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A CLOSER LOOK AT THE FEDERALIZATION SNOWBALL

Abigail R. Moncrieff[*]

Companion to: Abigail R. Moncrieff, Federalization Snowballs: The Need for National Action in Medical Malpractice Reform, 109 Colum. L. Rev. 844 (2009).

While on the academic job market, I presented *Federalization Snowballs* to several stellar law faculties.[1] My argument, in short, was that: (1) federal healthcare spending allows the states to externalize onto the federal government about 40% of the utilization costs associated with their medical malpractice policies (such as the cost of defensive medicine); (2) such an externality systematically distorts a rational state's incentive to reform medical malpractice; and (3) federalization of medical malpractice is necessary to correct the distortion. In other words, I argued that federalization of healthcare spending through Medicare, Medicaid, and similar programs has snowballed into a need for federalization of medical malpractice. Federalization snowballs.

As I presented this argument to faculties around the country, two questions commonly arose that I hadn't intended to—and hadn't in fact—explicitly addressed in the Essay. (Having been warned against "theoretical drift," I limited myself to one application of my theoretical idea, applying the snowball concept only to my primary area of expertise: healthcare law.) The two questions were: Given the ubiquity of federal spending, aren't federalization snowballs much more common than the Essay suggests? And given the ubiquity of *snowballs* that must result from the ubiquity of *spending*, isn't the Essay's theoretical idea much bigger and therefore either much more important or much more implausible than the Essay suggests? (The implied conclusion of "much more important" or "much more implausible" varied by questioner; some were highly skeptical, others much more generous.)

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* Associate Professor of Law, Boston University School of Law.

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1. Abigail R. Moncrieff, Federalization Snowballs: The Need for National Action in Medical Malpractice Reform, 109 Colum. L. Rev. 844 (2009).

This companion piece addresses those two questions, further delineating the general theoretical idea of the federalization snowball. The first part clarifies the scope of the snowball, demonstrating that the idea is indeed bigger than medical malpractice but is not (yet) as big as the federal budget. The second part clarifies the legal underpinnings of the snowball, discussing its ties to a constitutional debate that dates back to the framing era; the snowball idea provides an important theoretical clarification for interpreting the Spending Clause.

I. HOW COMMON IS THE FEDERALIZATION SNOWBALL?

Given the ubiquity of federal spending, aren't snowballs much more common than the Essay suggests? Well, yes and no. There are probably many snowballs out there; the phenomenon certainly extends beyond the examples provided in the Essay: medical malpractice, ERISA, and Social Security.[2] But not every penny of federal spending creates a federalization snowball.

The snowball has two critical elements. First, the problem arises only if federal spending has an *unintended* effect on a state-based regulatory regime, which usually means that the federal dollars must distort states' incentives in a regime other than the one that the federal government is directly subsidizing. The point here is that federal subsidization always distorts states' incentives, but there are many federal funding programs that are specifically intended to do just that—to encourage creation of a more robust program than the states would create in the absence of federal funding. This kind of distortion does not, in itself, result in snowballing federalization because it is exactly what the federal government hoped and expected would happen.[3] Medicaid itself is such a program. The federal government subsidizes the cost of providing health insurance to the poor so that the states will provide more health insurance to more poor people than they would in the absence of federal funding. This distortion is not a problematic

2. The most significant example provided in the Essay, of course, is medical malpractice. The argument there is that federal financing of healthcare utilization allows the states to externalize 40% of the utilization costs associated with their medical malpractice policy choices, necessitating federalization of medical malpractice policy. In Part V of the Essay, I offer two additional examples. First, I point out that federal funding of disability insurance through Supplemental Security Income allows the states to externalize costs associated with unemployment among disabled citizens, such that a snowball problem might justify federalization of antidiscrimination regulations for the disabled. And, indeed, such regulations were federalized with the passage of the Americans with Disabilities Act. Second, I point out that federal subsidization of retirement income through Social Security allows the states to externalize a portion of the costs associated with poor pension management among private employers, such that a snowball problem might justify federalization of pension management regulations. And, indeed, such regulations were federalized with the passage of the Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001–1461 (2006). See Moncrieff, supra note 1, at 890–91.

3. It does, however, probably necessitate regulatory interventions in addition to financial ones, a point that I'll develop more in the second section.

snowball; it is the purpose of the federal subsidy. Medicaid, thus, does not create a snowball for social health insurance; it does so only for the *unintentionally* affected medical malpractice regime.

