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RECONCEPTUALIZING UNFUNDED MANDATES AND OTHER REGULATIONS

Julie A. Roin*

I. INTRODUCTION

Beginning with the childhood maxim of "I cut, you choose," we learn the lesson that decisionmakers act more responsibly when forced to bear the costs of the rules they enact. Much legal scholarship bears the imprint of this lesson, but this scholarship also teaches us that the issue is more complex than first appears. Different arguments for cost awareness or cost internalization arise in different contexts: it is variously argued that unfettered decisionmakers underestimate the costs they impose, issue commands that are selfish, engage in inefficient and unfair redistributions, or are simply driven too much by the political benefits their directives generate. On the

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1 Contract law, for example, is often described as a system for creating incentives to prevent promisors and promisees from acting opportunistically (selfishly). See, e.g., George M. Cohen, The Fault Lines in Contract Damages, 80 VA. L. REV. 1225, 1242 (1994) (“To reduce the costs associated with opportunistic behavior, the optimal rules must discourage the promisor’s opportunistic behavior by disgorging the promisor’s gains or otherwise punishing the promisor.”); Charles J. Goetz & Robert E. Scott, Enforcing Promises: An Examination of the Basis of Contract, 89 YALE L.J. 1261, 1276 (1980) (“[U]nfettered individual behavior is incompatible with social optimization . . . . [T]he law can cause individuals to consider external effects in their decisionmaking and thus ‘internalize’ them.”).


3 Opponents of “unfunded mandates,” a term defined presently, and other costly forms of governmental regulation regularly make this claim. See, e.g., NEWT GINGRICH, TO RENEW AMERICA 229-33 (1995); U.S. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS REP. NO. M-193, Federally Induced Costs Affecting State and Local Governments (1994); Thomas Atwood, Home Rule: How States Are Fighting Unfunded Mandates, HERITAGE FOUND. ST. BACKGROUNDER No. 1011 (Dec. 28, 1994); Paul Gllmor & Fred Eames, Reconstruction of Federalism: A Constitutional Amendment to Prohibit Unfunded Mandates, 31 HARV. J. ON LEGIS. 395, 400 (1994); D. Bruce La Pierre, The
other hand, it has been pointed out, requiring explicit compensation for the costs of all rules may threaten the production of sensible rules when extracting payment for the benefits conferred by those rules is impractical.\(^4\) The presence of multiple decisionmakers produces additional difficulties. Sometimes, we have to rely on the goodwill of the rulemakers, or on less-than-concrete feedback mechanisms, to cause the rulemakers to care about the welfare of those subject to their rules. We do not, for example, expect governments to pay marginal victims or truckers when they raise or lower speed limits on highways; parents are not encouraged to pay their children when exercising disciplinary authority; employers do not pay when they issue unpopular workplace rules; judges do not pay disappointed litigants. In contrast, governments must occasionally pay when they intrude upon or "take" private property, legislators sometimes live by the rules they draft, and in the contrary examples just listed the rulemaker is thought to bear some costs—especially if its rules prove unwise and unpopular. As with most balancing acts, reasonable observers may disagree with the balance struck between the various concerns in particular contexts.

This Article deals with one such controversial context: unfunded mandates. As used in this Article, the term "unfunded mandates" refers to directives emanating from one level of government to subordinate levels, unaccompanied by the funds necessary to defray the costs of implementation.\(^5\) The obvious, and oft-stated, objection to such rulemaking is that unconstrained or "free" rulemaking—in this case an apparent separation of rulemaking power from the political costs inherent in raising the funds nec-

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\(^5\) There are almost as many definitions as there are articles written on the subject of unfunded mandates. The diversity stems in part from the multifarious burdens superior levels of government place on subordinate levels of government. See Rena I. Steinzor, Unfunded Environmental Mandates and the "New(New) Federalism:” Devolution, Revolution, or Reform?, 81 MINN. L. REV. 97, 104-11 (1996) (describing history of definitional dispute). Some descriptions bifurcate these burdens into two categories: “compliance legislation,” which ensures that state and local governments comply with federal requirements in operation of the enterprises they own, such as landfills and sewage treatment plants, or the services they provide, and “implementation legislation,” which requires that state and local governments act as enforcers of federal regulations applicable to private actors. See David A. Dana, The Case for Unfunded Environmental Mandates, 69 S. CAL. L. REV. 1, 5-6 (1995). A very modern reason for this sort of bifurcation is that the viability of implementation legislation has been called into question by the Supreme Court’s decision in Printz v. United States, 521 U.S. 98 (1997). The line between unfunded mandates and conditions of assistance has also been the subject of some dispute, again because courts tend to view conditions more favorably than mandates. See New York v. United States, 505 U.S. 144, 167-68 (1992). But see D. Bruce La Pierre, Political Accountability in the National Political Process—The Alternative to Judicial Review of Federalism Issues, 80 NW. U. L. REV. 577, 594 (1985) (questioning distinction).
Reconceptualizing Unfunded Mandates

Some critics describe this phenomenon as a form of fiscal illusion affecting both legislators and voters. Because the costs of unfunded mandates are "off-budget"; that is, off their budget, legislators may fail to take them into account when evaluating the wisdom of programs, while voters, who should be overseeing their legislative representatives, may fail to comprehend the source of the regulatory costs they bear. See, e.g., Gillmore & Eames, supra note 3, at 400 (mandates "foster a [Congressional] culture of irresponsibility"); Zelinsky, supra note 3, at 1369-70 (mandates as a form of hidden taxation). Fiscal illusion thus explains both legislative errors and legislative self-dealing. Of course, neither is possible if the political process operates to properly monitor legislators. One of the questions faced in this Article is the likelihood of such monitoring in the context of intergovernmental mandates.

This chorus of criticism has been sufficiently extensive to prompt the quip that "[unfunded mandates] now have achieved something akin to the status of Soviet Communism during the heyday of the McCarthy era: Everybody is against them." Dana, supra note 5, at 1. Eliminating such mandates was part of the conservative agenda set forth in the "Contract with America," see CONTRACT WITH AMERICA, THE BOLD PLAN BY REP. NEWT GINGRICH, REP. DICK ARMEY, AND THE HOUSE REPUBLICANS TO CHANGE THE NATION 229-33 (Ed Gillespie & Bob Schellhas eds., 1994), which was deemed fulfilled by the passage of the Unfunded Mandates Reform Act of 1995, Pub. L. No. 104-4, 109 Stat. 48 (codified as amended in scattered sections of 2 U.S.C.A.) [hereinafter UMRA]. See id. at 130. The UMRA seeks to deter the passage of unfunded mandates in two ways. First, it provides that a legislator may raise a "point of order" against any legislation that would impose an unfunded mandate; the point of order must be waived by a majority vote before the legislation can proceed. See 2 U.S.C.A. § 658(d) (West Supp. 1996). Second, it requires the Congressional Budget Office to prepare cost estimates for particular kinds of legislative regulatory activities. See 2 U.S.C. §§ 658b-658f. Whether UMRA will have much of an impact has been the subject of dispute. Compare Elizabeth Garrett, Enhancing the Political Safeguards of Federalism? The Unfunded Mandates Reform Act of 1995, 45 U. KAN. L. REV. 1113, 1168 (1997) ("Virtually no one characterizes UMRA as the final word in the search for new and stronger political safeguards for federalism . . . . Assessments range from 'positive, if modest' to 'a hoax.'") (footnotes omitted) and Steinzor, supra note 5, at 100 (expressing skepticism that UMRA will do more than raise legislators' consciousness) with Susan E. Leckrone, Turning Back the Clock: The Unfunded Mandates Reform Act of 1995 and Its Effective Repeal of Environmental Legislation, 71 IND. L.J. 1029, 1048 (1996) ("UMRA turns back the clock for environmental regulations, taking this country back to a time when it lacked any national policy on the environment . . . .").


riety of areas of law. Under a system of funded mandates, recipient governments have an incentive to overspend federal funds and to lobby the central government for unwise mandates. Funding may thus change the identity of the exploiter—state and local governments may begin exploiting the federal government—without reducing the overall amount of exploitation.

This Article explores the uneasy case against and for unfunded mandates in light of the wider literature on cost internalization. Its strategy is to compare unfunded mandates to alternative institutional arrangements, ranging from full federal funding—"funded mandates"—to full privatization of program costs—"unfunded regulation"—from three perspectives. The first, the public choice perspective, reduces to a question of political accountability or cost internalization by politicians. The second, the agency perspective, asks whether and when unfunded mandates may encourage more efficient behavior by the mandated (or regulated) party. The third and final perspective, labeled the "fairness" perspective, looks at the distribution of mandates' economic burdens among individuals. In particular, it explores the extent to which the tax system operates to redistribute that burden among taxpayers generally. One of the questions examined in each perspective is the extent to which subordinate governments are and are not different from other "victims" of the regulatory state, such as business enterprises and individuals. I reach the tentative conclusion that if there is a case for special sympathy for subordinate governments, which would justify special limitations on unfunded mandates, it is not one based on political process or agency cost considerations but rather on the grounds of fairness. In short, current attacks on unfunded mandates are misdirected.

In essence, this Article looks at unfunded mandates as its critics do—as a financing device. However, where its critics see only deceit and political gimmickry, this Article points out the positive attributes of such mandates—the same positive attributes that have made unfunded regulations of other sorts a staple of governmental control. Mandates share the advantages of such regulations. They also share the disadvantages of such regulations; mandates, like regulation, are no panacea. The final part of the Article tries to identify situations in which the advantages of mandates outweigh the dis-

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10 See Dana, supra note 5, at 36-37; KATHLEEN SEGERSON ET AL., INTERGOVERNMENTAL TRANSFERS IN A FEDERAL SYSTEM: AN ECONOMIC ANALYSIS OF UNFUNDED MANDATES (Law and Economic Publication Series, Center for Real Estate and Urban Economic Studies, University of Connecticut, 1995). For a more extended treatment of these issues, see infra notes 113-116 and accompanying text.

There is of course the alternative of no mandates at all, but for the most part the discussion here assumes the case for federal regulation, whether because of externalities, public choice considerations, gains from uniformity, or a number of other familiar possibilities. Critics of unfunded mandates often assume the opposite, and part of their claim is that unjustifiable regulations would disappear if federal funding were required.
advantages, as well as suggesting ways in which those disadvantages may be ameliorated.

The Article concentrates on pragmatic issues. It avoids direct discussion, for example, of the many constitutional issues raised by the federal government's use of unfunded mandates directed at states and localities. Such issues are discussed elsewhere by others more attuned to constitutional subtleties than I am.

II. UNFUNDED DIRECTIVES OF THE COMMON KIND

Subordinate governments are but one target of unfunded government directives and legislatures are but one source of such directives. All levels of government frequently require business enterprises and individuals to expend their own money—or fail to collect potential profits—to do certain things or not do certain things. Almost without exception, the government could indemnify the affected private parties, if not carry out the desired activity itself. By looking at situations in which the government has not chosen either of those alternatives, this Article attempts to identify the considerations at stake in such decisions. It then uses these considerations as a basis for reevaluating the desirability of unfunded mandates to subordinate levels of government.

