

Mandates: Fiscal Accountability Issues

by
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National leaders under pressure are often tempted to consider shifting costs to other levels of government and to satisfy new demands for public services by passing mandates and costs to other levels of governments to finance new programmes. These new mandates take a variety of forms but have one central feature: they permit the national government leaders to claim credit without paying for the costs of their own initiatives.

This article examines intergovernmental relationships and the various forms of mandates including direct-order mandates, grants, pre-emptions, and tax policy. The article discusses the arguments for mandates, trends in their use, and reforms to curb them. The roles of agency cost-benefit analysis and legislative information and deliberation are particularly important.

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1. Overview

As national governments face increasingly daunting fiscal challenges, they must come to grips with hard choices on the spending and revenue sides of the budget. Fiscal pressures arising from restive credit markets as well as long-term demographic and health-care changes are forcing OECD countries to consider tax increases and expenditure cuts that will impose significant pain on major social and economic interests in these countries. While fiscal retrenchment holds considerable promise to enhance economic growth over the medium and long term, political leaders face the prospects of alienating key constituencies, with their own political careers appearing to be at risk.

National leaders under pressure are often tempted to consider shifting costs to other levels of government and to private sector businesses. Cost shifting can actually have compelling rationales. The national government may have become overextended and financed costs that are more properly borne by local constituencies who most directly benefit from programme interventions. Shifting costs can force a potentially healthy re-examination of the need for programmes throughout the country at subnational levels, as subsidiary governments rethink the value for money of services that they must now more completely finance from their own resources.

In addition to shifting existing costs, national leaders are often tempted to satisfy new demands for public services by passing mandates and costs to other levels of governments to finance new programmes. As will be discussed, these new mandates take a variety of forms but have one central feature: they permit the national government leaders to claim credit without paying for the costs of their own initiatives.

In both of these cases, the shifting of costs and the imposition of new mandates and rules take advantage of two fundamental accounting principles:

- The costs of programmes to subnational governments and business are free at the national level.
- Taxpayers will suffer from the fiscal illusion and will fail to hold national leaders accountable for the additional costs their actions impose throughout the system.

While cost shifting and unfunded mandates apply to both private sector and subnational governments, this article will focus on intergovernmental relationships due to the broader implications for public accountability and fiscal costs throughout government. A broader look at the interactions of all levels of government is important for the private sector as well, since businesses are affected by regulatory activities from all levels of government in OECD countries.

2. Background: from devolution to centralisation?

In recent years, OECD countries have been experiencing significant shifts in relationships between the central government and subnational governments. In the past several decades, the combination of new public management and economic pressures forced national governments to re-examine their intergovernmental management systems.

Efforts to revise systems were aimed at improving the efficiency and reducing the overlap of services across levels of government, improving fiscal and policy co-ordination, and striking new balances to better achieve both national goals and local flexibility in implementation (OECD, 1997).

Many governments were seeking ways to devolve responsibilities to lower levels of government. Many were guided by the subsidiary principle which cautioned that the greatest economy and efficiency can be found by locating responsibilities at the lowest level of government consistent with broad public values. National structures were modified in Italy and Spain to introduce new intermediate regional levels of government to promote decentralisation and greater adaptability of national initiatives. Countries such as Austria, Denmark, Iceland and Sweden were shifting responsibility to local governments for services including education, social security, housing and criminal justice. Governments were also shifting their financial systems to subnational governments away from specific grants for national policies toward general-purpose assistance to help subsidiary governments better finance a wide range of needs.

It goes without saying that each country had to resolve these issues within its own very unique approaches to local autonomy, responsibility and financial division of resources. Federal systems, confederations and unitary systems featured different legal roles and responsibilities for subnational governments. Countries varied significantly in how much responsibility was levied on subnational governments to deliver national programmes and objectives. Against this backdrop, countries also varied in how they financed the intergovernmental responsibilities. Some, like Sweden, give local governments considerable room to raise their own revenues while others, like Australia, provide states with funding primarily through redistributive aid from the national treasury.

Thus, there is little doubt that OECD countries remain highly diverse in their structures and their relationships across levels of government. However, new national fiscal pressures threaten to place all systems under new forms of stress. Given other nationalising forces, OECD countries may be at the precipice of a new era of intergovernmental relationships that may prove to be far more centralising than was the case in previous decades. Some OECD countries such as Germany and the United States have been wrestling with growing pressures from more insistent national governments to impose new responsibilities and regulatory standards on states and other local governments. In Norway and Sweden, local governments complain about the burden of taking on many new onerous and expensive nationally required tasks, thanks to the new public management reforms featuring devolution to local governments ushered in during the 1980s and 1990s.

Anwar Shah of the World Bank suggests in one survey that the federal governments in Brazil, Canada, Germany, India, Malaysia, Russia, and the United States have recently increased national mandates and cost shifting in areas of federal-state shared rule (Shah, 2008). In Brazil, entitlements and earmarked revenues have restrained budgetary flexibility at the state level. In South Africa, the national government has taken over the responsibility for social security financing. In the United States, the federal government is assuming an ever-widening role in policy-making areas of shared rule while devolving responsibilities for implementation to state and local governments. This shift frequently occurs through unfunded mandates or with inadequate financing. In both Canada and the United States, federal governments have partly financed their debts in the past through reduced fiscal transfers to provinces or states.

In this article, we illustrate the implications of policy centralisation and mandates on national budgets and policy processes. The United States is used as a case illustration due to the extensive growth of mandates in recent years, as well as innovative approaches to curb the mandate impulse at the national level.

3. A taxonomy of nationally induced costs

The concept of mandates covers a wide range of policy actions with centralising and potentially coercive effects on the system. Mandates can apply to both the public and the private sector.

3.1. Private sector mandates

For the private sector, the government imposes mandates and regulation requiring changes in business operations, programmes and operations for a host of wide-ranging purposes. The costs of compliance for environmental protection, employee safety, minimum wage, employee health care, consumer safety and product quality are a few examples.

The regulation of business is imposed through various tools of government including:

- Direct orders imposing enforceable obligations on private businesses either requiring them to observe rules in business operations or prohibiting them from engaging in certain practices.
- Tax expenditure conditions prescribing specific conditions for business to take advantage of tax subsidies.
- Contracting rules which include a wide range of conditions on businesses choosing to do business with government including prescribed delivery of products and services and allowable costs. Businesses are also required to comply with a host of cross-cutting policy requirements that are not directly related to the specific contract at hand: promoting access of facilities and hiring to disabled people, promoting fair wages for employees and certifying drug-free workplaces are a few of the policy requirements imposed on contractors doing business with the national government in the United States.
- Licensing rules imposed on business as a condition for obtaining licences or permits to operate or incorporate. These can include compliance with codes of good practice and acceptance of conditions to satisfy broader public interests and values. For instance, broadcasting companies seeking approval to access the airwaves from national regulatory bodies must accept certain conditions such as agreeing to offer time to political candidates and providing appropriate levels of public service programming.