This element of the federalization snowball is important, but it might not knock out much federal spending from the list of snowball suspects. We could imagine two categories of federal spending that would seem least likely to impact states' incentives *unintentionally*: those over which the federal government takes full control (such that the states have no regulatory power that could be affected), and those over which the federal government takes very little control or provides very little financial support (such that the states' incentives do not feel the impact). It could be, though—and this is one of many empirical questions that I do not attempt to answer—that even those kinds of programs have unintended effects on *some* state-based regulatory regimes.

As an example of the first category, take military spending. At first blush, military regulation looks like the rare case of a fully federalized regime that cannot impact states' incentives because the states have no power in foreign diplomacy or military relations. But this outcome might be a completed snowball rather than a non-snowball.

Federal regulation of militarily relevant criminal activity, for example, might have become necessary, at least in part, because of the federal government's responsibility for military funding. The federal government first took a role in criminal regulation—a departure from the states' traditional policing powers—in the late nineteenth century, justifying the intervention by reference to interstate crime. But that power quickly expanded in World War I, as Congress gave the fledgling Bureau of Investigation (later to become the FBI) control over crimes of espionage—crimes that, at the time, had drastic military consequences.[4] That precise federal role in controlling militarily relevant crimes has continued into the present. Most recently, with the USA PATRIOT Act, Congress created federal crimes of harboring terrorists, materially supporting terrorism, engaging in terrorism, etc.[5]

Now, this particular field of federal criminal regulation *could* be justified by reference to something like foreign affairs preemption: a concern that embarrassing inconsistencies or incompatibilities might arise among fifty different states' interactions with foreign citizens. But federalization here could also be justified by reference to a snowball: a concern that the states lack sufficient incentive to avoid military costs that would arise from such crimes since those costs accrue only to the

4. See Espionage Act of 1917, Pub. L. No. 65-24, 40 Stat. 217 (repealed 1948); Fed. Bureau of Investigation, FBI History: Timeline of FBI History, at http://www.fbi.gov/libref/historic/history/historicdates.htm (last visited June 30, 2009) (on file with the *Columbia Law Review*).

5. Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001, Pub. L. 107-56, §§ 801–807, 115 Stat. 272, 374–86 (codified as amended in scattered sections of the U.S.C.).

federal government. In the end, then, even something as uniformly federal as military spending might have had unintentional effects on tangentially related state-based regulations and might, therefore, have snowballed.

As an example of the second category—i.e., federal spending that might be too insignificant to affect states' incentives—consider federal spending on higher education. The federal government provides the following funding for higher education: grants to low-income students, subsidized loans to low-income and middle-class students, tax breaks to those paying interest on student loans, and work study programs for part-time work while in school.[6] The federal government's total spending on higher education in 2008 was about $35.2 billion[7]—just .01% of total outlays that year.[8] In the meantime, substantive regulation of higher education remains firmly in the states' hands. So far, the federal government has not displaced any of the states' regulatory powers over higher education, nor has it taken financial responsibility (beyond the voucher-like programs described here) for funding any nonmilitary public universities. Public universities are still *state* universities.

The question then is whether this relatively tiny federal program—which does not directly affect or displace any state-based regulation—has any effect on the states' regulatory incentives. An empirical question, but the theoretical answer is certainly yes. Consider tuition-setting at state universities. If a state raises the cost of attending its public universities in the absence of federal funding, fewer state residents will be able to attend; fewer residents will receive degrees of higher education; and the state's workforce and productivity will weaken. But because the federal government diminishes some of those consequences by decreasing the effective cost of education for the state's residents, the state can be freer in raising tuition costs. It might also, as a result, allow its universities to be less efficient in managing their budgets. Similarly, consider a state's incentive to encourage parents to save money for their children's college. That incentive, too, must be diminished by the federal government's willingness to bail out students without savings.

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6. New America Foundation, Federal Education Budget Project: Federal Higher Education Programs—Overview, at http://febp.newamerica.net/background-analysis/federal-higher-education-programs-overview (last visited June 30, 2009) (on file with the *Columbia Law Review*).