A. Governmental Regulation of Employers and Businesses

A number of governmentally imposed restrictions hedge employment relationships. Some impose rules or responsibilities regarding the employment relationship itself, while others relate to other aspects of running a business; virtually all these directives require the employer to spend more money than it would spend in the absence of the regulation. The discussion in this Part focuses on the minimum wage, "reasonable accommodations" under the Americans With Disabilities Act, and environmental directives. While not randomly selected, these schemes exemplify the sorts of burdens the government imposes on employers. In any event, I hope to show that the seemingly disparate, if modest, examples of "unfunded" regulations I have chosen contain elements that illuminate questions about unfunded mandates in both the private and public contexts. In large part, the comparison will suggest that familiar criticisms leveled at intergovernmental


12 Many other examples of federal "unfunded" rulemaking exist. The federal income tax, immigration law, Federal Reserve policy, defense expenditures, retirement policies, and our evolving conception of federalism probably affect most firms far more than the illustrative, modest regulatory schemes explored in this Article. But some features of our mixed economy must be taken as given or any analytic enterprise quickly spins out of control with a kind of circularity.
unfunded mandates are misplaced or serve as merely rhetorical devices to draw attention to the regulatory state quite generally.

1. Minimum Wage Regulation.—Minimum wage legislation is in many ways the archetypal unfunded directive. It requires employers to pay some employees more than their market wage or to refrain from hiring these otherwise desired employees. The goals of minimum wage legislation might presumably have been effected through other strategies that did not target employers. Instead of regulating employers in an uncompensated manner, the law might have provided for direct payments to individuals, employed or otherwise, in amounts determined by reference to the difference between their wages and a legally defined "living wage." But it does not; one critic of minimum wage legislation describes the result as "a wage subsidy to low-wage employees, financed by a tax on low-wage employers."

This first example of unfunded regulation—assuming, as I will continue to do, that funding has not been provided through logrolling with other legislation providing offsetting benefits to the affected employers or customers—illustrates the point that unfunded regulations may be as controversial as unfunded mandates; the minimum wage has no lack of critics. Most economists object to minimum wage legislation much as they

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13 Alternatively, it could just establish a negative income tax program, an idea that has generated renewed interest. See Daniel Shaviro, The Minimum Wage, the Earned Income Tax Credit, and Optimal Subsidy Policy, 64 U. Chi. L. Rev. 405, 474-75 (1997).

14 Id. at 407. In fact, it is uncertain who bears the cost of the minimum wage. Although in the first instance, the cost falls on employers, employers undoubtedly attempt to shift its burden elsewhere. For example, employers may seek to pass the costs on to customers in the form of price increases. The success of such a strategy depends in large part on whether they compete against other enterprises exempt from such wage constraints. As most minimum wage employees are in the retail trade sector in which jobs are location-specific, see David Card & Alan B. Krueger, Myth and Measurement: The New Economics of the Minimum Wage 315 (1995), competition from unregulated foreign employers seems relatively unlikely. On the other hand, demand tends to fall as prices rise, because potential consumers choose to make different expenditures. Careful incidence analysis thus requires some investigation of the degree to which higher prices reduce demand and, in an imperfectly competitive market, employer profits.

15 Indeed, an important undercurrent here is that objections to unfunded mandates may amount to rhetorical strategies for objecting to the substance of various governmental decisions. Under this view, the objections to these legislative directives would take different form if federal funding were forthcoming, but the objections would continue. The point about the rhetoric, or adversarial nature of the criticisms, echoes what others have already noted. See Dana, supra note 5, at 3; Makram B. Jaber, Unfunded Federal Mandates: An Issue of Federalism or a 'Brilliant Sound Bite'? 45 Emory L.J. 281, 294 (1996). For examples of the adversarial approach, see Atwood, supra note 3; Gillmor & Eames, supra note 3, at 395-96; Robert R. Kuehn, The Limits of Devolving Enforcement of Federal Environmental Laws, 70 Tul. L. Rev. 2373, 2394 (1996) (defending environmental mandates as a special case); Leckrone, supra note 7, at 1047-48 (same); Sheriffs Versus the Brady Law, New Am., Aug. 22, 1994, at 15 (sheriffs admit they filed 10th Amendment challenge to Brady bill because of their opposition to all gun control).
do to rent control and to other well-intentioned barriers to free markets.\textsuperscript{16} Nevertheless, minimum wage legislation is politically popular and, indeed, Congress has recently revisited and renewed this regulatory scheme.\textsuperscript{17}

\textit{a. Public Choice Issues.--}It is interesting that public choice theory has played so small a role in the campaign against minimum-wage legislation because a substantial case can be made for the proposition that this particular unfunded regulation owes its survival to the political disadvantages of two important groups. These groups are potential workers who become or remain unemployed as a result of the legislated wage,\textsuperscript{18} and consumers who pay higher prices for goods produced or distributed in industries affected by minimum-wage regulation.

The potential workers affected by the minimum wage constitute a classic example of a dispersed, unidentifiable, powerless interest.\textsuperscript{19} The difficulties inherent in identifying individuals aggrieved by discriminatory hiring practices have been discussed elsewhere;\textsuperscript{20} individuals adversely affected by the minimum wage are even less likely to be identifiable or to self-identify correctly. A large subset of both groups has by hypothesis failed to secure employment, so that the workplace does not offer an opportunity for identification and political organization.\textsuperscript{21} Many workers who benefit from minimum wage legislation will, no doubt, also find it difficult to identify and organize in support of extensions of minimum wage legislation, but, as union experiences seem to demonstrate, the losers are in the more difficult position. Political organization and opposition to minimum wage regulation seem seriously underpowered because of this problem of self-identification. It is therefore unnecessary to add that, even if this problem of self-identification could be overcome, these individuals likely lack both the finances and proclivity to political action necessary to compete with opposing, organized groups.

\textsuperscript{16} Economists regard the minimum wage as generating the same effect as an employee cartel. It raises the price of labor and (perhaps) increases total income among low-wage workers as a group, but at the cost of destroying some low-wage jobs and thereby increasing unemployment. See \textit{CARD \& KRUEGER, supra} note 14, at 1; \textit{Shaviro, supra} note 13, at 406.


\textsuperscript{18} Unemployment results both because workers become expensive relative to capital, so at the margin, employers invest in labor-saving equipment and because of shrinkage of the sector of the economy affected by the wage increase. See \textit{supra} note 14 (demand falls as prices rise). In the latter case, another segment of the economy will expand as consumers decide to spend their money elsewhere, but the new jobs may not go to workers and potential workers displaced by the minimum wage.

\textsuperscript{19} I will leave alone the question of \textit{judicial} intervention on behalf of such underrepresented groups.


\textsuperscript{21} Indeed, they may not even have applied for jobs, because the minimum wage may have discouraged employers from offering such jobs in the first place.
Consumers suffer from similar, though perhaps less severe, disadvantages. Here the problem is less identification as a member of a group than identification of the magnitude of the cost imposed on them by proposed or actual regulation. Without information about the cost one bears, it is difficult to know how much to invest—even if collective action problems could be overcome—in an attempt to block the imposition of these costs.

There are, to be sure, public-choice-style responses to the puzzling fact that the unfunded character of mandates draws so much criticism fueled by political accountability considerations while the unfunded character of minimum wage legislation draws so little—even though some of the “losers” in the latter context seem significantly worse off than the “losers” in the intergovernmental mandate setting. Perhaps price increases resulting from minimum wages create less excitement than tax increases arising from mandates. Another possible response draws on the public choice literature about concentrated and dispersed benefits and costs. Minimum-wage regulation and intergovernmental mandates both impose dispersed costs, the argument might run, but minimum wage legislation is relatively more successful because the benefits it brings are more concentrated than those created by most mandates.

The most interesting explanation of the disparate reactions to these two kinds of unfunded legislation draws attention to yet another aspect of unfunded mandates. In the case of minimum wage regulation, the political strength of employers may remedy the weakness of affected consumers and potential workers. Many of these employers appear able to overcome collective action problems in the political arena by virtue of their sheer size or membership in historically effective trade associations of like-minded firms. Indeed, something of a public choice case can be made for prefer-

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22 People may be more accustomed to, and less offended by, what they perceive as “inflation” than by tax increases, which they often ascribe to government inefficiency, if not corruption.

23 At the very least, a subset of minimum-wage workers know that they received wage increases at the time the statutory requirement took effect. In contrast, few beneficiaries of, for example, environmental regulation are cognizant of their gains. They would be unlikely to think that, in the absence of regulation, they would with some probability have developed asthma from constant exposure to what would have been the ambient level of air pollution.

24 Large retailers and fast food franchisers come to mind. See CARD & KRUEGER, supra note 14, at 315 (64% of minimum wage workers employed by multi-establishment firms); Shavira, supra note 13, at 419.

25 Although many of those testifying against recent increases in the minimum wage represented only the interests of their own small businesses, the witnesses included representatives of trade associations such as the National Restaurant Association, the National Association of Convenience Stores, and the National Retail Federation. See 142 CONG. REC. S7346 (daily ed. July 8, 1996) (National Retail Federation Memorandum); Prepared Statement of Duncan Thomas on Behalf of the National Association of Convenience Stores Before the House Committee on Small Business, FED. NEWS SERVICE, May 15, 1996, available in LEXIS, News Library, Fednew File; Prepared Statement of Herman Cain On Behalf of the National Restaurant Association Before the Joint Economic Committee, FED. NEWS SERVICE, February 22, 1995, available in LEXIS, News Library, Fednew File.
ring the unfunded minimum wage over the alternative of government subsidies to low-paid workers or especially to firms that hire such marginal workers.

The argument is a variation of Gordon Tullock's intriguing idea aimed at curbing excessive government spending. Tullock was among the first to observe that well-organized coalitions push for spending programs at the expense of dispersed taxpayers.\(^{26}\) He suggested that a healthier political balance might be struck by a system that, in a kind of second-best fashion, thoughtfully matched combatants; proposals for new spending programs might be required to specify their funding sources and the "losers" ought to be fairly matched in organizational terms with the beneficiaries.\(^{27}\) Creating competition among interest groups might, in turn, actually lead to some consideration of the substantive merits of proposed programs, thereby promoting efficient government.\(^{28}\) In the case of minimum-wage legislation, employers might constitute well-matched opponents for unions that favor minimum wage regulation. These employers do not bear the entire cost of the regulation, nor do the proponents of minimum-wage regulation enjoy all the benefits, inasmuch as many of the beneficiaries are themselves unlikely to self-identify. At the least, the employers provide some counterweight to what might otherwise be an unopposed, special interest group arguing in favor of minimum-wage legislation.\(^{29}\)

Armed with this surprisingly cheery public choice view of minimum wage legislation, an optimist might advance the view that with organized interests in fair combat, the survival of minimum-wage legislation can be ascribed to the persuasiveness of the proponents' arguments addressed to


\(^{27}\) Tullock credits Buchanan for this suggestion. See Gordon Tullock, *Rent Seeking and Tax Reform*, 6 Contemp. Pol'y Issues 37, 46 (1998) ("Many years ago, James Buchanan suggested a solution: The U.S. could select—perhaps at random—some other group of people about the same size as the benefited group and could put the tax on them. Thus, two lobbying groups would be opposing each other and the outcome presumably would be improved.").