3.2. Intergovernmental regulation

National governments impose standards, rules and costs on subnational governments through a wide range of tools. The relationships between governments encompass a number of dimensions and governmental tools. Accordingly, the use of mandates and cost shifting in intergovernmental relationships involves more dimensions and is more complex than for private business operations. Like business, national rules can be imposed through an arm's-length relationship where subnational governments are treated very similar to private sector businesses. However, in many systems, national and subnational governments are often engaged in highly complex partnerships to implement domestic programmes, providing greater opportunities for national regulation of those subnational partners.

The following subsections discuss the kinds of national regulations that affect subnational governments (Advisory Commission on Intergovernmental Relations, 1994).

3.2.1. *Direct-order mandates*

Direct-order mandates can often include the same kinds of policies imposed on private business but also can range more broadly to cover specific mandates for public services delivered by subnational governments. For instance, prescriptions for educational content in schools and safety provisions for infrastructure controlled at the local level are two common areas for national rule making.

Many direct-order mandates are found in legislation or regulations promulgated by national government agencies. However, some are found in national constitutions. Courts are invited to interpret and issue commands applying to subnational governments, as aggrieved parties bring suit against these government officials for failing to observe national standards.

3.2.2. *Grant conditions*

In most systems, national governments provide a range of financial assistance for subnational governments. The purposes of intergovernmental grants include the following:

- **Vertical imbalances:** Grants compensate local governments for the limited scope of their tax systems over the economy. When those governments have major expenditure responsibilities, grants can achieve a better alignment between expenditure responsibilities and financial capacity.
- **Horizontal inequities:** Grants can provide a more level playing field for public services throughout the country by mitigating fiscal disparities between communities with varying levels of wealth and capacity to provide services. Examples include education where per pupil spending varies significantly between wealthier and poorer communities.
- **External benefits:** Grants can help correct for the under-provision of services by communities with benefits that accrue to citizens outside their boundaries. For instance, left to their own devices, subnational governments with highway responsibilities are not likely to provide a road network sufficient to serve the needs of an economically integrated country. Grants are a typical solution to stimulate those local communities to increase their highway networks beyond what they would have done from their own resources.
- **External costs:** Grants can also provide compensation for subnational governments to avoid exporting costs to the rest of the country. For instance, communities will be tempted to export water pollution to other communities sharing common rivers. Grants can give them resources to build sufficient treatment plants sufficient to protect those beyond that community's immediate boundaries.
- **Desirable national policies:** Beyond these economic rationales, grants are often used as a vehicle to promote subnational adoption of national priorities. For instance, grants can be used to encourage communities to adopt programming to combat obesity in schools, to prevent drug abuse by young people and to serve disabled children in schools.

Some grants consist of unrestricted general revenue transfers or sharing, with few if any conditions. The goal is purely fiscal to level the financial resources to serve the

communities' own priorities. General fiscal assistance programmes exist across many countries for these purposes.

However, many countries have crafted detailed and highly specific grant programmes where funding is available only for specific purposes. In the United States, nearly all of the USD 500 billion in grant funds is allocated through 700 categorical grant programmes tailored to support only narrow objectives determined by the national government.

Most grants have various conditions attached which constitute mandates for those programmes. In many cases, grant conditions impose costs well beyond those covered by the grant. For instance, in the United States, the federal grant for education for disabled people requires full service by local school districts for all handicapped children, including providing all necessary health-care services and other special services for severely disabled children. However, the national government only covers about 15% of the total state and local costs through the federal grant.

Some argue that grant conditions are not mandates, because subnational governments are free to take or leave grant money. However, in many cases, mandates are attached to large pots of money that subnational governments simply cannot refuse to accept. If they do, they can suffer blistering criticism from opponents that they have deprived their own residents of a return on their tax dollars sent to the national government.

The following kinds of requirements are typically imposed as a condition for receiving national assistance:

- Programmatic: requirements to achieve national service standards for specific services and clientele. Examples could include educational requirements specifying provisions needed for graduation, curriculum and teacher credentials.
- Fiscal: requirements for subnational governments to provide their own level of resources as a condition for receiving national funds. Such requirements include subnational matching requirements specifying the rate of necessary cost sharing. They also include maintenance of effort provisions which require communities to continue their own previous funding levels for aided programmes to avoid the temptation to substitute national funds for their own.
- Cross-cutting policy requirements: a wide range of broad policy conditions often are required as a condition of aid. In the United States, the central budget office found there were nearly 100 such requirements for grant recipients including disability access, wage standards for employees under grants, protection of environment from degradation, and audit requirements.

3.2.3. Pre-emptions

While mandates typically impose affirmative obligations, pre-emptions generally prohibit such governments and business from undertaking actions that are viewed as being contrary to national policy and authority. Many pre-emptions affect business and subnational governments equally. For instance, prohibitions on discrimination in the employment of disabled workers and the discharge of air pollution affect both sectors.

However, national pre-emption of subnational governments generally prompts unique and important issues that determine which level of government will be empowered to regulate key areas of national activity. Often national pre-emptions are adopted when the independent actions of subnational governments are viewed as imposing unreasonable

burdens on national commerce, international relationships or domestic policy goals and objectives. Such areas might include product safety, labour standards, environmental rules and tax policies. For instance, Australia is in the process of standardising rules applying to businesses across their states to create a “seamless economy”.

Constitutions in some systems delineate roles and responsibilities for national governments which can be viewed as pre-empting lower levels of government. In other areas, constitutions have clauses which imply pre-emptive authority for national governments which are used as policy evolves over time.

Pre-emptions are viewed by subnational governments as limiting their authority to respond to unique needs and demands in regional areas that vary across a country. Pre-emptions can impose costs every bit as onerous as mandates. For instance, the fiscal impacts of pre-emptions of state or local revenue sources can be every bit as costly as mandates ordering cleaner water.

A single uniform national set of standards threatens to impose a one-size-fits-all framework on local areas with vastly different markets and needs. Accordingly, even once the federal government adopts a national regulation, a continued strong role for independent subnational government programmes can be justified as an important feedback and learning mechanism that can continue to help national policy makers adjust to new developments and public expectations. Moreover, while assuming greater authority, national governments often do not have the resources, implementation capacity or political support to fully carry out new pre-emptive national policies on their own.