7. Id. The total amount disbursed for these programs in 2008 was about $95 billion, but $66.8 billion of that total went to subsidized loans that must be paid back to the federal government. Once we account for the principal and interest that the government will recover, the public cost of those loans is only about $7 billion. New America Foundation, Federal Education Budget Project: Student Loan Cost Estimates, at http://febp.newamerica.net/background-analysis/federal-student-loan-cost-estimates (last visited June 30, 2009) (on file with the *Columbia Law Review*).

8. The federal government spent nearly $3 trillion in 2008. Fin. Mgmt. Serv., U.S. Dep't of the Treasury, Combined Statement of Receipts, Outlays and Balances 13–14 (2008), available at http://www.fms.treas.gov/annualreport/cs2008/outlay.pdf (on file with the *Columbia Law Review*).

The bottom line here is that all federal spending will affect a rational state's regulatory incentives, and most or all will probably affect regulatory incentives other than those that the federal government intended to affect. In a rational state's cost-benefit calculation—in that state's decision of whether and how to regulate—federal subsidization will always have an impact; it will always decrease the cost of some decision that we might not want the state to make.[9]

So why is the snowball theory *not* coextensive with the federal budget? The answer to that question rests in the second critical element of the snowball: the threshold requirement. A distortion of states' incentives justifies greater federalization—and thereby snowballs—only if the distortion is so harmful that the cost of living with it exceeds the cost of fixing it. That is, the cost of the current distortion must exceed the cost of further federalization.

Of course, it is probably impossible to calculate the costs on either side with any precision. In the medical malpractice example (and this is not for lack of trying), we don't know the exact cost of harms that arise from the distortion of states' incentives (defensive medicine, iatrogenic injury, frivolous litigation); we don't know the exact cost of any *future* harms that might accompany federal intervention; and, most importantly, we don't know whether federalization would diminish existing harms sufficiently to compensate for future harms.[10] My call for federalization, then, rests not on empirical certainty but rather on a combination of theoretical certainty and circumstantial evidence: We know that the states externalize about 40% of monetary utilization costs associated with medical malpractice; we know that "40% of monetary utilization costs" in this industry amounts to a lot of dollars; we know—to a theoretical certainty—that such an externalization would weaken a rational actor's incentive to engage in cost-saving reforms; we know that the states have done an appallingly terrible job of reforming medical malpractice; and we know that the federal government is interested in intervening but has not yet done so. Combined, these factors indicate that the externality is causing real harm and that federalization might help—or at least is worth trying.

What, then, is an example of federal spending that does *not* cross the threshold? There are probably many (including higher education), but I'll focus here on the one that came up most frequently in job-talk questions: highway funding.

9. None of this is to claim that the snowball effect actually impacts states' decisionmaking when legislators are voting on regulatory change. There are undoubtedly many considerations that go into states' lawmaking decisions, and whether federal subsidization is a factor at all, much less a decisive one, is a difficult empirical question that I do not try to answer here.

10. See Moncrieff, supra note 1, at 851 (noting "academics and politicians have continued to disagree—both between and among themselves—on the significance of malpractice-related inefficiencies to healthcare costs and on the causal relationship between those inefficiencies and malpractice litigation").

The federal government pays for 90% of the interstate highway system's costs, while the states contribute the remaining 10%.[11] Meanwhile, the states retain control over the vast majority of relevant regulations: speed limit laws, wintertime maintenance (sanding, salting, plowing), auto insurance regulation, weight restrictions, etc. All of those regulatory regimes affect wear and tear of the interstate highways, and 90% of the cost of fixing that wear and tear—90% of the monetary cost of under-regulation—accrues to the federal government. Surely, then, highway funding gives rise to a snowball; the states externalize 90% of monetary cost and must, therefore, underinvest in such regulation.

They probably do—another empirical question beyond my current scope. But the circumstantial evidence indicates that further federalization would be more costly than underregulation. A historical fact for circumstantial support: The federal government was unwilling or unable to enforce its speed limit law, its only attempt at such regulation. That law required states to enforce a fifty-five mile per hour speed limit on their interstates or to forego federal highway funding.[12] During the time that the law was in effect, the states and their citizens largely ignored it; many states simply did not patrol for violators, while others instituted significantly reduced fines for speeds between the federal limit and the prior state limit.[13] Despite widespread noncompliance, the federal government never enforced the law itself (at least not with something like FBI highway patrol, though it did withdraw funding from a handful of states that got too cheeky). Ultimately, Congress repealed the law.[14]

Based on this circumstantial evidence (again, without any empirical certainty as to the relevant costs or as to the causes of federal failure), it seems that federalization of highway regulations would not have created enough savings to be worth its cost. At least, Congress decided to repeal the speed limit rather than spend money on enforcing it, implying that it deemed enforcement unjustifiably costly. So even though we can be theoretically certain that federal highway funding systematically distorts states' incentives to engage in cost-saving regulations, the costs associated with that distortion do not seem to be high enough to justify further federalization. Highway funding, thus, does not seem to meet the threshold requirement of the federalization snowball.