\(^{28}\) If we take the Tullock-Buchanan proposal seriously, then one practical problem is that the artificially burdened interest group may invest in passing the burden to others rather than in arguing against the merits of the substantive spending or other program. This sort of degeneration might be avoided if there is an independent rationale for choosing the cost-bearing group.

\(^{29}\) One way to think about this is to realize that the special interest group in favor of minimum-wage legislation is a given. Its existence does not depend on the choice of the financing mechanism as long as labor bears less than 100% of the cost of the proposal. The question, then, is under what circumstances effective political opposition to such proposals is most likely to develop. If the government chose to fund an income support program with its general revenues, tax conscious voters might come together to oppose the legislation or the legislators opposing such legislation. These voters, however, may also be too dispersed, and each individual's burden too minor, for anyone to shoulder the requisite organizational burden. A smaller number of more severely impacted voters (businesses) might in fact provide more potent political opposition to the program. This is an exemplar of the central mystery of public choice theory: sometimes, large numbers generate political power while at other times large numbers result in political weakness.
legislators or to the voting public, who apparently serve as the arbiters of clashes between interest groups. I turn now to these arguments, with an eye on the larger claim about unfunded mandates and unfunded regulations.

b. Agency Costs and Alternative Means.—Opponents of the minimum wage often point out the absence of a requirement that a wage floor be effected through constraints on employer pay scales. They argue that it would be better to let the market dictate wages and to have the government make direct payments to poor workers equal to the difference between their market wage and whatever minimum or “living wage” politicians sought to provide. Closer inspection reveals, however, the advantages of regulating through employers rather than funding through governments.

It is nearly axiomatic that many people tend to be less careful when spending other people’s money. This tendency is especially true when an expenditure benefits the decisionmaker. In such cases, overspending has little downside and a definite upside. As a result, the establishment of a system for monitoring expenditures becomes an integral part of the process of delegating spending decisions. Sometimes agents can easily be prevented from engaging in corrupt or wasteful practices; on other occasions, however, controlling such misbehavior can be extremely difficult. One would expect to see fewer delegations of spending authority when monitoring is difficult than when it is easy precisely because such situations provide too much room for inefficiency or corruption.

One can see just such monitoring difficulties in the minimum wage situation. If governments paid the difference between market and minimum wages, employers might be expected to underpay workers, knowing that their default will be corrected with government funds. Indeed, side-
payments from employers to workers may leave all parties to the employment contract better off. Alternatively, employers may put phantom workers on their payrolls, enabling friends, relatives, or others who are willing to pay for this privilege to collect an unintended government subsidy. The federal government would have a difficult time differentiating between legitimate and illegitimate employment arrangements, because to do so would require fairly extensive knowledge of the operation of the employer's enterprise as well as general industry practices. Indeed, the employer-financing mechanism of the minimum-wage laws may well provide a monitoring function that makes more transparent government wage subsidies such as the EITC workable. In any event, it is apparent that unfunded government regulation may be far superior to funded regulation or direct subsidies.

c. "Fairness".—One of the criticisms leveled at unfunded regulations concerns the apparent and unfair "singling out" of individuals or small groups. These "losers" sometimes bear the costs associated with programs that benefit the general public. This is, of course, the paradigmatic character of what we call compensable governmental takings of private property. Public benefits should be paid for by the public, rather than through an involuntary extraction from a few unlucky individuals.

In the short run minimum wage context, employers of minimum-wage employees appear to be "losers." They seem to bear a disproportionate share of the financial burden of the costs of this social program. Over the longer term, though, as prices adjust to take into account the burden of the wage increase, the incidence of the wage hike shifts (at least in part) to consumers and to unidentifiable, potential workers. Initial unfairness segues into inefficiency, which some may find less objectionable. But another reason exists to reassess the conventional view of the ideological battle over minimum wage legislation, and this subtle ingredient may prove to be an important distinguishing feature with respect to unfunded mandates and

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34 It is disproportionate, at least, either to their responsibility for creating the problem (low-skill employees), or to our conception of "ability to pay," because their contribution is not correlated with their income.

35 See Boris Bittker, Equity, Efficiency, and Income Tax Theory: Do Misallocations Drive Out Inequities?, 16 SAN DIEGO L. REV. 735, 746 (1979). Professor Bittker enumerates some of the circumstances in which inequities would remain. See id. at 746-48. Moreover, the inefficiencies may have an inequitable component in redirecting investment or employment opportunities from politically or economically disadvantaged groups.
regulations quite generally. Employers may pay higher wages because of minimum-wage regulation, they may pay more for substitute nonlabor inputs, and they may fail to recoup some of these costs through higher product prices, but they do secure some offsetting benefit through the federal income tax. All income-tax paying employers may deduct labor costs as a business expense. The value of the deduction depends, of course, on the taxpayer’s marginal tax rate. Each additional dollar of deductions reduces a taxpayer’s tax bill by a dollar times the taxpayer’s tax rate. The tax “saved” as a result of the deduction can be seen as the government’s “co-payment” with respect to the employer’s minimum-wage bill.36

Another way of looking at this phenomenon of sharing the costs of regulation through the tax system builds on the fact that an employer retains after-tax profits. The cost of the minimum wage to an employer is thus measured by the difference between what its after-tax profits would have been had there been no minimum-wage legislation and its actual after-tax profits. The federal government pays the remaining addition to the employer’s wage bill in the form of foregone tax revenues. This particular regulation can in this way be understood as partially funded.37

There are, to be sure, employers, including nonprofit and unprofitable enterprises as well as governmental organizations, who pay little or no federal income taxes. The burden of the minimum wage thus falls on employers, and in the longer run, their customers and potential employees, unequally. This is true even if, as seems unlikely, all employers have comparable ability to pass on costs in the form of higher prices. But it seems fair to insist that through the deductibility of higher wage costs, as well as the costs of substitute inputs, in the short run the overall burden of the minimum wage falls on the tax-paying public in a way that has not been recognized.39 This short-run redistribution may, in turn, decrease the long-

36 Many tax purists take umbrage at labeling a tax decrease a governmental “copayment,” preferring instead to describe the phenomenon as a reduction in the taxpayer’s net cost of compliance with the restriction. This distinction is important in some contexts—for example, when trying to determine whether a particular tax provision rises to the level of “state action”—but in the absence of such a concern here, this Article uses the copayment language because it more vividly conveys the economic relationship between the taxpayer, the government, and the expenditures than does “net cost reduction.”

37 The employer’s share of the minimum-wage burden is the additional salary amount multiplied by one minus the employer’s marginal tax rate. If, for example, the employer’s wage bill increases by $50,000 as a result of the minimum-wage rules, and its marginal tax rate is 38%, the government “pays” $19,000 through a reduction in its tax revenues and the employer pays $31,000 in the form of reduced after-tax profit. The government’s copayment decreases along with the employer’s marginal tax rate. The deduction for business expenses reduces the net cost of all business expenditures; wage expenses are in no sense special in this regard. Thus, this tax treatment serves only to reduce the financial burden borne by employers as a result of the minimum wage; it does not provide employers with an incentive to expend money on wages as opposed to more capital-intensive labor substitutes.

38 The extent to which this copayment leaves the government worse off depends upon the relative tax rates of the employer and employee, because employees must include their wages in taxable income.

39 The cost-spreading implications of such tax treatment seem to have gone unnoticed. Similarly, the government does not draw attention to its “copayments.” As the discussion in the text emphasizes,
term inefficiencies created as affected parties readjust their activities and transactions to take the new labor costs into account.

Although my analysis of unfunded regulations needs to expand and unfold before returning to unfunded mandates, the careful reader will see the beginning of a punchline. Minimum-wage regulation is financed in part by the federal government in a way that unfunded intergovernmental mandates are not. Mandates might therefore be more objectionable. But I will not rush the reader to this conclusion. My point in sketching what lies ahead is to give some definition to the "fairness" label. An assessment of the fairness of a regulatory scheme refers, at least here, to the redistribution of wealth effected by that scheme, with an eye on the baseline drawn by the preexisting tax scheme and regulatory structure. In the absence of detailed incidence analysis, regulated parties are assumed to be better off when a substantial portion of the cost of regulations affecting them is borne by taxpayers quite generally. Unfunded regulations are regarded as "fairer" when innocent losers are in part rescued by the taxpayers. This somewhat arbitrary terminology aims, of course, to emphasize the wedge that might grow between unfunded regulations and unfunded mandates. Further sketching is, however, deferred to Part III below.

2. The Americans With Disabilities Act.—It is useful to repeat the exercise just concluded with a new, rather than seasoned, example of unfunded regulation of employers; the obligations imposed by the Americans With Disabilities Act ("ADA") offer suitable grist. The ADA imposes numerous responsibilities on public and private entities "to provide a clear and comprehensive national mandate for the elimination of discrimination against individuals with disabilities." The ADA regulates physical structures as well as labor markets. Thus, owners of "public accommodations and commercial facilities" must ensure that the disabled have access to new and remodeled spaces and employers must offer any "qualified" the obscenity of these copayments may serve to increase the political pressure against regulation and may prevent more aggressive rent-seeking by groups seeking subsidies. On the other hand, if the true cost to the government could be calculated, it might form the foundation of better government decision-making. However, this cost calculation would be complex because it would have to integrate the tax burden of recipients of attributable wage increases. See supra note 38.

The analysis differs, of course, when the "losers" are not "innocent" but are instead being called upon to rectify harms that their actions have created. See infra notes 74-75 and accompanying text.

40 The analysis differs, of course, when the "losers" are not "innocent" but are instead being called upon to rectify harms that their actions have created. See supra note 38.
42 Id. § 12101(b).
43 Id. § 12183.
44 A disabled person is a "qualified individual with a disability" if she is "an individual with a disability who, with or without reasonable accommodation, can perform the essential functions of the employment position that such individual holds or desires." Id. § 12111(8). Under the ADA, an employer will be deemed to have discriminated against, and be liable for damages to, a "qualified individual" if it fails to make available to that individual "reasonable accommodations to the known physical or mental..."
disabled persons the same employment opportunities as those offered to nondisabled persons. Employers must structure their selection processes to enable a "qualified applicant with a disability to be considered for the position such qualified applicant desires;" they must provide and pay for "reasonable accommodation[s]" required by "qualified individual[s] with a disability" to "perform the essential functions of that position;" and employers must enable such employees "to enjoy equal benefits and privileges of employment as are enjoyed by its other similarly situated employees without disabilities.""
extent and type of each individual employee's disability. An outsider may be able to judge whether an employer's accommodations allow an employee to fulfill the essential functions of a job so that the employee enjoys "equal benefits and privileges of employment," but the outsider would be unable to determine whether the employer had achieved those aims in a cost-effective manner. Employers who were paid by the government to take these steps might often make wasteful expenditures that they would never incur with their own money even when required to meet the same ends. Opportunities for corrupt arrangements would abound. Finally, a system of substantial penalties for misspent government funds might simply chill the very investments anticipated by the ADA. The agency cost perspective, in which the government is viewed as delegating to employers the task of improving the workplace accommodation of disabled citizens, suggests that unfunded mandates might well be far superior to a "payments-for-services" scheme. And inasmuch as employers are perhaps the parties best informed and best situated to effect these accommodations, we are driven to the somewhat surprising conclusion that unfunded regulation may conceivably be the best of all possible worlds. Regulated employers will have selfish reasons to proceed efficiently, while funded programs, whether optional or required, might be expected to produce grave waste.

