The tug of war between the president and Congress is steadily escalating. The most recent sign of incipient institutional breakdown is House Speaker John Boehner’s suit against President Obama for rewriting laws and stepping on Congress’s turf.

But lurking in the wings is a second separation-of-powers issue, just as important, that Americans have mostly overlooked—the separation between federal and state government. In many areas, that vital divide is fast disappearing, owing to a relentless expansion of federal power. And both political parties share the blame.

Programs like Medicaid, Common Core, the Clean Air Act, and the federal highway system enjoy popular support because they appear to allow the federal government to accomplish things all
Americans want, at least in the short run. But those programs often turn states into mere field offices of the federal government, often against their will, in turn creating a host of structural problems.

Federal officials exert enormous influence over state budgets and state regulators, often behind the scenes. The new federalism replaces the “laboratories of democracy” with heavy-handed, once-size-fits-all solutions. Uniformity wins but diversity loses, along with innovation, local choice, and the Constitution’s necessary limits on government power.

Take Medicaid. On the surface, it looks like a federal matching-grant for state health care programs targeted at the needy. In fact it is the opposite: a way to rope states into match-funding a federal program. Federal Medicaid funds come with so many strings attached that states have little room to deviate from federal dictates—except by expanding their programs to fiscally unsustainable levels, which Medicaid actually encourages the states to do.

A state’s participation in Medicaid is supposed to be voluntary. The Supreme Court has insisted in such cases as New York v. United States (1992) that the federal government can’t command the states to regulate according to federal instructions. But if a state rejects Medicaid and decides to establish its own program for the needy, there is a huge penalty: It loses its share of Medicaid funds, but its citizens still have to pay Medicaid taxes, meaning state residents end up paying twice for the same services. That means less money for schools and roads and other things they need.

Facing this penalty, states have little choice but to comply and be essentially deputized into federal service. In the 2012 decision NFIB v. Sebelius, the Supreme Court held that states couldn’t be threatened with the loss of their existing Medicaid funds just because they refused to comply with the Medicaid expansion required by Obamacare. That was “a gun to the head,” said the Court—coercion, pure and simple.

But the Court failed to see that even losing new Medicaid funds also imposes a double tax, albeit on a smaller scale. Virtually every federal program of assistance to the states involves intrusive conditions and coercive penalties. States lose Medicaid funds if they refuse to comply with intricate requirements of the Medicaid program itself. They lose federal highway funds if they drop their drinking age below 21. They lose Common Core funds for not complying with Common Core. Yet their residents have to pay for the programs either way. The amount of money involved shouldn’t make any constitutional difference; the question is one of principle, not degree. Whether a robber says, “all your money or your life,” or merely “five dollars or your life,” it’s coercion just the same.
Federal “assistance” to the states currently accounts for 30 percent of state budgets, on average. Since the early 1980s, the federal government has transferred about 15 percent of its budget to the states, which is almost as much as the federal deficit in an average year. Why does the federal government borrow so much money, only to transfer it to the states? Do the states really need that much help?

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They don’t. States have their own taxing authority. The real reason for federal “assistance” lies in the conditions that come attached to it, which allow the feds to dictate state policies and even what the states do with large chunks of their own money. The result is a massive increase in real federal control and real federal spending—entirely behind the scenes.

States like Texas, Florida, and New Hampshire pride themselves on having no state income tax on individuals. But that is only literally true of the 60 or 70 percent of their budgets that comes from state revenue. With respect to the portion derived from federal sources, Washington in effect imposes a high state income tax, which it collects on their behalf. States have no choice about that. Their only viable option is to accept on bended knee the sovereign’s offer to return their money back, in exchange for their obedience. It’s a fair bet few Americans understand what is really going on behind the façade of federal assistance.

Federal dominance is often justified as the only way to secure uniform laws. But states don’t need coercion to achieve that end. The Uniform Commercial Code of 1962, for example, was a marked improvement over the old state common law of contracts, and it greatly facilitated interstate commerce. Every state has adopted it, with the partial exception of Louisiana, which kept its old French civil code for sales. The American law of contracts was successfully modernized and harmonized without any federal involvement, under a scheme that gave free rein to diversity and local choice.

Similarly, Common Core was originally an initiative of the National Governors Association, with no federal involvement, but the Obama administration made participation a criterion for federal education grants. That’s where many states cry foul. States that comply are rewarded in part from taxes collected in states that buck Common Core—the familiar coercion at the heart of federal grants.

Money isn’t the only lever the feds use to increase their influence over state governments. Formally, the federal government can’t require states to implement federal regulations. But environmental regulations show how easy it is to get around that constraint. The Clean Air Act allows the states to issue federal
permits—but only under federally approved state implementation plans, or SIPs. Those plans must meet a dizzying number of conditions; otherwise, the EPA trumps with a federal implementation plan, or FIP.

When EPA comes in with its FIP, it often comes to “crucify” local industries, as former EPA Regional Administrator Al Armendariz boasted at a closed-door meeting early in the Obama administration. The crucifixion takes the form of costly added requirements and endless delays. The federal government basically says to uncooperative states, “Implement our regulations for us, or we’ll do it ourselves, and your constituents will be sorry.” Predictably, constituents pressure state officials to protect them from the dire prospect of EPA implementing its own regulations, as we saw when Texas at first resisted implementing EPA’s new greenhouse gas regulations.