In the end, then, the following hypothesis seems most plausible: All

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11. 23 U.S.C. § 120 (2006) ("[T]he Federal share payable on account of any project on the Interstate System . . . shall be 90 percent of the total cost thereof . . . .").

12. Emergency Highway Energy Conservation Act of 1974, Pub. L. No. 93-239, § 2, 87 Stat. 1046, 1046 (repealed 1995). The speed limit was later adjusted to 65 mph in rural areas. Surface Transportation and Uniform Relocation Assistance Act of 1987, Pub. L. No. 100-17, § 174, 101 Stat. 132, 218 (1987).

13. Paul Grimes, Practical Traveler: The 55-M.P.H. Speed Limit, N.Y. Times, Dec. 26, 1982, at XX3 (reporting that 83% of travelers on New York's interstates drove over fifty-five mph).

14. National Highway System Designation Act of 1995, Pub. L. No. 104-59, § 205, 109 Stat. 568, 577.

federal spending gives rise to a *potential* snowball because all federal funding unintentionally distorts states' incentives, but at least some and probably many federal dollars do not cause a costly enough distortion to justify further federalization.

II. HOW IMPORTANT IS THE FEDERALIZATION SNOWBALL?

If all federal spending creates a potential snowball, isn't the theoretical idea much bigger than the Essay suggests? I hope so! At very least, the snowball idea contributes to an important constitutional debate that is not broached in the Essay.

To start discussion, allow me to restate history in my terms: In their views on the proper interpretation of the Spending Clause, James Madison was concerned about snowballs, while Alexander Hamilton was *enthusiastic* about them. The Spending Clause gives Congress power to collect taxes in order "to pay the Debts and provide for the common Defence and general Welfare of the United States."[15] The Madison-Hamilton interpretive debate was whether that provision gives Congress the power to spend on anything that promotes the "general Welfare" (Hamilton's view) or to spend *only* on those things that *both* promote general welfare *and* fit into other enumerated powers (Madison's view).[16]

Importantly, Hamilton was comfortable with his interpretation of the Spending Clause because he was comfortable with giving Congress full substantive power. That is, Hamilton did not believe that a broad spending power would be distinct from a broad regulatory power; rather, he believed that Congress should have broad spending power *so that* it would have broad regulatory power, limited by political forces rather than constitutional constraints.[17] Equally importantly, Madison's entire reason for wanting to limit the breadth of the Spending Clause was his recognition that spending and regulating could not be disentangled; he wanted to tether the spending power to the enumerated powers because he worried that it would otherwise render the enumeration irrelevant. That is, he recognized that the power to spend on anything was tantamount to the power to regulate everything, and he did not want Congress to have the power to regulate everything.[18] Both men, thus,

15. U.S. Const. art. I, § 8.

16. Jeffrey T. Renz, What Spending Clause? (Or the President's Paramour): An Examination of the Views of Hamilton, Madison, and Story on Article I, Section 8, Clause 1 of the United States Constitution, 33 J. Marshall L. Rev. 81, 87 (1999).

17. The Federalist No. 31, at 165 (Alexander Hamilton) (E.H. Scott ed., 1898) (arguing, in support of broad spending power, that "[a] government ought to contain in itself every power requisite to the full accomplishment of the objects committed to its care, and to the complete execution of trusts for which it is responsible; free from every other control, but a regard to the public good, and to the sense of the people"); The Federalist No. 32 (Alexander Hamilton), supra, at 168 ("I am persuaded that the sense of the people, the extreme hazard of provoking the resentments of the State Governments, and a conviction of the utility and necessity of local administrations, for local purposes, would be a complete barrier against the oppressive use of [the broad taxing] power.").