Unfunded regulation may be better than the alternatives, but it is not without problems even when viewed from an agency cost perspective. Unfunded directives aimed at employers encourage employers to find reasons not to hire employees who will prove expensive. Antidiscrimination rules aim to prevent this escape, of course, but enforcement remains imperfect and expensive. This might suggest that unfunded regulation makes most sense in situations in which both the sufficiency of outcomes—in this case, the sufficiency of accommodations—and inputs, or coverage—in this case, the individuals in need of protection—can easily be monitored, while government funding should be provided or seriously considered in situations in

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54 See Rutherglen, supra note 20, at 135 (noting that claims of intentional discrimination "continue to protect workers who already have jobs, but they offer little continuing protection to workers who cannot get jobs"). See generally John J. Donohue III & Peter Siegelman, The Changing Nature of Employment Discrimination Litigation, 43 STAN. L. REV. 983, 1032-33 (1991) (speculating on reasons for decrease in failure to hire cases).
which monitoring the sufficiency of outcomes or inputs presents difficulties. But this would be an oversimplification; the real trade-offs are more complicated.

Governmental funding cannot rectify deficiencies in the ability to measure outcomes. Indeed, providing governmental funding in situations in which the sufficiency of outcomes cannot be evaluated is a recipe for waste and corruption, because there could be no standard against which the employer's use of government funds could be measured. That is, it makes little sense to reimburse employers for the expenses of accommodating disabled employees when the efficacy of those accommodations cannot be monitored. Instead, the proper response in such situations may be the avoidance of regulation altogether.\(^5\)

By contrast, government funding may help prevent "underprovision"\(^5\) that takes the form of employer avoidance of disabled employees. Certainly an open-ended governmental program for the reimbursement of employer costs would eliminate much of the economic justification for disfavoring disabled job applicants. However, as discussed above, it does so only at the expense of creating significant opportunities for waste and fraud. Other funding mechanisms may be more promising. For example, the government might provide employers with a standard reimbursement amount tied to the number of disabled employees and the extent of their disabilities.\(^5\)

Of course, the difficulty of determining an appropriate reimbursement amount due to differences among employment situations provides one of the justifications for relying on unfunded mandates to begin with. Once one assumes an inability to determine the correct reimbursement rate, a trade-

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\(^5\) Focusing on the methods of accommodation, rather than their outcomes, does not provide a way out of this quandary. Although the government can always monitor the existence or not of specifically identified accommodations, it would be bizarre and wasteful to specifically identify and require particular accommodations that cannot be validated as improving individuals' job performance. Nor would it make sense to try to hold employers to a standard that the government can neither identify nor measure compliance with. At best, such standards would become mere political window dressing; at worst, they would fuel endless, expensive litigation between employers, the government, and ostensibly benefited employees.

\(^5\) I use this term for lack of a better alternative. This underprovision can take several forms. In addition to the example provided in the text—the failure to hire an ostensibly-protected employee—underprovision may result from an employer's decision to avoid hiring anyone by failing to expand (or start) its business. The prevalence of such "activity level effects" are a staple of law-and-economics analysis. See Hills, supra note 11, at 894 & n. 269.

\(^5\) The government could create a schedule similar to those that it has developed for purposes of workmen's compensation or disability payments, estimating the cost of accommodating particular disabilities. Employers whose expenses exceeded the scheduled amounts would suffer from their profi- gacy, while others could profit by providing more cost-effective accommodation.

Note that providing reimbursements on a less tailored basis—say, providing an amount based on average costs or average number of disabled employees—risks reintroducing the incentive to discriminate against disabled employees, or some subcategories thereof.
off, or balancing act, ensues—additional protection for new hires versus the likelihood of wasteful expenditures on unnecessary accommodations.  

Employers are not the only source of wasteful expenditures. Employees may also ask for unreasonably expensive accommodations. It is noteworthy in this regard that the ADA’s directives are not all categorical. While all new buildings must provide handicapped access, employers need not make accommodations in cases in which such accommodations would impose an “undue hardship.” The definition of “hardship” does not depend solely on the cost of the accommodation. Congress specifically rejected an amendment that would have provided that employers need not provide an accommodation bearing a cost exceeding ten percent of the employee’s or potential employee’s annual salary, as well as another that would have limited total accommodation expenses to five percent of the employer’s “annual net profit.” Instead, the regulations, consistent with congressional intent, provide that what constitutes an “undue hardship” be determined in light of the financial resources of the employer’s enterprise.  

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58 Or, perhaps more likely, the employer usurpation of excess funds in the event of overly generous reimbursement amounts or the continuation of employer discrimination in the event of insufficient reimbursement amounts. Congress’s decision in this instance to rely on unfunded regulation can be explained through a public choice lens: one might argue that this particular choice was preordained by the inability of the not-hired, or potential nonhires, to organize effectively. One might counter this analysis, though, by arguing that there were no obvious opponents to federally funded accommodations for disabled employees; employers surely preferred that the federal government fund their accommodation responsibilities.

59 The sole exception is for situations “where an entity can demonstrate that it is structurally impracticable to meet the requirements of such subsection . . . .” 42 U.S.C. § 12183(a)(1) (1994). Entities remodeling buildings are required “to make alterations in such a manner that, to the maximum extent feasible, the altered portions of the facility are readily accessible to and usable by individuals with disabilities . . . . where such alterations . . . are not disproportionate to the overall alterations in terms of cost and scope.” Id. § 12183(a)(2). “Structural impracticability” has been defined to include “only . . . those rare circumstances when the unique characteristics of terrain prevent the incorporation of accessibility features.” 36 C.F.R. Ch. XI, pt. 119, App. A § 4.1.1(5)(a) (1997). No definitions for the terms “maximum extent feasible” or “disproportionate” have been issued.

60 42 U.S.C. § 12112(b)(5)(A). This hardship excuse does not apply to other employer obligations, such as the obligation to “select and administer tests concerning employment . . . . to ensure that, when such a test is administered to a job applicant or employee who has a disability . . . . that such test results accurately reflect the skills, aptitude, or whatever other factor . . . . that such a test purports to measure,” id. § 12113(b)(7), or to avoid using qualification standards, employment tests or other selection criteria that screen out or tend to screen out an individual with a disability . . . unless the standard, test or other selection criteria, as used by the covered entity, is shown to be job-related for the position in question and is consistent with business necessity. Id. § 12113(b)(6).


62 The pertinent regulation reads, in part:

In determining whether an accommodation would impose an undue hardship on a covered entity, factors to be considered include:
One employer’s reasonable accommodation may in this way be another’s undue hardship. It follows that an employee’s rights, and residual burden, are as much a function of the characteristics of his or her employer as of his or her own special needs.

I will have something else to say in the next Part about this difference between the ADA and most regulations directed at the employment relationship. But agency considerations may provide a partial explanation. The escape valve available to the employer in the form of the undue hardship exception may encourage some employees to moderate their demands, or to invest their own funds alongside their employer’s in what might be seen as an efficient joint venture, or face the possibility of no accommodation at all.

c. Fairness Again.—It is plausible that the minimum wage affects competing employers equally but that the employee-accommodation rules found in the ADA do not, if only because the smaller numbers of these expensive employees make sporadic and randomly distributed realities more relevant than averages. From a public choice perspective it is noteworthy that the collective action problem among employers might be yet greater because these employers will find cooperation more difficult than when the gains available from joint political activity are equal and well known, and when the temptation to free-ride is the only hurdle confronting the group. But as a matter of fairness, a world with small numbers of employees in need of expensive accommodations makes differential impact a source of concern. Highly burdened enterprises cannot pass on the costs of ADA-

... (iii) The overall financial resources of the covered entity, the overall size of the business of the covered entity with respect to the number of its employees, and the number, type and location of its facilities;

... (v) The impact of the accommodation upon the operation of the facility, including the impact on the ability of other employees to perform their duties and the impact on the facility’s ability to conduct business.


63 If an employee can find alternative sources of funding for an accommodation, including self-financing, an employer must provide the accommodation even if it would have been excused from providing the accommodation itself on grounds of “hardship.” See 29 C.F.R. App. to Part 1630, Interpretive Guidance on Title I of the Americans with Disabilities Act, Section 1630.2(p) Undue Hardship, at 357 (West Supp. 1997).

64 With no accommodation there is no job, inasmuch as an individual must be able to “perform the essential functions of the employment position” to be considered a “qualified individual” covered by the antidiscrimination statute. 42 U.S.C.A. §§ 12111(8), 12112(a).

65 In contrast, enterprises will be subject to the same structural modification requirements laid down in the Act; those responsibilities exist regardless of the particular characteristics of a business’s work force or customer base. The idea is to make future access possible for all persons, including disabled persons, without expensive retrofitting or alterations. A few competitors may be disadvantaged because
required employee accommodations to customers because these enterprises must compete for customers with enterprises that are less burdened by the ADA. Once again, tax deductions may provide some relief and with it a "fairer" distribution of the costs of regulation. Still, the scheme perhaps unnecessarily affects employers in disparate fashion. Finally, something less than a tax deduction may be allowed because structural and other investments must be amortized over many years rather than immediately deducted on the next tax return. This treatment may make sense, at least in the overall context of the income tax, if these improvements will be used by an employee over a multi-year period; when the accommodated employee leaves early, however, continuing to defer the deduction is inconsistent with general tax principles as well as overly harsh to the employer.

To the extent that the fairness perspective under development here draws attention to the tax system and the implicit baseline it offers, the fairness argument can be restated in the following terms: We would be hard pressed to justify a tax system that imposed special burdens on employers who happened to employ disabled employees. A forced redistribution of wealth from employers to employees as a form of reparations or compensation similarly lacks justification; these employers rarely caused their employees' disabilities. And if we permit fairness concerns to drift over to efficiency considerations, it is worth observing that an employer faced with an employee in need of accommodation is unlikely to be better situated economically to solve this problem, or be a least cost avoider, than are taxpayers more generally or competing employers with no such employees.

This comparison across employers returns us to the conditional nature of the employee accommodation mandate as opposed to the structural modifications mandate. When an employer can prove that the necessary accommodations create a business "hardship," its duty to provide them evaporates. This generally leaves the disabled individual bearing the financial burden of his or her disabilities. Though this arbitrary allocation of hardship is no more or less fair than the equally arbitrary allocation of its burden to a particular employer who happened to employ the disabled indi-

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66 The accommodation may be viewed as just another capital investment used to generate income over a series of years, or the economic equivalent of paying the disabled employee a higher salary each year. Though this approach corresponds to tax logic, it may seem less logical to employers interested in bringing their economic and tax situations into conformity with employers that have no disabled employees. On the other hand, to allow the up-front deduction of such costs might bias employers against accommodations that involved recurring, rather than one-time capital investments.