Often, subnational governments are brought back in as partners to implement national regulatory programmes through what is known as partial pre-emption in the United States. Under this approach, the federal government typically promulgates national standards, but enables lower levels of government to go beyond those standards to respond to unique local conditions and constituencies. From a political perspective alone, it is an effective approach to both accommodate national uniformity and state diversity. For instance, in the United States clean air programme, the national environmental protection agency sets national air quality standards, while states prepare implementation plans detailing their own strategies for reaching these standards, including initiatives to exceed the federal standards. The partial pre-emption approach recognises that a partnership between federal and state governments can constitute a more effective approach to dealing with the broad sweeping challenges than if each government acted alone.

3.2.4. Intergovernmental tax policy

Tax policy constitutes a unique area of intergovernmental sharing and shifting of responsibilities. Authority for raising revenues is shared in different ways in different systems. A federal system will characteristically provide independent revenue-raising authority to subnational provinces or states to determine which revenue sources to use and how much to raise from each of them. A more unitary government may provide more limited authority for subnational governments to tax. In nearly all systems, whether federal or unitary, the national government also provides significant intergovernmental grants to compensate for differences in revenue-raising capacity between national and subnational governments.

National governments can impose revenue constraints on subnational governments for both shared revenue sources and for sources unique to state and local governments.

- **Shared revenue constraints:** Often, national and subnational governments share common tax bases. In some cases, such as Australia, the national government collects the revenues from the Goods and Services Tax (a form of value-added tax) and then reallocates across the states using an equalisation formula. In other cases, subnational governments adopt national tax base rules and definitions to limit their own administrative costs and promote greater uniformity and simplicity for taxpayers. When the national government acts unilaterally to change the rules and the scope of the tax base, this can have profound effects on subnational revenues as well. For instance, if VAT exemptions or income tax deductions are broadened by the national government, this can negatively affect revenues for subnational governments sharing these same tax bases. Conversely, national rules that expand bases or tighten exclusions and deductions can increase subnational revenues in linked systems.
- **Pre-emption of unique subnational taxes:** At times, the national government may move to pre-empt a tax used by lower levels of government. This can occur when the national government chooses to conscript that tax for its own purposes, or even to introduce its own new tax in an area formerly occupied by subnational governments. For instance, in some systems, new national consumption taxes were introduced on top of existing consumption-type taxes already imposed by the subnational governments. In Canada, this prompted the provinces to decide whether to continue their taxes or to join in on the newly nationalised system. In other cases, the national government pre-empts the ability of any government to tax a transaction in the interest of economic efficiency or at the behest of certain interest groups. For instance, in the United States, the Supreme Court and the Congress have acted to prevent states from collecting sales taxes on the sales of goods over the Internet, an action that will limit state and local revenues by USD 18 billion per year according to studies sponsored by state and local governments.

3.2.5. *Other cost shifting*

Beyond creating new programmes and responsibilities, national governments can shift costs to subnational governments for existing programmes during budget retrenchments. Subnational governments often complain that cost shifting is fiscally onerous and irresponsible, since one level of government gets to experience the joy of reducing costs without realising the painful consequences of those choices.

However, there can often be compelling public finance and policy rationales for national fiscal load shedding. In some cases, national financing may be overextended, paying the costs for programmes whose benefits are primarily enjoyed by local citizens rather than those of the entire country. For instance, some suggest that the national government should not be financing local transit operations, due to the primarily local nature of these benefits. Further, national governments may conclude that funding is poorly targeted and that many subnational governments have sufficient resources to finance aided services from their own resources. Finally, it may be felt that grants often compromise accountability for public funds by permitting local officials to enjoy the benefits of claiming credit for activities without being accountable for raising the funds. Intergovernmental programmes inherently confound traditional accountability by separating the source of funding from the responsibility for spending, thereby raising questions about the appropriate discipline being exercised with regard to the spending.

Such actions can range from incremental reductions to broader devolution of financing for existing programmes:

- **Incremental strategies:** These can include changes at the margin for grant programmes which pass greater costs to other levels of government. Such actions might include narrowing the targeting of grants to concentrate more limited funds on fewer communities with greater needs. It could include changing cost-sharing formulas to increase the share paid by subnational recipients of national funds. It might include tightening of funding eligibility, thereby narrowing the types of activities and recipients eligible for reimbursement from national grant funds. More significantly, it might cap formerly open-ended entitlement programmes to subnational governments, forcing those governments to deal with higher costs exceeding the federal funding constraint. These strategies shift the burden to subnational governments to either pass on these nationally based cuts or to offset them by continuing funding from their own sources.
- **Broader devolution:** Although less common, there are times when national governments consider a more fundamental reassessment of roles and responsibilities between and among governments for financing broad portfolios of public services. The last time this was seriously considered in the United States was under President Reagan who proposed a radical sorting out of responsibilities, with broad-scale devolution of existing federal responsibilities for education, welfare, transportation, criminal justice and many other areas to the states in exchange for full national funding for Medicaid, the health programme for low-income persons shared with the states. This proposal foundered due to opposition from liberal organisations and the states. Some were concerned that without national standards and rules, services would become too disparate among states with highly different priorities and fiscal capacities. Others were concerned that devolution of responsibilities was not accompanied by sufficient national funding, leaving states and local governments with disproportionate fiscal burdens. Australia is now in the midst of a broad devolution of responsibilities for health and other domestic programmes, featuring greater flexibility through grant consolidation and a shift of accountability from inputs to outcomes for the states.

Devolution can take several forms along a continuum from modest to more fundamental shifts of authority:

- **Block grants:** Authority for determining eligibility and priorities is devolved to states for bundles of existing programmes, often with national funding cuts to recognise the purported greater efficiencies stemming from programme consolidation.
- **Trade-offs:** Programmes are devolved to subnational governments in exchange for the national assumption of other programmes. The idea here is to “decongest” the system by more clearly delineating full responsibility for programmes among levels of government. Principles of fiscal neutrality often govern these fiscal arrangements.
- **Tax and spending devolution:** Programmes are fully devolved to the subnational governments along with a commensurate revenue source to pay for these new responsibilities.
- **Devolution without compensation:** This is the budget-driven devolution where the national government sheds responsibilities. While not as coercive as an unfunded mandate, subnational governments are left with the difficult choices about whether and how to continue services formerly financed by the national grants.

4. Rationale and concerns

Mandates and other national policies imposed on subnational governments prompt significant controversy between advocates of national policy centralisation and those who are concerned about the potential consequences for flexibility and fiscal choices at subnational levels of government. Principles of public finance are marshaled to support all sides of these debates. While analytic principles are important, we should also keep in mind that these debates are about more than philosophies of governance. Rather, shifts in authority and financing for public purposes vitally affect the substantive outcomes of policy debates. Decisions about where to vest power and authority affect who wins and who loses from these decisions, since various interests have differential access to different levels of government in any system.

