categories of spending, the Author is concerned that NASBO's data may occasionally transpose numbers from one column into another and that data belonging in one column has occasionally been reentered erroneously in multiple columns. Additionally, pre-2002 federal funding data appears dramatically smaller in magnitude, more so than suggested by Census data. Lastly, another data discrepancy that may exist between NASBO and Legislative Service data may arise

from accounting differences relating to the fiscal year to which funding and expenditures are attributed, as well as the treatment of federal mineral royalty payments. To control for possible errors relating to these discrepancies, the Author has reviewed and presented both Legislative Service and NASBO data where necessary to justify a conclusion. However, despite these discrepancies, the Author believes that none discovered to this date are of sufficient magnitude and frequency to alter the conclusions reached in this Report. When these apparent discrepancies (basic data entry errors) were brought to the attention of NASBO in a series of emails, ultimately the NASBO representative took the position that NASBO relies on the data provided to them by state budget officers and did not offer any corrections.

14 Tax Foundation, "Federal Spending Received per Dollar of Taxes Paid by State, 1981-2005," Oct. 19, 2007, available at <http://www.taxfoundation.org/taxdata/show/22685.html> (last visited August 17, 2008).

15 U.S. Census Bureau, Federal Aid to States for Fiscal Year 2006, U.S. Government Printing Office, Washington, DC, 2008, pp. x, 13 (Figure 5; Table 1), available at <http://www.census.gov/prod/2008pubs/fas-06.pdf>.

16 See USA Spending.gov, Assistance Spent in Wyoming (FY2000-2006), available at http://www.usaspending.gov/faads/faads.php?principal_place_state_code=56&sortby=u&detail=1&datatype=T&reptype=p&database=faads&fiscal_year=2006&submit=GO ; http://www.usaspending.gov/faads/faads.php?principal_place_state_code=56&sortby=u&detail=1&datatype=T&reptype=p&database=faads&fiscal_year=2005&submit=GO ; http://www.usaspending.gov/faads/faads.php?principal_place_state_code=56&sortby=u&detail=1&datatype=T&reptype=p&database=faads&fiscal_year=2004&submit=GO ; http://www.usaspending.gov/faads/faads.php?principal_place_state_code=56&sortby=u&detail=1&datatype=T&reptype=p&database=faads&fiscal_year=2003&submit=GO ; http://www.usaspending.gov/faads/faads.php?principal_place_state_code=56&sortby=u&detail=1&datatype=T&reptype=p&database=faads&fiscal_year=2002&submit=GO ; http://www.usaspending.gov/faads/faads.php?principal_place_state_code=56&sortby=u&detail=1&datatype=T&reptype=p&database=faads&fiscal_year=2001&submit=GO ; http://www.usaspending.gov/faads/faads.php?principal_place_state_code=56&sortby=u&detail=1&datatype=T&reptype=p&database=faads&fiscal_year=2000&submit=GO (last viewed August 17, 2008); St. Louis Federal Reserve, Oct. 2000 Implicit Price Deflator, available at <http://research.stlouisfed.org/fred2/data/GDPEF.txt> (last viewed August 17, 2008) (hereinafter "Fed 2000 Price Deflator"); U.S. Census Bureau, "Table 1: Annual Estimates of the Population for the United States, Regions, and States, and for Puerto Rico: April 1, 2000 to July 1, 2006 (NST-EST2006-01)" (December 22, 2006), available at <http://www.census.gov/popest/states/NST-ann-est.html>. Calculations performed by Author.

17 See *supra* note 15.

18 Press Release, *Wyoming Receives More \$503 Million in Mineral Royalties Royalty Payments Help Fund Schools, Roads, Necessary Infrastructure*, available at <http://www.house.gov/cubin/news/2004/February18c.html> (last visited November 16, 2008).

19 Dean Temte, Legislative Analyst, Wyoming Severance Taxes and Federal Mineral Royalties: Wyoming Legislative Service Office (August 28, 2007), p. 29; U.S. Census Bureau, Governments Division, 2006 Survey of State Government Finances, Tabulation Date: December 12, 2007. Calculation performed by Author.

20 Temte, *supra* note 19, at 30; see also W.S. 9-4-601.

21 See National Association of State Budget Officers, State Expenditure Reports, Washington, D.C., 1995-2006 (hereinafter "1995-2006 NASBO State Expenditure Reports"), Elementary and Secondary Education Expenditures (Table), available at

<http://www.nasbo.org/Publications/PDFs/fy2006er.pdf>, <http://www.nasbo.org/Publications/PDFs/2005%20State%20Expenditure%20Report.pdf>,
<http://www.nasbo.org/Publications/PDFs/2004ExpendReport.pdf>,
<http://www.nasbo.org/Publications/PDFs/2003ExpendReport.pdf>,
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<http://www.nasbo.org/Publications/PDFs/1996exrpt.PDF>,
<http://www.nasbo.org/Publications/PDFs/1995exrpt.PDF> (last visited August 17, 2008). Calculations performed by

Author. In performing the calculations underlying this observation, the Author assumed that NASBO data for “Federal Funds” did not include federal mineral royalty payments based on the definition of federal funds provided in each report and the fact that the magnitude of the amount in “Other State Funds” appears similar to Legislative Service Data for federal mineral royalty payments, whereas the amount typically shown in the “Federal Funds” column is quite dissimilar. See Wyoming Legislative Service, 2007 Budget Fiscal Data Book (2007), *inter alia*.