These problems have their roots in a major constitutional transformation that began a hundred years ago. In 1913, the 16th Amendment was ratified, allowing Congress to institute a real income tax for the first time. Later that year the 17th Amendment provided for direct election of senators. These two changes made the government much bigger and more “national.” That era also gave birth to the modern administrative state, which has steadily absorbed the rule-making functions of Congress. Then came President Franklin D. Roosevelt’s New Deal, with its insistence on intrusive regulations of labor and agriculture that were clearly outside Congress’s constitutional power to regulate commerce “among the several states.”

The Supreme Court at first mounted some resistance, but then, starting in 1937, it dramatically backed down. In *Steward Machine Co. v. Davis* the Court allowed the government to attach pretty much any condition to a federal tax rebate. Five years later, in *Wickard v. Filburn*, the Court allowed the federal government to regulate virtually any activity of an economic nature. These rulings opened the door to the “great consolidation of Government” that the Constitution’s original opponents had warned of during the ratification debates.
One result has been the integration of federal and state governments under federal control, a process that abounds with hidden problems, starting with accountability. When Americans vote in state and local elections, they think they are voting on state and local policies. But often they are just deciding which local officials get to implement the dictates of distant and insulated federal bureaucrats, whom even Congress can’t control.

Federal-state integration also creates strong incentives to expand government power at every level. State officials get to claim credit for 30 percent more spending than they raise in taxes without having to pay any political price for higher taxation. Meanwhile, federal officials claim credit for addressing national problems through the largely hidden use of state resources. Medicaid might never have passed Congress if proponents of the bill hadn’t been able to shift the program’s true costs to state budgets.

The original Constitution kept overall government intrusion to a minimum, by placing most government spending and regulation in the exclusive domain of the states. Interstate competition reigned both for taxation and regulation. But things took a dramatic turn for the worse in 1923, when the Supreme Court ruled in two related cases, *Massachusetts v. Mellon* and *Frothingham v. Mellon*, that neither states nor their citizens had the power to challenge federal grants for going beyond the limits of the federal spending power. Left with no way to block unconstitutional spending programs, the most states could do was refuse to accept their fair share of federal grants—a worthless protection. The federal takeover began a few decades later in the most modest of ways: the national highway program.

Until 1956, the nation’s highways were built and managed exclusively by states, which had even cooperated among themselves to develop a national system of numbering highways for ease of travel, without federal involvement. President Eisenhower correctly saw the need for a system of federal roads for defense and interstate commerce. His mistake was to involve the states in building that system.
Today states are so reliant on federal highway funds—which come directly from gasoline taxes they collect—that Congress uses the funds as a cudgel to enforce state agencies’ compliance with such unrelated federal dictates as the Clean Air Act and the 21-year drinking age. As recently as NFIB, the Supreme Court continued to insist that such penalties are mere encouragement, not rising to the level of coercion; but, as a recent symposium of the Yale Law Journal shows, nobody on the right or left takes its homage to federalism seriously anymore.

A common justification for federal overreach is that it allows for administrative convenience, but the Constitution doesn’t exist for the convenience of the government. Its purpose is to protect the people from government abuse. By leaving most government spending and regulation within the exclusive domain of states, the original Constitution created a dynamic framework of interstate regulatory competition. Citizens and businesses could choose to live in whatever state they wanted, a choice they could make with increasing ease as the nation’s communications and transportation dramatically improved, and states competed to offer an attractive package of services and taxation.

Just like cable-TV providers offer premium channels in pricy packages and basic cable at a cut rate, some states and municipalities offered lots of services and benefits—and higher taxes—while others offered smaller government and a lower tax bill. That larger menu meant more choices.

This interstate regulatory competition could accommodate a wide diversity of approaches, from the progressive safety blanket of Wisconsin to the frontier freedom of Texas. Vigorous interstate competition tended to punish excessive government, leading for example to higher growth rates in states with less restrictive labor laws. It also made it more difficult for special interests to wield
government as a tool for extracting benefits from the rest of society in the form of hidden subsidies, cartels, and monopolies. Where special interests reign, market efficiency is lost, leaving everyone worse off.

The easier it is for people to choose between state options, the weaker the case for federal control of markets.

Even today, states with high taxes, tough zoning laws, and restrictive labor laws tend to lose out to those with a lighter footprint—witness the tens of thousands of people—especially poor people—moving to Texas every year. The easier it is for people to choose between state options, the weaker the case for federal control of markets.

That leaves heavily regulated and highly taxed states at a disadvantage in the competition for people and businesses. Those states have cleverly solved much of their problem by using the federal government to impose higher taxes and regulation across the states. Burdened by often-costly progressive policies, states such as California, Massachusetts, and New York form coalitions in Congress to neutralize the advantage of states like Wyoming, Texas, and Florida. Protection from competition is the strongest impetus for the integration of federal and state governments under an umbrella of overall federal control.

That process undermines one of the great advantages of a modern economy: the choice that mobility offers to families and businesses. It hastens the erosion of one of our most essential constitutional protections, the separate domains of federal and state governments, each confined to its proper sphere of authority.

American society is blessed with a diverse array of institutions. Not everything needs to be done by government power, either federal or state. When government must act, it’s best to turn to the lowest unit of government capable of dealing effectively with the issue. The Constitution was meant to enshrine that very principle, in order to protect individuals and communities from the pervasive and often overbearing power of central government.

The mounting federal takeover of the states started slowly during the New Deal and has intensified substantially, especially in recent years. That inexorable trend is leading to unsustainable levels of government spending and a regulatory regime that grows more intrusive and oppressive by the day. One solution is paramount: Strengthen the vital but oft-neglected separation of federal and state governments.