67 Unless, of course, there is some reason to believe either that the employer was responsible for creating the disability or, because of some form of market failure, was able to exploit the worker by, in the absence of government intervention, paying the worker a lower wage than would be justified by the worker's productivity.
vidual, it may seem less fair than allocating the burden to society as a whole. The "hardship" rule thus provides another example of how the necessary constraints of an unfunded program disadvantage some of the intended beneficiaries of the ADA.

3. Environmental Directives.—We come last to an example of unfunded regulation that seems less likely to suffer from the sort of fairness and efficiency problems associated with interemployer comparisons with respect to the accommodation portions of the ADA. The environmental regulations imposed by such statutes as the Clean Air Act, Federal Water Pollution Control, and Surface Mining Control and Reclamation Act generally affect enterprises in a given industry rather similarly; firms need to spend to reduce pollution or waste, or they need to absorb the cost of foregoing various business activities. Once again, numerous objections have been raised to the rulemaking and its federalization, and there is even some discussion of the unfunded nature of the directives, but relatively little attention has been paid to the way these enactments burden selected industries while allowing citizens more generally to enjoy "free" environmental improvements. As with the other examples in this Part, businesses bear a portion of the costs generated by the statutory schemes and they may form something of an appropriate interest group to compete with the imperfect representatives on the other side, who favor unfunded regulation. The funded alternative is also rife with monitoring difficulties because of the situation-specific nature of the required adjustments.

One important difference reflected in this example of unfunded regulation lies in the relatively fair and efficient distribution of its costs. Passing

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68 If an employer is forced out of business, nearly all the firm's employees will be worse off. If not, it remains difficult to see why the employer is asked to bear the cost of this social policy. The employer is likely to be neither a useful cost-avoider nor insurer.

73 Virtually all of this criticism is directed at those portions of the Acts that impose unfunded mandates on subordinate governments, rather than unfunded regulations on business entities. See, e.g., Dana, supra note 5, at 5-6; Steinzor, supra note 5, at 104-11.
74 Indeed, the commentary that exists stresses the equalizing feature of these laws. Specifically, some environmental legislation has been criticized for eliminating cost or market advantages formerly enjoyed by "naturally" clean participants in an industry. See BRUCE A. ACKERMAN, CLEAN COAL/DIRTY AIR 11 (1981). There is somewhat more discussion of the private burden-public benefit issue with respect to environmental laws such as the Endangered Species Act in which the economic burdens vary considerably within an industry.
Reconceptualizing Unfunded Mandates

on costs serves neither fairness nor efficiency goals if those who pay the passed-on costs bear no particular relationship to the beneficiaries of a regulation or to the source of the problem that gives rise to it. For example, there is no particular reason to think that consumers of fast food, purchased from firms in the practice of employing low-wage workers, ought to pay for the social welfare goals reflected in minimum-wage legislation. In contrast, it may be sensible as a matter of internalization and fair as a matter of claims on resources if these consumers, along with others who are heavy users of paper products, pay a suitable fraction of the water pollution costs associated with the manufacture of paper goods. These consumers might essentially be charged user fees that are more direct and defensible than the "fees" charged to consumers of fast food when prices in that industry reflect minimum-wage legislation.

If unfunded environmental regulation often amounts to the imposition of user fees, then any case against the unfunded character of the regulation will be quite weakened. An obvious analogy can be drawn to the law of takings, which distinguishes between regulations abating common-law nuisances and regulations redistributing property away from innocent private owners; only the latter constitute compensable takings. Plainly, environmental regulations that force the internalization of social costs that had formerly been externalized on others present the strongest case for unfunded regulations.

To the extent that fairness concerns remain because of differential impacts on competing firms, as when one firm has older, dirtier equipment or finds itself near environmentally sensitive areas, net compliance costs and interfirm differentials will again be partly reduced through the tax system because of deductible expenses and the government's penchant for sharing in all gains and most losses. In an important sense, all taxpayers share in most costs imposed on firms by government regulation because the government loses when profits fall.

It is likely that there is more sharing when regulations lead to deductible expenditures than when revenues are simply reduced because firms contract. Regulations sometimes require firms to do things that many would have done anyway. Funding these regulations then provides wind-

75 See, e.g., Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992) (stating and applying the nuisance-redistribution distinction). See generally Richard A. Epstein, Babbitt v. Sweet Home Chapters of Oregon: The Law and Economics of Habitat Preservation, 5 SUPREME CT. ECON. REV. 1, 28-31 (1997) (discussing nuisance law); Levmore, supra note 4, at 1340 (developing positive theory on the basis of the distinction); Robert E. Litan, Comment on Fischel's Political Economy of Just Compensation, 20 HARV. J.L. & PUB. POL'Y 65, 65-66 (1996) (distinguishing between regulatory actions "which may diminish the value of property in order to achieve a larger public purpose, but where the property owner has caused not harm" and "regulatory actions specifically designed to internalize an externality"). But see Fischel, supra note 2, at 54-55 (arguing that "one can characterize any beneficial activity as preventing the 'harm' of foregoing it")

76 Moreover, greater fairness or neutrality is virtually impossible to obtain.
falls to these firms. More generally, even when regulations affect behavior, these behavioral changes likely add some value to the firm. A firm that is required to offer certain unfunded fringe benefits to its employees may gain a portion of the value of these fringe benefits not only from its workers' satisfaction but also from a new ability to attract better workers or to reduce explicit wages to workers.\(^7\) Even the after-tax costs of such regulation, then, overstate the true cost to the enterprise because the calculation process disregards such offsetting benefits. In contrast, a firm likely gains nothing—though reduced external effects may be socially beneficial—when a regulation simply reduces its revenues and the government's corresponding tax, or forces the firm to cease or contract its operations.\(^8\)

It is plausible that deductibility is a decent proxy for expenditures that produce some private benefits to the target of regulation, while regulations that merely reduce a firm's income are better associated with compliance that produces no private benefit. If this is so, then the relationship between deductibility and fairness is fairly straightforward. The government's copayment constitutes a greater fraction of the true cost, including offsetting benefits, of deductible expenditures than one would think from looking at the taxpayer's marginal tax rate, while the marginal rate accurately reflects the amount of the government's and fellow taxpayers' copayment in decreased revenue situations. Of course, as explained earlier, most regulatory situations create both an increase in deductible expenditures and some decreases in revenues.\(^9\)

**B. Directives Aimed at Individuals**

It is useful to scout terrain that is yet further removed from that occupied by intergovernmental mandates. I do this by considering directives aimed not at organizations comparable to subordinate governments, but rather at individuals who are more numerous but less politically organized than the entities discussed to this point. When a federal directive imposes losses on a very few individuals, and these losers are neither implicitly compensated nor acting wrongfully, the Constitution normally requires the payment of compensation. The public choice explanation is so obvious that it has not needed that modern label. When, however, rulemaking brings on military conscription or speed limits or restrictions on foreign travel, affecting numerous but dispersed individuals, the law chooses not to require compensation for disadvantaged interest groups. Numerosity normally pre-

\(^7\) The firm may not always benefit. A requirement that a firm build higher smokestacks is unlikely to benefit the firm unless the improvement in air quality is so great that health insurance premiums for the firm's employees are reduced.

\(^8\) See supra notes 64 & 68 and accompanying text (justifying hardship exception to ADA requirements).

\(^9\) See supra note 14 (discussing mixed effect of minimum wage).
cludes constitutional protection. This is so even though the numerosity may create a public choice problem rather than solve it. Though numerosity can confer political power, it is unlikely to do so when class members only vote and do not organize to pursue their interests through other means. The dispersal of costs among large numbers of voters may paradoxically rob individual voters of the incentive for political action, leading to the absence of desired checks and balances. It goes almost without saying that these numerous “victims” find themselves in the very situation that taxpayers would face were funded mandates or other regulations to replace unfunded ones.

When the public choice perspective fails to justify a particular funding structure, a sensitivity to agency costs or moral hazard problems often demonstrates the superiority of unfunded over funded regulations. False claims and inefficient activity would abound in a system that promised to compensate those who were burdened by highway speed limits or restrictions on travel. Full compensation for conscripts would bring on other well-known problems.

Perhaps the most interesting thing about a comparison between unfunded regulations applied to businesses—applied in situations in which business firms serve as obvious intermediaries for groups of individuals—and those directed at individuals is that these dispersed, uncompensated individuals are generally unable to use the tax system to share their losses with other citizens. Liberty is not taxed as imputed income, and restrictions on liberty—an important variety of the costs imposed directly on individuals—do not give rise to deductions. These burdens are shared only in the sense that they normally fall on a great many people.

A quick glance at the examples provided in Part II suggests that regulations aimed at individuals—particularly those that take the form of restrictions on liberty—ought to be scrutinized more carefully than those directed at businesses and governments. Individuals, unlike businesses and governments, usually do not have preexisting organizations devoted to overcoming the collective action problems inherent in lobbying efforts. These collective action problems may be more intense in the individual context because of the nonmonetary nature of the interests at issue. Finally, the loss-spreading mechanism provided by the tax system provides no relief

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80 See Levmore, supra note 4, at 1344-48.
81 See Fischel, supra note 2, for an interesting perspective on the rise and fall of the draft.
82 To the extent that a conscript loses foregone earnings there is some sharing in the sense that the government collects less in the way of taxes. On the other hand, many conscripts do not feel bettered by the imposition. See supra notes 76-78 and accompanying text (generalizing about the difference between sharing through deductibility and mere income reduction).
83 Even on those occasions when the restrictions increase an individual’s out-of-pocket costs, deduction of the cost increase will be barred because the expenditure in question will be characterized as a “personal, living, or family” expense. I.R.C. § 262 (disallowing deductions for personal, living, or family expenses).
in the absence of monetary injury. The counterargument is that, with all due respect to modern public choice thinking, there is some safety in numbers and some protection in the fact that restrictions on individuals continue to attract a kind of media and academic attention not often found when the nominal losers are employers or subordinate governments.