4.1. Arguments for mandates

There is a strong case to be made for the nationalisation of policy initiatives. Any country seeks to provide an optimum level of services for its citizens and a growing economy for the country as a whole. Countries increasingly compete with one another in a global economy for jobs, trade and prestige, thus accentuating the pressures on national leaders to improve economically efficient outcomes for the country as a whole.

From this standpoint, national mandates have several rationales:

- **Intergovernmental competition:** Subnational governments are in competition with each other for tax bases and lower service costs. While this may improve the efficiency of subnational governments, it also may lead them to adopt services that are insufficient for satisfying national communities and values. In particular, studies have shown that subnational competition can lead to a “race to the bottom” as governments vie to attract higher-income taxpayers and businesses by reducing taxes and public services to lower-income citizens who rely on government the most (Peterson, 1994). From this perspective, mandates on local governments can compensate for the pressures of competition that these governments face.
- **Externalities:** Often there are mismatches between the boundaries of subnational governments and the scope of public policy problems. Subnational governments, like businesses, can provide suboptimal levels of public services when those services have externalities that are not accounted for by local budget processes. As noted previously, local governments can provide too little services when the benefits accrue to people outside their jurisdictional boundaries, such as providing sufficient security to ports to satisfy needs of national and international shipping and defence interests. Similarly, subnational governments have incentives to export their costs to other taxpayers throughout the country as well by pursuing policies that, in effect, externalise costs by under-investing in such areas as pollution control.
- **National policy uniformity:** As media and other phenomena knit countries together into a stronger policy community, demands increase for uniformity in policy outcomes across the various subnational governmental jurisdictions within each country. Increasingly, any policy diversity is not cause for celebration but rather prompts alarm. National leaders and interest groups raise strong concerns that different policies constitute inequitable treatment of citizens, who should be treated similarly regardless of where they happen to live. National policy mandates come to be justified as a way to guarantee equitable treatment across a country.

- **Economic interdependence:** As economies become more national and even global, differences in policies pertaining to economic issues such as labour markets, energy, product quality and environmental protection are cause for alarm among the business community. This is an historic turnaround in the position of business communities which often favoured devolution due to their ability to exploit intergovernmental competition for their own advantage. However, in recent years, national and international businesses have come to favour national pre-emption and standards to avoid the inefficiencies inherent in responding to numerous subnational standards and enforcers.
- **National implementation constraints:** Compelling policy goals adopted by national governments often can prompt mandates when their implementation rests squarely on actions or inactions by subnational governments. Whether it be education, climate change or quality of health care, many new domestic policy thrusts cannot simply be taken over or implemented wholly by national bureaucracies. Rather, national budget limits and long-standing traditions of local jurisdictional authority prompt national leaders to pursue these goals through grants and mandates imposed on subnational governments. In federal systems, for instance, education has long been in the domain of state or provincial governments. However, in recent years, national political leaders have taken it upon themselves to prescribe various educational reforms through various mandates on lower levels of governments.

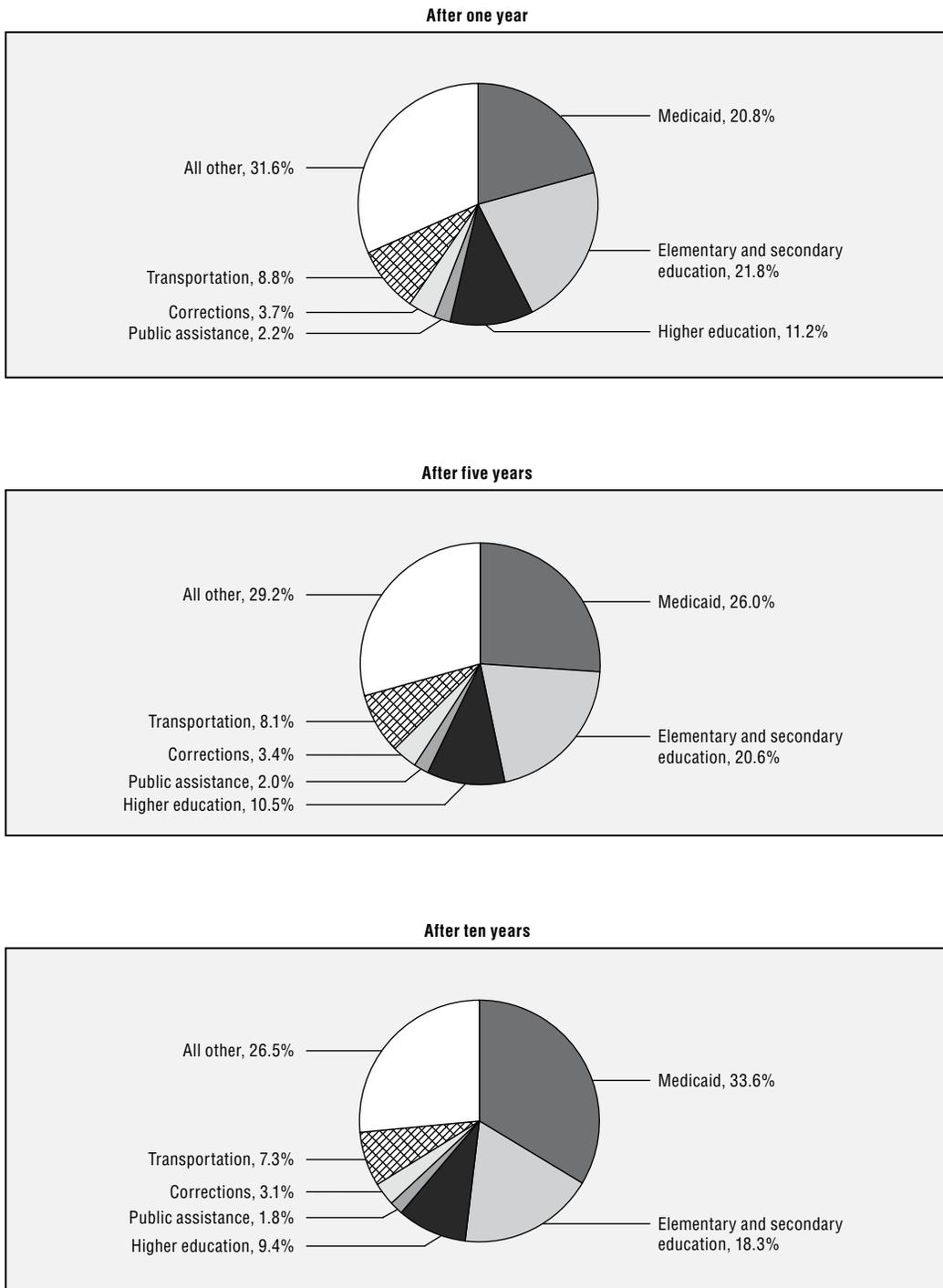
4.2. Concerns over mandates

Mandates have prompted concerns about their impacts on public accountability and subnational finances. Some critics are outraged about the fiscal effects of unfunded mandates, accepting national mandates only if national money is attached to offset their costs. Others are concerned about the policy inefficiencies arising from the imposition of uniform frameworks on diverse local areas and regions within countries.