18. The Federalist No. 41 (James Madison), supra note 17, at 230 (arguing that other

believed that the power to spend necessarily implied the power to regulate; their disagreement centered only on whether the new Congress should possess such a regulatory power.

A century after this framing-era debate (a century during which the debate went unsettled), a snowball *denier* came onto the scene: Joseph Story. In his *Commentaries on the Constitution of the United States*, Story argued that the Spending Clause gave Congress an untethered power to spend but that such a power did *not* imply that Congress could engage in substantive regulations beyond those enumerated.[19] That is, Story denied that spending would or could snowball into greater regulatory incursion.

The debate among the three came to a head in the New Deal Era, when the federal government ramped up its taxing and spending in an effort to combat the Great Depression.[20] In that critical moment, the Supreme Court adopted the denier's account, holding that the federal government could spend on anything that promotes the general welfare. In the first relevant case, *United States v. Butler*, the Court laid out Hamilton's, Madison's, and Story's interpretations and expressly adopted Story's.[21] But in that case the Court also held that appropriations are *not* constitutional if they are means to an unconstitutional (i.e. non-enumerated) regulatory end.[22] Under *Butler*, thus, taxes could be imposed to promote the general welfare, but appropriations could not be made to regulate subjects beyond those enumerated. After the "switch in time," however, the Court abandoned the *Butler* means-ends restriction on the spending power, and, in the next two relevant cases, it upheld the Social Security tax despite the resulting appropriations' creation of an unemployment program and a public pensions program—two regulatory ends that Congress did not have express power to pursue.[23] Indeed, in the first of those cases, the Court directly held that Congress had power to address unemployment under the Spending Clause's general welfare language, thereby fully abandoning any need to tie an appropriation to an enumerated substantive power.[24]

In the end, then, the Supreme Court adopted Story's myth that

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enumerated powers in art. I, § 8 proved that the Spending Clause did not amount "to an unlimited commission to exercise every power, which may be alleged to be necessary for the common defence or general welfare").

19. 2 Joseph Story, Commentaries on the Constitution of the United States § 920, at 383–85 (Boston, Hilliard, Gray, & Co. 1833).

20. For a careful exploration of the three men's views as revealed in their writings, see Renz, supra note 16.

21. 297 U.S. 1, 65–66 (1936).

22. Id. at 68.

23. Steward Machine Co. v. Davis, 301 U.S. 548, 585–90 (1937) (upholding Social Security's unemployment program); Helvering v. Davis, 301 U.S. 619, 640–42 (1937) (upholding Social Security's pension program, and holding that Congress has unreviewable discretion in deciding what constitutes "general welfare").

24. *Steward Machine Co.*, 301 U.S. at 586–87.

unlimited federal spending can coexist with limited federal regulation. Of course, the Supreme Court has since curbed the myth somewhat, not by limiting spending but rather by allowing substantive regulation. The Court has since explicitly permitted Congress to attach substantive regulatory conditions to its grants, thereby acknowledging that appropriations necessitate regulation.[25] But the legal community still fails to recognize what Hamilton and Madison both knew: that federal spending ultimately *is* federal regulation.

What does the snowball theory add to this story? Employing simple economic analysis, the snowball theory not only helps Madison and Hamilton to rebut the myth, showing that the power to spend on X is the power to regulate X, but goes one step further, showing that the power to spend on X frequently necessitates the power to regulate Y. In so doing, the snowball theory also demonstrates that Madison and Hamilton understood the crux of the debate better than we do today: that our preferences regarding the scope of the Spending Clause ought to align perfectly with our preferences regarding the scope of federal regulatory power. Because all spending distorts states' incentives to regulate, all spending necessitates federal regulation to some degree. Of course, Hamilton had a point in arguing that politics would limit the extent of federal incursion; the threshold requirement of the snowball is just that—a political limit on further federalization. But we cannot deny that our broad reading of the Spending Clause (combined with a generally slack view of federalism limits) has set us on a trajectory to full federalization. And *if* we want to get off that trajectory, we need to do more than limit our reading of the Commerce Clause; we also need to revert to Madison's view of the Spending Clause.

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25. South Dakota v. Dole, 483 U.S. 203, 206 (1987) ("Congress has acted indirectly under its spending power to encourage uniformity in the States' drinking ages. . . . [W]e find this legislative effort within constitutional bounds even if Congress may not regulate drinking ages directly.").