22 1995-2006 NASBO State Expenditure Reports, Total State Expenditures by Fund Source. Calculations performed by Author. In performing the calculations underlying this observation, the Author presumed that NASBO data for “Other State Funding” between 1992 and 2006 includes federal mineral royalty payments which bypass general fund appropriations pursuant to state “autopilot” statutes, rather than the data for “Federal Funding,” because the magnitude of the amount in “Other State Funds” appears similar to Legislative Service Data for Federal Mineral Royalty Payments, whereas the amount shown in the “Federal Funds” column is quite dissimilar. See Wyoming Legislative Service, 2007 Budget Fiscal Data Book (2007), *inter alia*.

23 *Id.*

24 *Compare id. with* Wyoming Legislative Service, 2007 Budget Fiscal Data Book (2007), *inter alia*.

25 U.S. Census Bureau 2005 Survey of State Government Finances (2007) and population data.

26 1995-2006 NASBO State Expenditure Reports, Total State Expenditures by Fund Source; Fed 2000 Price Deflator. Calculations performed by Author.

27 *Id.* If, as we expect, federal grants-in-aid ratchet-up state-funded expenditures, we should expect to see a close correlation between increases in federal funding and increases in state-funded expenditures. Of course, for purposes of this Report, we are only interested in investigating the kind of federal funding that undermines state sovereignty by causing state appropriations to grow in accordance with federal priorities. As discussed above, federal mineral royalty payments may indeed cause the bloating of state government, but such payments are not the kind of federal funding that is necessarily inconsistent with state sovereignty. Therefore, one challenge is to control for the influence of federal mineral royalty payments on the growth of appropriated state government expenditures. Fortunately, most of the revenues that originate from federal mineral royalty payments are diverted away from the state’s general fund by “autopilot” statutory formula into separate fund accounts designated for education, transportation and municipal services. Therefore, our review of Wyoming’s fiscal data begins by comparing the growth of federal funding against the growth of state-funded expenditures from the state’s general fund. By excluding state-funded expenditures outside of the general fund, we should minimize, but not completely eliminate, the impact of federal mineral royalty payments on the growth of state-funded expenditures

28 Alex Kean, Associate Research Analyst, Total Federal Funding, Wyoming Legislative Service, Fact Sheet 08FS041 (October 28, 2008). It is believed these figures exclude federal royalty payments because it appears to be a custom and practice of

the Legislative Service to exclude royalty payments from “federal funds.” See, e.g., Matthew M. Sackett, Research Analyst Total Federal Funds Distributed to Wyoming, Wyoming Legislative Service Fact Sheet 06FS079 (November 3, 2006).

29 Kean, Historical State and Local Government Funding and Expenditures, *supra* note 29.

30 Kean, Total SCHIP Expenditures, Wyoming, *supra* note 29.

31 *Id.*

32 *Id.*

33 *Id.*

34 See Appendix.

35 Kean, Associate Total Medicaid Expenditures, *supra* note 29.

36 See National Association of State Budget Officers, State Expenditure Reports, Washington, D.C., Medicaid Expenditures, available at <http://www.nasbo.org/Publications/PDFs/fy2006er.pdf>, <http://www.nasbo.org/Publications/PDFs/2005%20State%20Expenditure%20Report.pdf>, <http://www.nasbo.org/Publications/PDFs/2004ExpendReport.pdf>; <http://www.nasbo.org/Publications/PDFs/1997exprpt.PDF>, <http://www.nasbo.org/Publications/PDFs/1996exprpt.PDF>, <http://www.nasbo.org/Publications/PDFs/1995exprpt.PDF>; <http://www.milbank.org/1998shcer/nastab14.html>; <http://www.milbank.org/reports/2000shcer/nasbotable15.html>; <http://www.milbank.org/reports/05NASBO/nasbotable15.pdf>; <http://www.milbank.org/reports/05NASBO/nasbotable16.pdf> (last visited August 17, 2008). Calculations performed by Author.

37 See Appendix.

38 National Association of State Budget Officers, State Expenditure Reports, Washington, D.C., Medicaid Expenditures, *supra* note 37.

39 *Id.*

40 Barr, *supra* note 3, at 12-13.

41 *Id.*

42 Wyoming Legislative Service Office Research, An Eye on the Wyoming State Budget: A Look Back & Short-Term Projection Forward II, 07IP002-2 (July 9, 2007), p. 3; see also Matthew Sackett, Figure 1: Historical and Estimated Discretionary Revenues v. Spending, 08FS023 (March 8, 2008).