- **Accountability:** There is a fundamental lack of accountability when one group of leaders can experience the joy of providing new benefits without also experiencing the pain of paying for those benefits. The disjuncture between benefits and costs will tempt leaders to approve more mandates than they would otherwise have done if they had to fund all or a significant portion of the costs. Unfunded mandates also prompt confusion on the part of the public, as they have difficulty assigning responsibility for the outcomes and costs of public programmes when the responsibility for providing benefits and paying for their costs is split between national and subnational political leaders.
- **Cost impacts:** Subnational governments have little choice but to make room for national mandates by shifting their budget priorities in the national direction or by raising taxes. In either case, subnational budgets no longer reflect simply the priorities of citizens of those jurisdictions, since they often must give way to national needs and priorities. In the United States, for instance, states will be taking on more than USD 20 billion in additional costs over the next ten years to implement the new national health reform signed by President Obama in early 2010. This additional load is on top of substantial costs states were already bearing in their budgets from their required matching share for the federal-state Medicaid programme. As shown in Figure 1, the states' portion of these costs was projected to consume ever-greater shares of state budget dollars over the next ten years before the health reform.

Figure 1. Medicaid as a share of state spending over the next ten years in the United States

Assuming current growth rate for Medicaid and current average growth for all other categories



Source: National Association of State Budget Officers, 2006.

- Policy rigidity: In seeking uniformity, national rules and standards imposed what some view as a one-size-fits-all regime on subnational governments regardless of differences in local area values, economies or experiences. In countries with highly diverse

subnational governments and populations, single uniform standards can prove to be overly costly and onerous. A strength of a federal system is the learning that occurs in what amounts to individual policy laboratories offering different models for policy in various areas. A single national standard intercepts this learning process and can compromise the capacity of the system to continue to innovate. Whether it be homeland security or climate change, subnational governments have different types of risks that should prompt different strategies and emphases.

5. Trends in mandates

Powerful forces are reshaping the allocation of power and responsibility in federal and unitary systems alike. Fiscal, political, global and media forces are combining to centralise policy in certain OECD countries. National governments have reacted to assert policy direction and standards in areas that were previously considered to be in the domain of non-federal or private sectors. In the United States, the federal system has become far more centralised in recent decades, as political leaders from both parties have reached for mandates to promote national goals across a wide range of policy areas. This section will briefly chronicle the factors at work promoting nationalisation and mandates in the United States, with the recognition that many of these same forces are at work in other countries as well.

5.1. Trends in the United States

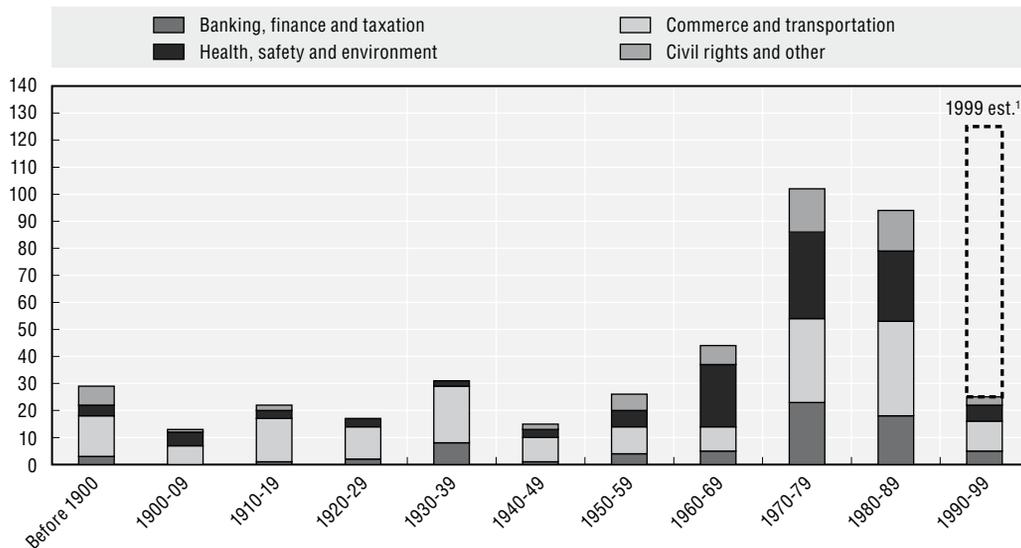
Over the past forty years, mandates and pre-emptions have become among the primary tools relied upon by Congress and the President in the United States to project national priorities and objectives throughout the intergovernmental system (Kincaid, 1990). This contrasts with American policy making before 1960 when systemic political factors as well as social and economic forces worked to place limits on the role of the federal government, reflected in a general forbearance and restraint that federal officials demonstrated in policy formulation. The trends toward the use of coercive tools have proven to be durable and long lasting, albeit punctuated by episodes of reform, as leaders of both parties have engaged in significant expansion of federal powers through mandates during their terms of office.

These trends are illustrated in Figure 2 prepared by the United States Advisory Commission on Intergovernmental Relations which charts the growth of national pre-emptions in recent decades through 1999 (when the ACIR went out of business). Since then, a leading scholar has found that there were over 500 statutes pre-empting state and local authority (Zimmerman, 2007, p. 436).

The first decade of the 21st century illustrated how deeply rooted the centralising forces are in the United States at the national level. In 2001, new political forces were gathering that might have been expected to change course toward more decentralisation and national policy forbearance. The election of President Bush presaged a period of unified government presided over by unprecedented conservative political leadership not seen since before the Great Depression. President Bush himself proved to be more committed to conservative ideological principles than many had expected, given his self-proclaimed profile as a consensus leader with democratic state legislators in Texas (Fortier and Ornstein, 2003, p. 139). The President was able to work with Republican majorities in both House and Senate, albeit with a brief period of Democratic Senate control. The Republicans controlling the Congress were far more conservative than previous Republican regimes in

the Congress. Moreover, the Congress had passed the Unfunded Mandates Reform Act of 1995 which reflected a bipartisan commitment to curb the use of mandates in the Congress.