III. RECONSIDERING MANDATES

Many of the mandates that lead subordinate governments to complain apply to employers generally. For example, the three employer mandates discussed in Part II apply to subordinate governments as well as private actors. Other mandates, however, apply to activities performed largely or solely by subordinate governments. The Education of All Handicapped Children Act, for example, requires public school systems to provide certain services to disabled students, while the Family Support Act of 1988 requires states to extend Medicaid services to previously ineligible groups of people. Similarly, the Clean Water Act imposes wastewater treatment standards and the Safe Drinking Water Act sets standards for the operation of public water systems. Subordinate government behavior may also be controlled by the federal, or state, government’s subsidizing local government activity, by requiring such activity and compensating for the associ—

84 Although Congress adopted minimum-wage legislation covering private employers in 1938, it did not attempt to impose the minimum-wage laws on state employees until 1974. These amendments to the Fair Labor Standards Act were initially overturned in National League of Cities v. Usery, 426 U.S. 833 (1976), but then accepted in Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985). The definition of “employer” subject to the antidiscrimination provisions of the ADA excepts “the United States, a corporation wholly owned by the government of the United States, or an Indian tribe,” 42 U.S.C.A. § 12111(5)(B) (West Supp. 1998), but not state or local governments or their agencies. Not only are subordinate governmental entities subject to the specific regulations contained in the various environmental laws, but also they have been delegated implementation and enforcement responsibilities under the Federal Water Pollution Control Act, 33 U.S.C. § 1342 (1995), the Safe Drinking Water Act, 42 U.S.C. § 300g-2 (1995), the Resource Conservation and Recovery Act of 1976, 42 U.S.C. §§ 6926, 6946 (1995), and the Clean Air Act Amendment of 1990, 42 U.S.C. § 7410 (1995). The extent to which the latter can survive constitutional challenge following the decision in Printz v. United States, 521 U.S. 98 (1997), remains an open question. The portions of these statutes that apply with equal force to private businesses as well as state agencies have been deemed less problematic by previous commentators on public choice grounds. See La Pierre, supra note 5, at 648-49 (political checks imposed by private entities provide “vicarious protection” against federal overreaching). Moreover, to the extent the activities of state and local governments overlap with those provided by for-profit enterprises in such areas as garbage collection and utility provision, anything less than uniform application of the rules would create competitive concerns.

ated costs of funded mandates, or by demanding payments from subordinates that choose to avoid undertaking the desired activity. 89

The closest we come to the last scheme is when expected transfers from the federal government are suddenly conditioned on previously unconstrained, and somewhat unrelated, performance. For instance, recent federal legislation withholds previously available highway funds from states that do not conform to federal wishes regarding minimum age requirements for the consumption of alcohol. 90 These and other "subsidies" risk being characterized as unconstitutional conditions, but that subject need not distract us here. Our puzzle, if it is still that, is the special criticism reserved for unfunded mandates, under which the subordinate governments have little choice but to conform. 91 I proceed under the assumption that much of this criticism would subside if the federal government attached payments to its orders, and that the critics would surely relent if the federal strategy were always to employ subsidies that subordinate governments could choose to decline. 92

A. Public Choice Considerations

The case against mandates focuses on the likelihood that Congress can regulate in a way that satisfies some interest groups while hiding the burden imposed on other interests and voters—and sometimes even from themselves. If this imbalance between winners and losers is indeed a characteristic of, or even the explanation for unfunded mandates, then inefficient and excessive regulation is likely. From a public choice perspective, the danger might be the rent-seeking that accompanies regulation, as resources are wasted in influencing Congress to regulate at the expense of presumably underrepresented subordinate governments and their constituents. Either way, federal legislators may benefit through the pockets or votes of those who stand to gain from mandates while these legislators need not worry as much about the negative reactions of those who will lose.


90 See 23 U.S.C. § 158 (1995) (linking receipt of highway funds to establishment of minimum drinking age); 23 U.S.C. § 153 (linking receipt of highway funds to state enactment of seat belt and motorcycle helmet requirements). Federal highway funds have served as a recurring tool of persuasion.

91 Unless, of course, the point of the federal rulemaking is to generate supposed gains from uniformity, in which case an opt-out provision would be self-defeating.

92 I do not mean to suggest that the subsidies would not generate independent criticism; they may be attacked as a waste of the government's money. Moreover, overly generous subsidies may be regarded by some as the equivalent of compulsion—offers that are "too good to be refused." See William J. Klein, Pressure or Compulsion? Federal Highway Fund Sanctions of the Clean Air Act Amendments of 1990, 26 RUTGERS L.J. 855 (1995). But see Hills, supra note 11, at 862-63.
Putting the case against unfunded mandates this way makes clear that it rests on questionable empirical foundations.\(^9\) First, even assuming voters begin ignorant of the source of their financial burdens, they can rectify their ignorance through education. Further, if one is willing to assume irretrievably ignorant voters, one must question whether such ignorant voters would effectively oppose funded mandates. Indeed, it seems reasonable to believe that by burdening relatively interested, educated, and organized intermediaries, such as state and local governments, unfunded mandates actually provide a more effective counterweight against special interest groups than would funded mandates. Each of these points is discussed in more detail below.

The case against unfunded mandates relies either on the presence of unsophisticated voters\(^9\) or on a systematic pattern of weaker interest groups at the local cost-bearing level than at the federal benefit-enjoying level.\(^9\) Even if voters, as an initial matter, misunderstand the source of their governmental spending requirements, this ignorance need not last forever. The cost of complying locally with a given mandate falls on the very voters and taxpayers who are told at the national level that they are getting something for nothing. If they pay attention to the finances of their states and localities, they will realize the truth and take the appropriate political action.\(^9\)

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93 The argument about political accountability, and some of the specific points made here, form the thrust of the earlier, excellent piece by David Dana. See Dana, supra note 5.

94 The unsophisticated voter is the key element in Ed Zelinsky’s model. See Zelinsky, supra note 3, at 1374 (“Further postulate that there is slack in the agency relationship between legislators and the electorate . . . . Assume additionally that the unsophisticated anti-service voter does not comprehend the import of the unfunded mandate as state legislators thereby impose services without any perceptible state tax increases to signal the corresponding costs.”).

95 One complaint leveled against unfunded mandates is that, were the matter left to local voters, the mandate would not have passed. In short, local priorities differ from national ones or the ones set by the national legislature. This is, of course, more a complaint about national intrusion into the subject matter being regulated or mandated than about the funded or unfunded nature of the mandate itself. If the mandate were funded, after all, local residents would find themselves paying for the mandate through their federal tax payments; there would be no guarantee that this levy would be any smaller than the one assessed at a more local level as the result of an unfunded level. Indeed, in his article, David Dana suggests that some localities may prefer unfunded mandates to funded mandates precisely because their jurisdictions bear lower costs under the unfunded mandates scenario. See Dana, supra note 5, at 26-27. Nonetheless, it may be harder for residents to identify their personal contribution towards the cost of federally funded mandates than of mandates funded at a more local level, which may make the burden more politically acceptable but also less likely to be subject to effective monitoring by the electorate. See Garrett, supra note 7 (noting the difficulty of monitoring particular expenditures at federal level).

96 Whether these actions will be successful is another issue; they may fail because of the dispersed costs-concentrated benefits phenomenon. However, this impediment to success exists whether the federal government provides the benefits in funded or unfunded form. Moreover, it is possible to tell a story in which the lack of voter sophistication leads to too little legislation rather than too much. If the beneficiaries, as opposed to the general public, misattribute benefits to state or local politicians, federal officials would be denied political gains from passing legislation. Indeed, the result might be too little federal regulation.
The question is whether they can be made to pay such attention. If they can, any public choice problem that exists will turn out to be a transition problem. In fact, the dynamics of the political process should be sufficient to dispel the ignorance of voters. If there is indeed a kind of information asymmetry, such that Congress issues unfunded mandates in order to enjoy gain without pain because of uninformed losers, then state and local politicians should be expected to educate their constituents. In fact, there are indications that they are beginning to do that. As the success of corporate "voter education programs" has shown, voters do respond when information is provided to them in easily accessible form. Moreover, the more egregious the behavior of mandating governments, the more susceptible voters will be to such educational efforts. Voters who may have once "tuned-out" state and local politics will become more interested as the monetary stakes rise. In short, if the problem with unfunded mandates results entirely from the presence of uninformed voters, then the problem may be short-lived.

Further, most of the critics of unfunded mandates ignore the independent political power of state and local government units. If gross inefficiency or information asymmetry exists, or if voters persist in their ignorance, states and localities can be expected to try to influence Congress directly to eschew unwise unfunded mandates. Subordinate governments do, to be sure, face something of a collective action problem because mandates are generally aimed at all states or at least at many states. But it is hard to see why subordinate governments should be expected to be less powerful in the federal political arena than individuals or even the largest business firms and industries, which also face this sort of collective action problem. Indeed, subordinate governments—like businesses and unlike most individuals—have already created structures to overcome these collective action problems.

97 See Dana, supra note 5, at 20.
98 See id. at 20 n.53. The extensive coverage of the unfunded mandates issue in both the popular and academic presses may be regarded as both the means of and evidence of the success of such efforts.
99 Many commentators have decried the success of corporate advertising campaigns on topics such as "bottle bills." See David R. Lagasse, Undue Influence: Corporate Political Speech, Power and the Initiative Process, 61 BROOK. L. REV. 1347, 1348 (1995) (decrying effectiveness of corporate-sponsored campaign expenditures against environmental initiatives).
100 Voters need not be perfectly educated in order to place responsibility where it belongs. Of course, knowledge may not change their voting behavior; they may decide that their general satisfaction with a particular politician outweighs their anger at his or her complicity in passing a particularly expensive and unwanted mandate. However, the same absence of political reaction could follow the enactment of a federally funded mandate. The real issue or "problem" here is that citizens' votes are always implicit logrolls; voters rarely get to express their preference regarding individual issues at any level of government. The federal level may be the worst in this regard because of the multiplicity of diverse issues controlled by federal legislators.
101 There are about 60 organizations representing state and local public officials and governments. The influential "big seven" include the Council of State Governments, International City Management...
The organizational ability of subordinate governments and Tullock’s theory of countervailing interest groups\(^\text{102}\) suggests that, on public choice grounds alone, unfunded mandates may be superior to funded intergovernmental directives. State and local governments, or the interests that they tax or service, may balance or offset those interest groups that stand to gain from intergovernmental mandates.\(^\text{103}\) When funded mandates may simply burden dispersed taxpayers across the country or unidentifiable future taxpayers who will one day repay money the federal government now borrows, unfunded mandates may shift the burden to subordinate governments. These local government units may be far superior political intermediaries than those who would enter the fray under the alternative of funded mandates or modest subsidies.\(^\text{104}\) It is noteworthy that, for what is probably itself explained by public choice reasoning, the federal government is much more likely to resort to debt than are state and local governments.\(^\text{105}\) The immediacy of payment at the state and local government levels adds to the sense that impositions threatened against these governments will stimulate political reaction superior to that generated by federal mandates funded through debt.\(^\text{106}\)

\(^{102}\) See supra notes 26-29 and accompanying text for a discussion of Tullock’s theory of countervailing interest groups.

\(^{103}\) Moreover, the beneficiaries are often ideally organized and situated for political advantage.

\(^{104}\) See supra note 101 (listing state and local political organizations).