43 National Association of State Budget Officers, State Expenditure Reports, Washington, D.C., Medicaid Expenditures, *supra* note 37.

44 Barr, *supra* note 3, at 18-19.

45 *Id.* at 21-23 (citing Paul Gillmor and Fred Eames, *Reconstruction of Federalism: A Constitutional Amendment to Prohibit Unfunded Mandates*, 31 Harv. J. on Legis. 395 (1993)).

46 See Appendix.

47 Funds for State Formula-Allocated and Selected Student Aid Programs, U.S. Department of Education Funding, at 117, available at <http://www.ed.gov/about/overview/budget/statetables/09stbystate.pdf> (last visited December 3, 2008).

48 1995-2006 NASBO State Expenditure Reports; Fed 2000 Price Deflator. Calculations performed by Author.

49 Kean, Total Education Expenditures, *supra* note 30. Calculations as to percentages performed by Author.

50 See generally Barr, *supra* note 3, at 14-17.

51 See generally Robert G. Natelson, *The General Welfare Clause and the Public Trust: An Essay in Original Understanding*, 52 Univ. Kan. L. Rev. 1, 8 (2003-2004).

52 *Arlington Central School District v. Murphy*, 126 S.Ct. 2455 (2006); *Pennhurst State School v. Halderman*, 451 U.S. 1, 17 (1981); *South Dakota v. Dole*, 483 U.S. 203 (1987); *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985); *California Bankers Assn v. Shultz*, 416 U.S. 21 (1974); *Lau v. Nichols*, 414 U.S. 563 (1974); *Oklahoma v. CSC*, 330 U.S. 127 (1947); *Helvering v. Davis*, 301 U.S. 619 (1937); *Steward Machine Co. v. Davis*, 301 U.S. 548 (1937); *United States v. Butler*, 297 U.S. 1, 65-66 (1936).

53 *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 550 (1985).

54 *New York v. United States*, 505 U.S. 144, 182 (1992); see also *Nat'l League of Cities v. Usery*, 426 U.S. 833, 852 (1976) (observing if federal laws "directly displace the States' freedom to structure integral operations in areas of traditional governmental functions, they are not within the authority granted Congress by Article 1, Section 8, clause 3").

55 The Federalist No. 51, p. 323 (C. Rossiter ed. 1961) (J. Madison) (arguing "[i]n the compound republic of America, the power surrendered by the people is first divided between two distinct governments, and then the portion allotted to each subdivided among distinct and separate departments. Hence a double security arises to the rights of the people. The different governments will control each other, at the same time that each will be controlled by itself"); see also *Gregory v. Ashcroft*, 501 U.S. 452, 458-459 (1991) (holding "[j]ust as the separation and independence of the coordinate branches of the Federal Government serve to prevent the accumulation of excessive power in any one branch, a healthy balance of power between the States and the Federal Government will reduce the risk of tyranny and abuse from either frontIn the tension between federal and state power lies the promise of liberty") (emphasis added).

56 See, e.g., *Development Fin. Corp. v. Alpha Hous. & Health Care, Inc.*, 54 F.3d 156, 163 (3d Cir. 1995) (“An illegal contract can never provide the basis for a cause of action: ‘The law when appealed to will have nothing to do with it, but will leave the parties just in the condition in which it finds them’”) (citations omitted); *In re Loretto Winery Ltd.*, 898 F.2d 715, 723 (9th Cir. 1990) (holding “Contracts for transactions that violate the law are illegal and void under California law.”); *Stone v. Freeman*, 82 N.E.2d 571, 572 (N.Y. 1948) (holding “no court should be required to serve as paymaster of the wages of crime, or referee between thieves”); *Crichfield v. Bermudez Asphalt Paving Co.*, 51 N.E. 552, 556 (Ill. 1898) (observing if performance “has an evil tendency, or furnishes a temptation to use improper means, the contract is illegal”).

57 Cf. *Pollard v. Hagan*, 44 U.S. 212, 223 (1845) (observing “[w]hen Alabama was admitted into the union, on an equal footing with the original states, she succeeded to all the rights of sovereignty, jurisdiction, and eminent domain which Georgia possessed at the date of the cession. . . And, if an express stipulation had been inserted in the agreement, granting the municipal right of sovereignty and eminent domain to the United States, such stipulation would have been void and inoperative: because the United States have no constitutional capacity to exercise municipal jurisdiction, sovereignty, or eminent domain, within the limits of a state or elsewhere, except in the cases in which it is expressly granted”)

58 *U.S. v. Lopez*, 514 U.S. 549, 576 (1995); *New York*, 505 U.S. at 181 (observing “the Constitution divides authority between federal and state governments for the protection of individuals. State sovereignty is not just an end in itself: ‘Rather, federalism secures to citizens the liberties that derive from the diffusion of sovereign power’”) (quoting *Coleman v. Thompson*, 501 U.S. 722, 759 (1991) (Blackmun, J., dissenting)).

59 *Id.*