Figure 2. Number of federal pre-emption statutes enacted per decade in the United States



1. The 1990-91 rate was multiplied by five to estimate how many pre-emptions might be enacted during 1990-99.

Source: Advisory Commission on Intergovernmental Relations (1992), *Federal Statutory Preemption of State and Local Authority: History, Inventory, and Issues*, A-121, ACIR, Washington DC, p. 7.

Notwithstanding these forces, the period of the Bush presidency in fact witnessed the continuation of the centralisation and nationalisation of priorities and policies that had characterised previous administrations, both Republican and Democrat alike. During this period, federal goals and priorities were extended to new intergovernmental service arenas heretofore primarily controlled by states and localities. Educational testing, election administration, fire protection and emergency response, and tax policy were important arenas that were once relatively off-limits for federal officials but that fell under the influence of major new national programmes. The persistence of centralising and coercive national policy decisions during the Bush presidency reflects the continued attenuation of federalism as a value commanding loyalty from elites and publics in the face of numerous other more politically compelling national values and interests.

President Obama has followed a high-level profile as a national policy activist. National leaders with ambitious policy agendas generally increase the national government's power and authority in relation to subnational governments. Thus, it is less surprising that Obama has continued previous centralising trends. As noted earlier, the health reform legislation alone features major new mandates and roles for states both in extending coverage to new groups and in managing new health exchanges. Pending climate change legislation would serve to pre-empt emerging state-based initiatives, causing significant costs for the states according to the Congressional Budget Office. While strengthening the role of the national government, the Obama administration has provided significant additional grant funds to state and local governments as part of the economic stimulus programme. Indeed, over the past two years, states have received more than USD 100 billion in new and relatively unrestricted federal funds.

5.2. *Specific forces promoting mandate trends*

Gathering fiscal forces will likely affect countries' proclivity to use mandates. However, the fiscal temptation will come on top of existing trends and forces which have already promoted the centralisation of policy. Important underlying forces affecting governments in recent decades have already served to nationalise policy and promote the growth of mandates. In the United States, the following political, economic and social changes were instrumental in this policy shift:

- **Party systems:** The position of state and local governments in the federal system had been protected before 1960 by the decentralised nature of the party system itself whose power base was concentrated at the state and local level. National office holders, whether they be presidents or congressmen, owed their nominations and political allegiances to state and local party leaders, embedding a sensitivity to the prerogatives of state and local officials in fundamental political incentives. Federalism was an important line of cleavage between the parties, with the Republican Party dedicated to preserving states' authority and constraining the growth of federal power.
- **In recent decades, the party system has fundamentally changed** as candidates for national office have been forced to assemble their own coalitions to compete for nominations and elections. With the rise of direct primaries among other features, interest groups and media have eclipsed state and local parties as gatekeepers of candidate recruitment and legitimation; national elected officials have converted from being ambassadors of state and local party leaders to independent political entrepreneurs anxious to establish their own visible policy profiles to appeal to a diverse coalition of interest groups, media, and an increasingly independent base of voters. Far from allies, the relationship between congressional officials and state and local elected colleagues from their districts resembles more of a competition among independent political entrepreneurs for money, visibility and votes.
- **Media and interest groups:** The growth of national media institutions focused on Washington created a powerful resource for those groups wishing to nationalise problems and issues, and reporting increasingly sought to find national dimensions or applications for state and local problems or solutions. The advent of lobbies representing broad, diffuse interests – the so-called public interest groups – has fueled national policy advocacy, as many of these groups have settled in Washington rather than the states.
- **National and global economic forces:** As noted earlier, the growing integration of business throughout the country and the world has converted the business community from advocates of state authority to promoters of national pre-emption. As corporations increasingly operate in a global environment, coping with separate state regulatory regimes is seen as a hindrance to economic efficiency and competitiveness. This trend is reinforced by trade agreements which have been interpreted by the courts and international bodies as having pre-emptive effects on subnational laws and regulations.

5.3. *The political standing of subnational governments*

The positioning and cohesion of the state and local sector played a pivotal, if not surprising, role in the politics of mandates. In some systems, subnational governments have major roles in the national government. One house of the German legislature, for instance, is comprised of representatives from the states. In other systems, subnational officials

are invited to negotiate collaboratively with national officials in formal semiannual or quarterly conferences among leaders of national and subnational governments (Australia and Canada).

In the United States, there have been no such formal opportunities; state and local governments exercise influence as another interest group among many in Washington. While they have at times succeeded in modifying mandates to reduce costs, in many cases state leaders are neutralised and even champion particular mandates and pre-emptions (Posner, 1998). Their interest groups are often disarmed by their lack of political cohesion on key policy issues; lacking agreement, they are often unable to articulate positions in national debates (Haider, 1974). As political leaders, they are often swept away by the compelling political appeal of major federal mandates and pre-emptions, whether they be election reform, educational standards or homeland security requirements. Indeed, when examining the major mandates enacted in the past five years, governors and other state executive officials provided active national policy leadership. Many mandates originate from innovations piloted by state officials themselves. For instance, President Bush's educational reform enacted in 2001, the No Child Left Behind legislation, marks the culmination of educational reforms enacted by many states.

In the United States, state leaders have come to endorse certain pre-emptions and mandates to address collective action problems stemming from intergovernmental competition that can undermine states' incentives to assume policy leadership in key areas. Governors and other state leaders have become supporters of mandates to put a floor under competition from other states that can undermine their policy initiatives. In recent years, progressive or advanced states have come to champion partial pre-emptions which place a floor on competition among states. For instance, states taking the initiative to curb carbon emissions will find their efforts undermined by states without such regulation; businesses may be tempted to relocate to the non-regulatory states. States and communities passing gun control laws have seen their rules undermined when people can buy guns in states without stringent regulations and bring them home to cause injury and death in their own communities.

5.4. Explaining when mandates are likely to be used

Summarising the factors discussed above, the likelihood of the adoption of national mandates can be viewed as stemming from combinations of two variables – federal and state political cohesion. The classic unfunded mandate outcome can be expected when federal officials are cohesive and states are either divided or not engaged. On the other hand, we might expect national governments to provide funding and flexibility for mandates when states and federal officials are both equally engaged and cohesive. When states are cohesive and federal officials divided or unengaged, a grant or even outright defeat of federal involvement might be expected (Moneypenney, 1960). Finally, lack of cohesion and engagement from both sides can be expected to produce policy gridlock. This analysis is depicted in Table 1.

Table 1. Federal and state political cohesion

State cohesion	Federal cohesion	
	High	Low
High	Funded mandate/partial pre-emption	Grant
Low	Unfunded mandate/total pre-emption	Gridlock

Source: Paul L. Posner (2008), "Mandates: The Politics of Coercive Federalism" in Timothy J. Conlan and Paul L. Posner (eds.), *Intergovernmental Management for the 21st Century*, Brookings Institution, Washington DC, p. 303.