\(^{106}\) Note that an effective balanced budget requirement at the federal level could lead to the creation of a Tullockian combat between proponents of funded mandates and proponents of other programs and interest groups that would see their federal allocations correspondingly reduced. Such confrontations would be inferior to those produced by unfunded mandates in two respects. First, in the absence of a rational basis for choosing among potential revenue offsets, more effort would be expended on passing the burden of such offsets onto others than on defending the relative merits of the competing spending programs. See supra note 28. Second, this tendency towards unproductive rent-seeking would be exacerbated by the fact that the parties with the most knowledge about mandates would have an institutional stake in supporting them, regardless of their overall social value. See infra text at note 108 (detailing benefits to state and local governments of federal spending). Thus the quality of useful information provided to legislators may decline. Moreover, the option of raising taxes may provide an escape from even this diminished Tullockian competition. Though critics of mandates assume that ignorant constituencies are capable of monitoring exercises of the taxing power, recent history suggests otherwise. See Glenn E. Coven, Congress As Indian-Giver: “Phasing-Out” Tax Allowances Under the Internal Revenue Code of 1986, 6 VA. TAX REV. 505, 526 (1987); James Edward Maule, Getting Hamr’d: Highest Applicable Marginal Rates That Nail Unsuspecting Taxpayers, 53 TAX NOTES 1423, 1429 (1991).
Several commentators have suggested that agency problems will prevent states and localities from adequately protecting their constituents' interests in this regard. While it is undoubtedly true that, like all agents, state and local officials have interests that diverge from those of their principals, the divergence would militate in the direction of excessive rather than insufficient "protection" against unfunded mandates. After all, as opponents of unfunded mandates regularly claim, state and local officials can be seen as the primary victims of such mandates. They are saddled with the financing responsibilities that bring political opprobrium but denied political credit for the benefits purchased with those funds. As such, it would be in their political and personal interests to discourage even sensible unfunded mandates; their opposition to irresponsible or unnecessary ones can be taken for granted. Interestingly, the significant divergence of interest that troubles opponents of unfunded mandates appears much more likely in the case of funded mandates. Indeed, these subordinate governments might lobby for funded—or, of course, for overfunded—mandates when there is some gain to uniformity or when there is some political gain to a claim that the federal government forced certain policies on the states and localities—or because they smell pork-barrel opportunities.

Perhaps the safest intuition is that there are at least some areas in which state and local governments are politically well situated. Informational advantages and experience can give subordinate governments and their established agencies special credibility. Environmental controls, social welfare programs, criminal enforcement strategies, and educational reforms come to mind as areas in which there may be evolution toward federal regulation but in which there is also subordinate government expertise. This expertise can translate into political influence at the federal level. It is perhaps not entirely circular to add that the weaponry of better information may be further improved by the support available to these "victimized" subordinate governments under the Unfunded Mandates Reform Act of 1995.

107 See, e.g., Garrett, supra note 7, at 1127-31.
108 See Garrett, supra note 7, at 1126; Krane, supra note 101, at 148 (noting importance of expertise in drafting legislation); see also Carol F. Lee, The Political Safeguards of Federalism? Congressional Responses to Supreme Court Decisions on State and Local Liability, 20 URB. LAW. 301, 335-37 (1988) (detailing institutional links that prevent state and local governments from being "just another interest group").
109 See UMRA, 2 U.S.C.A. § 602 et seq. (West 1997), Pub. L. No. 104-4, 109 Stat. 48 (1995). Some critics of unfunded mandates view the absence of definitive information regarding the cost of such mandates as an independent accountability problem. The absence of such information makes meaningful cost-benefit analysis at any level of government impossible. Reckless proposals may therefore generate little opposition. Of course, this problem afflicts unfunded regulation of private entities as well as unfunded mandates. An acknowledgment of the ubiquity of this problem can be found in UMRA; its information requirements apply to both types of unfunded directives. Title I of UMRA, among other things, requires the Congressional Budget Office to estimate the direct costs of proposed unfunded mandates, when such mandates are expected to impose burdens exceeding specified thresholds. See 2 U.S.C.A. §§ 658c(a)-(e) (West 1997) (establishing a $50 million threshold for intergovernmental man-
I do not mean to suggest that state and local governments are always in a position to influence federal law and politics. With respect to some issues, subordinate governments may be better able to shift costs onto other losers than to block federal directives. Some federal directives that are at their core unwise or inefficient, either in terms of substance or in terms of their press for uniformity across states, may survive attacks by even politically capable states. But on balance it seems that unfunded mandates may well pose less of a problem than do other categories of unfunded federal regulation and even certain categories of funded regulation.

If there is a special public choice case to be made on behalf of regulated subordinate governments, then it might build on distinctions that have played little role in the discussion and literature thus far. It is, for example, remotely possible that state and local governments are at a relative disadvantage in the political process because they are subject to special constraints limiting their ability to contribute to federal candidates. The ability to provide or hold back in-kind services that have monetary value, not to mention the ability of subordinate governments—but not most trade associations and the like—to tax its constituents, would seem to make this missing tool of minor importance. Moreover, an optimist might say that these funding limitations ensure that state and local politicians will not be too powerful as compared to private interests, and especially those interests likely to oppose increased federal debt or funded mandates more generally. On balance, state and local governments do not seem especially weak in political and fiscal terms.

These estimates of financial burden must be included in the committee report accompanying the bill proposing the mandate or, if such information is not ready prior to the publication of this report, in the Congressional Record prior to the bill's floor consideration. See 2 U.S.C.A. § 658b; Garrett, supra note 7, at 1145. Bills containing mandates for which such information is lacking are subject to a "point of order" that must be specifically waived by majority vote. See 2 U.S.C.A. § 658d; see Garrett, supra note 7, at 1161-63, 1165-67 (explaining significance of "point of order"). Whether meaningful information can be gathered in all cases remains an open question but, again, one not unique to unfunded mandates. See Garrett, supra note 7, at 1155-57 (enumerating some of the difficulties with budget estimations for unfunded mandates). The circularity, of course, is that the Act is a response to criticism of unfunded mandates; its very passage indicates the influence retained by state and local governments over the federal legislature.

Another argument made against unfunded mandates is that spending on federal priorities may squeeze out funding for former state priorities and, in particular, state-funded social welfare programs. The argument goes as follows: In determining its tax rate, a jurisdiction trades off the benefits of attracting more tax base by lowering its rate against the cost of reducing the tax rate applicable to the base already located within the jurisdiction. If an unfunded mandate causes a state to raise its tax rate, the nature of the trade-off changes because the higher the state tax rate, the stronger the incentive to attract additional increments to the state tax base. The way to attract the base is to lower the state tax rate. Of course, lowering the state tax rate changes the trade-off in the opposite direction; it is hard to predict the new equilibrium. The empirical evidence is equivocal. States raised taxes to replace federal grants-in-
B. Intergovernmental Agency Costs

Governments are not exempt from the general rule that it is easier to spend another’s money than one’s own; indeed, this is precisely the claim made by opponents of unfunded mandates and of government programs generally. But once we adopt the perspective suggested here, comparing funded and unfunded regulation, no clear conclusion follows from the axiom about externalized costs. If intergovernmental mandates were funded, separation would remain between implementation and cost-absorption. Instead of being ordered to do things by a non-paying master, subordinate governments would now be in a position to choose means toward mandated ends unconstrained by costs. The result would be something like a federal entitlement program. Subordinate governments would have little reason to exercise restraint in drawing on the blank check given by the federal government for fulfillment of a mandate. Expenditures with little if any effect on the achievement of the federal mandate would provide opportunities for a subordinate government to employ more people, perhaps on a patronage basis, perhaps not, but always with the effect of pumping more money into the local economy. It would allow them to purchase more goods from either local or politically favored suppliers. The subordinate government would not be subject to an effective political check for such wasteful practices because its constituents would see only the benefits and none or few of the detriments from such spending. Thus, subordinate governments could not be depended upon to adequately monitor the cost-effectiveness of decisions made by their bureaucrats and the bureaucrats have their own independent reasons to overspend.

The funding government would, of course, have an incentive to monitor the behavior of recipients and to issue subsidiary rules to control waste.

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113 The federal government could, of course, mandate means instead of merely ends, virtually eliminating the distinction between “mandates” and federal programs. Doing so, however, would undercut the initial rationale for implementing programs through subordinate governments rather than the federal bureaucracy.

114 Alternatively, jurisdictions may try to pass off their own routine spending obligations as attributable to—and thus reimbursable by—the federal program. The limited experience with state bookkeeping in the mandate area intensifies such concerns. State and local organizations have routinely submitted highly exaggerated estimates of the cost of federal mandates. See, e.g., Adler, supra note 9, at 1184-86.

But this sort of monitoring and controlling can be difficult. Two common reasons for choosing mandates rather than federal spending programs in the first place are to allow local variations in response to local conditions and to facilitate local experimentation with methods of achieving the mandated goals.\textsuperscript{116} Local variation and experimentation make monitoring and controlling problematic. If, for example, waste is controlled by \textit{ex post facto} auditing of effectiveness, then experimentation will be discouraged because local governments will have a strong incentive to act in ways that guarantee reimbursement rather than long-term efficiency. In short, a strong case can be made for preferring unfunded mandates over funded mandates on agency cost grounds.

There is, of course, the countervailing concern about underprovision. The absence of external funding undoubtedly causes subordinate governments to reduce costs in undesirable as well as desirable ways. Like private employers, local governments may shy away from hiring expensive, disabled employees. Or they may pick a relatively inexpensive method for attaining a legislative goal that does not, in fact, attain the goal. Or they may decide to avoid providing a service altogether, relegating its provision to private enterprises. Unfunded mandates may be inappropriate except as a form of political window-dressing in situations in which the federal government cannot effectively monitor the attainment of its desired goals. Of course, funded mandates often do not fare much better in such situations. As in the earlier discussion of the ADA, the choice of funding mechanisms often reduces to a choice of the lesser of three evils, the third being to do nothing at all.

\textbf{C. Sharing Through Taxation}

The burden of governmental mandates will often fall unequally across jurisdictions, whether that burden is measured on a per capita or other basis.\textsuperscript{117} But governments, unlike employers, are not taxpaying entities, and their extraordinary costs are therefore not simply reflected back onto taxpayers at large through the deductibility of expenses. Subordinate governments, unlike employers and more like individuals, thus bear the brunt of any inequities in the allocation of fiscal responsibilities through mandates. It appears, then, that what really distinguishes unfunded mandates from unfunded regulation is not the public choice problem, which has been the fo-

\textsuperscript{116} The desire—or need—to grant flexibility in the means of achieving desired goals clearly increases the attractiveness of unfunded mandates or regulations. Although agency issues arise in other situations, alternative monitoring devices are available when the desired behavior is sufficiently certain to make reasonable estimates of the cost of compliance possible.

\textsuperscript{117} See Michael Fix, Observations on Mandating, in COPING WITH MANDATES: WHAT ARE THE ALTERNATIVES?, supra note 89, at 36 (estimating per capita costs of 6 mandates as ranging from $51.50 to $6 in different jurisdictions). Cost variations can be attributable to any number of factors, ranging from physical conditions within particular states to residential patterns to prior political decisions and expenditure patterns.
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ocus of most of the commentary, but rather the possibility of striking inequality or "unfairness" in the distribution of the short-term, and sometimes long-term, economic burdens imposed by the mandates. This relative unfairness, or distinction between unfunded mandates and other unfunded regulation, can be traced to the sometime availability of the ameliorating aspects of the federal tax system.

This distinction or, perhaps, flaw—if it can be called that—in the operation of unfunded mandates should not be overstated. There is, after all, just a possibility rather than a probability of heightened inequality. On occasion, mandated actions will improve the lives or businesses of residents of the subordinate governments, or they will offset damage caused by these subordinates' activities and function in the manner of user fees. Further, the unfairness that is created is not entirely unique to subordinate governments. Although businesses can deduct their costs of complying with governmental regulations, the consumers that purchase goods and services at "inflated" prices often cannot. The tax system thus ameliorates only part of the total compliance cost of most regulations. And, as previously discussed, most individual mandates do not give rise to tax-deductible expenditures.