6. Reforms to curb the use of unfunded mandates

As the foregoing suggests, the imposition of mandates and other forms of cost shifting have deep fiscal, political and economic roots. Reversing these trends will likely require fundamental reforms to a country's policy-making process, political incentive structures and intergovernmental allocation of power and responsibilities.

Nonetheless, comparatively modest reforms have been suggested to mitigate or even reverse the use of unfunded mandates and regulations in systems. Conceptually, reforms attempt to reunify accountability for costs and benefits by requiring national decision makers to more systematically consider the cost impacts of their actions. Several generic types of actions have been proposed in the United States: i) agency requirements for cost-benefit analyses; ii) legislative information requirements and other procedural requirements promoting greater deliberation on projected costs of proposed legislation; and iii) mandate reimbursement approaches.

6.1. Agency cost-benefit analysis requirements

In the United States, most mandates originate in the Congress, but they must take the form of agency regulations before they are imposed on state and local governments. Since at least 1981, federal agencies have been required to review the costs and benefits of major proposed rules before they are issued. Cost-benefit analysis involves a systematic identification of all costs and benefits associated with a project, regulation or policy decision, including a full analysis of how those costs and benefits are distributed across different groups in society. A full analysis recognises that the quantitative assessments of benefits and costs are necessarily uncertain and heavily dependent on numerous assumptions, thus requiring qualitative analysis. Particularly difficult to quantify are long-term or uncertain effects where suspected but subtle interactive effects are not well understood or directly measurable. A regulatory requirement is judged to pass the test if the sum of future benefits outweighs the sum of present and future costs in present-value terms. The analysis is extremely controversial when it seeks to rationalise inherent value trade-offs. Used carefully and with adequate data, cost-benefit analysis can be an effective tool for assessing regulatory costs (Garcia, 2000).

Several other tools have been added to ensure greater compliance and visibility for these requirements. First, the President's budget office reviews and approves all proposed regulations before they are issued, including a review of cost-benefit analyses. Second, the public is given significant opportunity to review and comment on proposed regulations, including their costs and their benefits. Third, the Congress enacted a requirement that the Government Accountability Office (GAO) review all major regulations, before they are finally issued, for compliance with the cost-benefit analysis requirements as well as other accountability provisions, and Congress can pass a resolution of disapproval of the regulation, which can be vetoed by the President. (To date, only one major regulation has been disapproved by the Congress, a regulation promoting ergonomic safety in the workplace for repetitive work.)

6.2. Legislative information and deliberation

For many years, Congress has required its principal budget agency, the Congressional Budget Office (CBO), to provide cost estimates on all proposed legislation approved by committees. Paralleling the "fiscal note" processes used by state legislatures, these estimates

provide some public notification of the cost impacts of legislative proposals before they are voted on by the House or the Senate.

As will be noted below, the Congress in 1995 strengthened this provision by passing the Unfunded Mandates Reform Act (UMRA). Here the CBO is required to estimate the costs of major committee-approved legislation on both the private sector and state and local governments. In addition, to ensure compliance, the UMRA enabled any member of Congress to prevent the full legislative body from moving to vote on a bill if the required cost estimate was not produced. In congressional terms, this is phrased as raising a point of order against moving a piece of legislation – a point of order which can be overridden if majorities in the House or Senate vote to ignore the objection.

Moreover, the UMRA added another point of order just for intergovernmental mandates that can be raised by any member to prevent consideration of any measure with “major” costs, as determined by the CBO. This provision can also be waived by a majority in the House and a 60-vote supermajority in the Senate. The UMRA will be discussed further below.

A separate “pre-emption note” has also been proposed to provide Congress with more information on the federalism impacts of proposals involving intergovernmental pre-emptions. As noted earlier, pre-emptions of authority may not trigger cost estimate requirements but are viewed as having significant governance implications that warrant greater transparency and review.

6.3. Mandate reimbursement

Another approach that can be used to change the incentives to mandate is a national reimbursement provision. Here the national government would be obligated to pay for all costs that are imposed on other levels of government due to national legislation or regulations. This approach was rejected at the national level in the United States but has been piloted by several states in the United States in recent decades.

Of course, subnational governments view this approach as the most potent accountability remedy available. If it were adhered to, a reimbursement requirement would no doubt change the incentives of national leaders in promulgating mandates and other legislation that shift costs to other levels of government. However, the experience of the states shows that this approach is plagued with a number of problems, including:

- The ease with which legislatures and executives can skirt the requirement. States with reimbursement provisions were able to pass subsequent mandates by either ignoring the prohibition or stating that it simply was not applicable.
- The lack of definitive information on the costs of implementing programmes that is available when legislation is considered. While some general notions of costs may be estimated, when providing budget authority much more detail is needed to understand the amount of costs that will actually be imposed on other levels of government. Often regulations issued by agencies several years hence are necessary to fully determine the actual costs.
- It may not be appropriate for the national government to pay for all costs realised under mandates. Many national laws and regulations benefit local citizens as well, thus reimbursement should reflect the relative benefits as well as costs received by subnational governments. Moreover, in many cases, subnational governments may have already been operating programmes subsequently mandated by national laws. Reimbursement would give them a potential unearned windfall.

6.4. The Unfunded Mandates Reform Act of 1995

Growing pressures from state and local governments culminated in passage of the 1995 Unfunded Mandates Reform Act. This act requires the CBO to estimate the costs of all major legislation reported by committees affecting both state and local governments and the private sector. It also requires executive agencies to review the costs of mandates before they issue regulations, a process that was already largely in place due to presidential orders.

The act also permits mandate opponents to raise a point of order against proposed unfunded intergovernmental mandates in pending legislation under consideration by the Congress. The point of order does not prevent mandates from being enacted, since it can be overridden in each chamber, but it does promote accountability by prompting a separate vote on the issue of mandating itself. As such, it is not an impenetrable barrier, but more of a “speed bump” that can potentially embarrass mandate proponents and rally opponents.

In the 14 years since the passage of the act, numerous cost estimates were prepared by the CBO for both private sector and intergovernmental mandates, as shown in Table 2. The table shows that mandates covered under the act appeared in 12-15% of major legislation reported by committees. Relatively few bills had fiscally significant mandates, but the most important ones had significant fiscal effects.

Table 2. Cost estimates prepared under the UMRA, 1996-2009

	Total legislation proposed	Total with mandates	Total major mandates
Intergovernmental	8 093	1 022	91
Private sector	7 971	1 229	306

Source: Robert J. Dilger and Richard S. Beth (2010), *Unfunded Mandates Reform Act: History, Impact and Issues*, Congressional Research Service, Washington DC.