Although subordinate governments cannot share their burden through the tax system, they pass on compliance costs to their own "customers," which is to say the taxpayers in their jurisdictions. Some of these taxpayers can then claim deductions against their federal income tax for state and local tax payments, just as some of the price increases will be borne by deduction-claiming businesses. Admittedly, this option may be available to just a minority of taxpayers, because such deductions can be claimed only by businesses and itemizers and only with respect to certain types of state

118 See supra note 83 (nondeductibility of personal expenses).

119 Indeed, another argument in favor of unfunded mandates may be that changing the financing entity entails a change in the financing mechanism. Congressional advocates of consumption taxation, for example, may prefer more extensive utilization of sales and property taxes relative to income taxes. Although more direct methods of accomplishing such shifts in financing mechanisms exist, such as restoring the tax deduction for state sales taxes, they may not be politically feasible. Proposals to restore the sales tax deduction, for example, have been opposed on distributional as well as budgetary grounds.

120 To be sure, these itemizers tend to be high earners so that the percentage of state and local taxes that is deducted on federal returns is greater than one might think from simply looking at the percentage of taxpayers who itemize. In 1994, almost 28% of taxpayers and about 79% of those with adjusted gross incomes of $50,000 and above filed returns claiming an itemized deduction for state and local tax payments, see INTERNAL REVENUE SERV., STATISTICS OF INCOME—1994 INDIVIDUAL INCOME TAX RETURNS 78 tbl.2.1; such payments represented about 83% of the total amount of state and local income taxes collected during the 1994 calendar year. See U.S. Census Bureau, Table 1, National Totals of State and Local Tax Revenue, By Type of Tax (visited on August 28, 1998) <http://www.census.gov/govs/qtax/qlt9811.txt>. Presumably, a similarly large percentage of the property taxes collected by local jurisdictions are also claimed as deductions by itemizing taxpayers, although the statistics required to definitively prove this point are unavailable. On the other hand, sales
and local taxes.\textsuperscript{121} By contrast, an overwhelming fraction of businesses can deduct or at least capitalize the costs of complying with the unfunded regulations they face.\textsuperscript{122} To the extent that these regulations generate higher costs for the services or products that businesses buy, these costs are of course similarly deductible.

\textbf{D. Summary}

Unfunded regulations often seem markedly superior to funded directives when viewed from an agency cost perspective. This is so whether those regulations are directed at businesses or subordinate governments—in the form of what I have labeled as "mandates" rather than broader "regulations." The public choice perspective does not clearly favor either unfunded or funded mandates. If a special case can be made against unfunded mandates, then, it needs to be made from a perspective that focuses on the wealth or income effects of regulation. Unfunded mandates have the potential to alter the fiscal burden among polities and their diverse constituents and tax bases,\textsuperscript{123} and the impact of unfunded mandates on taxpayers and others would therefore seem to be critical to any judgment of the desirability of unfunded mandates.

The politics and commentary dealing with unfunded mandates often reflect underlying substantive views of federal rulemaking or standards. Those who oppose a federal standard generally devote at least some of their energy to criticizing the unfunded format of the mandate, assuming it is that, while some proponents of a federal standard favor unfunded regulation over funded regulation.\textsuperscript{124} I have tried to suggest that one should set aside independent views of the federal regulation in question, and that when that is done, the choice between funded and unfunded directives is rarely obvious. It undoubtedly depends on the context and specific terms of the mandate as well as on the collective effects of all such mandates and of the taxes currently account for about 24\% of state and local tax revenues, \textit{see} U.S. Census Bureau, \textit{supra}, at Table 1. They once accounted for about 17\% of the taxes deducted by individuals, \textit{see} Susan Hostetter & Jeffrey Bates, \textit{Individual Income Tax Returns, Preliminary Data}, 1987, 8-4 \textit{STAT. INCOME BULL.} 5, 9 (Spring 1989) (noting that amount of taxes paid deduction decreased by 17.6\% in the year state sales taxes became nondeductible). Sales taxes may not be deducted by individuals unless incurred in connection with a trade or business. Individuals are similarly barred from deducting a host of other miscellaneous taxes that account for another approximately 6\% of state and local tax revenues. \textit{See} 26 U.S.C. § 164 (1994) (listing deductible taxes); U.S. Census Bureau, United States State and Local Government Finances by Level of Government: 1993-94 (visited on August 28, 1998) <http://www.census.gov/govs/estimate/94stlus.txt>.

\begin{itemize}
\item Only state income and property taxes are deductible by nonbusiness taxpayers; sales taxes are not. \textit{See} 26 U.S.C. § 164.
\item \textit{See} 26 U.S.C. § 162 (allowing a deduction for "ordinary and necessary business expenses").
\item Indeed, once created, disparities might snowball as taxpayers in high-cost jurisdictions vote with their feet and move to lower-cost jurisdictions, leaving behind a smaller and perhaps poorer population to cope with the financial burden.
\end{itemize}

\textsuperscript{121} Only state income and property taxes are deductible by nonbusiness taxpayers; sales taxes are not. \textit{See} 26 U.S.C. § 164.

\textsuperscript{122} \textit{See} 26 U.S.C. § 162 (allowing a deduction for "ordinary and necessary business expenses").

\textsuperscript{123} Indeed, once created, disparities might snowball as taxpayers in high-cost jurisdictions vote with their feet and move to lower-cost jurisdictions, leaving behind a smaller and perhaps poorer population to cope with the financial burden.

\textsuperscript{124} \textit{See} Dana, \textit{supra} note 5, at 26.
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various taxes and charges that ultimately finance their implementation. Indeed, any given subordinate government, apt to complain about unfunded mandates directed its way, might be pressed by the question of whether it would prefer all federal mandates to be funded or all to be unfunded.  

IV. COMPROMISES

These unyielding comparisons of funded and unfunded directives draw attention to the possibility of compromise, or partial funding. Such compromises run the risk of undercutting the agency-cost advantages provided by schemes without funding. The tax system effects, however, just such a compromise, at least when costs are placed on employers. This precedent may indicate that the legal system, or at least the tax system, has decided that the fairness gains from sharing through tax deductibility outweigh the concomitant efficiency costs of biasing agents. Partial funding may also assuage any continuing discomfort about public choice concerns. The trick, if this qualifies as one, is to develop partial funding mechanisms that minimize incentives for misbehavior by the subordinate, implementing government.

When put this way, the task is familiar to readers who have thought about contracting problems in general or, closer to home, federal-grants-in-aid and federal contracting. Without revisiting the broader or narrower literatures, it should suffice to say that one can choose among a plethora of familiar arrangements, including matching grants, block grants, and cost-plus arrangements, and that each comes with advantages and disadvantages. Other mechanisms, perhaps better suited to private businesses, have been explored in analogous cost-sharing situations, including medical reimbursement arrangements. There is no reason to think that any one arrangement, whether presently found in intergovernmental or private settings, is best for all intergovernmental directives.

It is worth noting that providing partial funding of intergovernmental mandates by simply making all state and local tax payments deductible even to non-itemizers—if only to mimic the treatment of employers who are subject to unfunded regulation—is probably unwise. State and local tax revenues do not all go toward the cost of complying with intergovernmental mandates; the case for allowing an expensive unlimited deduction for non-

125 Their attitude would also be affected by the source of funding. Few subordinate government officials would be favorably inclined if they knew that federal mandates would be funded by cutting back on federal block grants and other relatively unconstrained forms of federal aid to states and localities; they would be much happier—indeed, perhaps too happy, see supra text at notes 107-108—if the money were to come from the defense budget or new federal tax levies.

mandate related expenses must be made on independent grounds. Nor can one easily separate out the portion of the subordinate government expenditures, and hence of the tax payments, attributable to these unfunded mandates. Moreover, because these mandates affect diverse jurisdictions differentially, it would be unappealing to employ for this purpose an average percentage of taxes traceable to unfunded mandates. Unfortunately, perhaps, a resolution in the direction of uniform cost-sharing would appear to require a fairly complex mechanism.

V. CONCLUSION

Three points stand out when comparing unfunded intergovernmental mandates to other forms of regulation. First, the claim that unfunded mandates reflect and substantively suffer from a lack of political accountability, at least relative to other types of unfunded regulation, is unfounded. It is not just that subordinate governments may be significant players in the federal political system. It is also that alternative arrangements—in particular the one of funded mandates preferred by many critics of unfunded mandates—would likely lead to even less political accountability. The political accountability problem is, in short, far more complex than critics of unfunded mandates have realized. Once those complexities have been unraveled, unfunded mandates seem like a reasonable arrangement even for the average voter. Though political accountability problems remain, they are no more serious or pervasive than those afflicting unfunded regulations affecting individuals and firms, and perhaps even those afflicting funded mandates.

The second point addresses the role the absence of funding plays in minimizing, though not eliminating, agency costs. It is inescapable that if one government sets standards for another to implement, then either funding will be separated from implementation, as it is with funded mandates, or rulemaking will be separated from apparent political accountability, as critics describe unfunded mandates. Either form of separation has its costs. I have suggested that the costs associated with the second kind of separation, as generated by unfunded mandates, need some reassessment. In most settings these costs are unlikely to be much different from those engendered by unfunded regulation more generally. The special criticism saved for unfunded intergovernmental mandates is thus somewhat puzzling and perhaps misplaced.

The third and perhaps most novel point advanced here is the sense that the real concern with unfunded intergovernmental mandates may be distributional. Part of this concern stems from understanding the role that the tax system plays in spreading the costs of other forms of unfunded regulation. The routine deductibility of some compliance costs produces a sharing of costs between the apparent, and less than apparent, victims of regulation and the larger, tax-paying public. This sharing ameliorates fairness concerns about some of these regulations, though it also has the potential to threaten the optimistic view that interest groups that would be heavily burdened by proposed regulations successfully invest in order to defeat such rulemaking. By contrast, to the extent that subordinate governments’ compliance costs are not shared through the tax system, unfunded mandates resemble uncompensated regulations directed at individuals. It is perhaps unsurprising to note that when individuals, rather than subordinate governments, are concerned, common intuitions have long supported anxieties about the fairness of these regulations. The contemporary fuss over unfunded mandates offers us the opportunity to think further about the more complex distributional impact of regulations aimed at state and local governments.

POSTSCRIPT

When presenting this Article, I have frequently been asked whether I believe that Congress would pass the same intergovernmental mandates if it were forced to pay for them. I do not. But I would not ascribe all such changes in outcome to the salutary effects of the self-discipline of the budget process any more than I believe that such changes in outcome would necessarily benefit the American polity. Rather, I would ascribe many changes to legitimate concerns about the dangers of providing state and local governments with open-ended federal funding—the agency cost problem. Intergovernmental mandates, like uncompensated regulation generally, make it possible to achieve certain types of public goals at reasonable social cost. These problems may be left unaddressed if the only alternative is public overfunding. Underregulation—whether of private entities, individuals, or subordinate governments—can be as big a social problem as overregulation.