In gauging the impact of UMRA on mandates at the national level, it is important to look at several dimensions. The first involves the actual raising of points of order by members of Congress to stop mandates in their legislative tracks. This pathway has not been particularly productive from the state and local standpoint: a GAO report found that, as of March 2004, 13 points of order had been raised in the House and none in the Senate since the passage of the UMRA, and a point of order was sustained only once, on a 1996 minimum wage vote (Government Accountability Office, 2004).

The second pathway is where the CBO cost estimate and the potential for a point of order work as a deterrent to prompt mandate advocates to temper or withdraw their proposals. This pathway certainly has worked in recent years on several notable occasions. For instance, legislation reported out of the House Ways and Means Committee would have narrowed the authority of states to impose taxes on businesses that lacked physical nexus in their states.¹ When the CBO estimated annual revenue costs exceeding USD 3 billion over time, the leadership of the House was persuaded to pull the bill from the calendar.² However, this “worked” only as part of an effective state and local lobbying campaign that adroitly used the CBO estimate to sidetrack the proposed tax pre-emption.

Nonetheless, major mandates proceeded in spite of the UMRA web of procedures and information. For example, in 2008, state government interest groups asserted that “although fewer than a dozen mandates have been enacted that exceed the threshold established in

UMRA, Congress has shifted at least USD 131 billion in costs to states over the past five years” (Dilger and Beth, 2010).

This outcome can be explained by pointing to the limited coverage of the UMRA, exempting many of the mandates passed in the past five years. Specifically, the UMRA primarily covers only statutory direct orders, excluding most grant conditions and pre-emptions whose fiscal effects fall below the threshold; statutory direct orders dealing with constitutional rights, prohibition of discrimination, national security and social security are among those excluded from coverage. Moreover, the analytical and procedural requirements do not apply to appropriations bills, floor amendments or conference reports, which have become increasingly prevalent ways to pass legislation in recent years. The Bush administration’s No Child Left Behind Act and legislation requiring states to impose a new national identification as part of their driver’s licences were not covered by the UMRA due to these exclusions.

7. Concluding observations

There is a need for dialogue and partnership among all levels of government to resolve the growing gaps between spending commitments and tax resources at all levels of government. These gaps often have common sources: rising health-care costs, burgeoning retirement benefits, slower economic growth and lagging government revenue. Even as countries emerge from the current deep recession, these problems will continue to undermine the fiscal foundations of governments. While economic recovery will be most welcome, the fiscal relief will be both temporary and increasingly fragile.

The structural fiscal gaps facing all levels of government are unprecedented in magnitude and increasingly interconnected. Policies and actions of each level of government affect the fiscal and economic prospects of the entire country. Since problems spill over the boundaries of jurisdictions, each level of government acting alone will not be able to deal effectively with the root causes. Go-it-alone strategies may only push problems to other jurisdictions, leaving the public confused and frustrated. Concerted and co-ordinated action across levels of government provides the best prospect.

Elected officials must come to grips with these challenges at a time when the spending and revenues of different levels of government have become increasingly intertwined. Following years of devolution and the pursuit of subsidiarity principles, subnational governments have become the real workhorses of public governance. They are vital partners in implementing many major national programmes, relied upon by national governments for faithful and effective management of complex national policies. Non-federal governments have become more dependent on national financial aid and rules to fund and govern key services. While this has elevated their importance to the country, it has also compromised their ability to serve unique needs across the diverse communities in many countries.

Unilateral national actions risk overgrazing the “fiscal commons”, the fixed resources available to each level of government as well as business entities and other taxpayers. This unilateral behaviour often takes shape by way of spending mandates (more resource demands on the commons) and revenue limitations (more fences). These actions have the effect of both limiting total subnational revenues as well as encumbering the use of those revenues for nationally defined purposes. Imbalances can also result when governments

separately impose tax burdens on the private economy without carefully considering their aggregate impact on economic efficiency and equity.

When all governments in a national governance system suffer from common maladies, joint solutions would be preferable. Through fiscal collaboration, governments can join together in developing win-win solutions. Dealing with health-care costs, for example, is most efficiently accomplished through concerted action. Each government can strike its own deal but will be at a disadvantage when dealing with a complex national industry.

7.1. Principles

Countries would be advised to observe the following principles when considering policy proposals affecting all governments in interdependent systems:

- **Whole of government.** When new policies are adopted, their effects on governments as a whole should be considered. Accountability requires each level of government to assume responsibility not only for the benefits of public policy but also for the costs across governments in the system.
- **Establishing an institution to serve as the champion for intergovernmental collaboration.** Such an institutional focal point should not only serve as a neutral convener of discussions among officials across levels of government but should have a highly competent staff to do the studies and analysis necessary to guide the collaboration process.
- **Providing neutral and credible analysis of the fiscal impacts of national proposals.** National governments should provide systematic estimates of the prospective costs of major legislation and regulation in highly visible forums. Such analyses should be prepared by institutions that are perceived to be neutral and credible. For purposes of these estimates, the scope of national actions to be covered should be defined broadly to include direct orders as well as grant conditions, pre-emptions and other forms of cost shifting.
- **Performing periodic assessments of the fiscal outlook for all levels of government.** A periodic analysis of the current and future fiscal conditions of national and subnational governments should be performed on a regular basis. This should serve as a benchmark against which proposed new national legislation may be evaluated.
- **Preparing fiscal analysis of the proposed budget.** National budgets should include a section providing an assessment of the implications of the executive budget proposal in general on the fiscal outlook for subnational governments.

The stakes involved with intergovernmental relations go beyond the fiscal dimension alone. As countries approach the complex choices ahead, they should gain respect for one important function served by subnational governments in policy formulation and implementation: learning. The experiences of other levels of government – both successes and mistakes – help inform a country about the economic, ecological and political consequences of the daunting challenges involved with any major new policy proposal. Policy models that offer subnational governments significant roles in policy formulation as well as in policy implementation can help ensure that the country as a whole can learn by doing things differently across a diverse country.

Inviting other levels of government into the national policy dialogue is guaranteed to be messy and inefficient. As a senior public administration observer once said, the only

thing that intergovernmental collaboration can guarantee is that “no damn fool at the top can screw it all up”.³ As we face the “unknown unknowns” in so many policy areas, those are words we need to remember.

Notes

1. See HR 1956, Business Activity Tax Simplification Act of 2005.
2. Congressional Budget Office cost estimate, 11 July 2006.
3. Quote attributed to Frank Bane, the first Chairman of the United States Advisory Commission on Intergovernmental Relations (1959-66).

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