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Optimal Federalism Across Institutions: Theory and Applications from Environmental and Health Care Policies

*Dale B. Thompson**

Simply because you have a problem that needs addressing, it's not necessarily the case that Federal legislation is the best way to address it.¹

— United States Supreme Court Chief Justice John G. Roberts, Jr.,
addressing the United States Senate

Instead of turning immediately to federal legislation, the question of “federalism” then becomes: When is federal action appropriate, and when should the problem be addressed by the states? Over the past fifteen years, courts and legal scholars have attempted to answer this question. This Article presents a framework that provides a new technique to answer this question. This framework analyzes federalism across enactment, implementation, and enforcement institutions, by examining economies and diseconomies of scale inherent in each of these institutions. This Article then applies the framework to a

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1. *Hearings Before the S. Comm. on the Judiciary*, 108th Cong. 59–60 (2003) (statement of Sen. Russell D. Feingold), available at <http://www.access.gpo.gov/congress/senate/pdf/108hr/92548.pdf>.

comparison of environmental policies for wetlands and endangered species, and in an analysis of a health care policy. These applications can then serve as guides to legislators and judges as they grapple with the question of federalism.

Federalism, an American invention put forward in the drafting of the Constitution,² posits that parallel government systems operate in their own spheres of authority over shared constituencies. These spheres of authority may overlap. When they do, conflicts arise in defining these spheres, and in managing relations among them. During its first two hundred years, American federalism underwent a number of changes as our understanding of it altered in the face of dramatic circumstances. These developments have accelerated during the past fifteen years, through advances in jurisprudence, legal scholarship, and through new legislation and governmental programs

In a sequence of cases including *United States v. Lopez*,³ *United States v. Morrison*,⁴ *Solid Waste Agency of Northern Cook County v. U.S. Army Corps of Engineers (SWANCC)*,⁵ *Gonzales v. Raich*,⁶ and *Rapanos v. United States*,⁷ the U.S. Supreme Court has attempted to articulate limits to the federal sphere that had seemed to disappear since *NLRB v. Jones & Laughlin Steel Corp.*⁸ was decided in 1937.⁹ This

2. Federalism originated with the six nations of the Iroquois confederacy (the Mohawk, Oneida, Seneca, Cayuga, Onondaga, and the Tuscarora). There is a scholarly debate over the influence of the Iroquois confederacy in the drafting of the Constitution. See Frederick M. Wirt, *Book Reviews*, in 13 *PUBLIUS* 97, 97-99 (1983) (reviewing BRUCE E. JOHANSEN, *FORGOTTEN FOUNDERS: BENJAMIN FRANKLIN, THE IROQUOIS AND THE RATIONALE FOR THE AMERICAN REVOLUTION* (1982)).

3. *United States v. Lopez*, 514 U.S. 549, 567 (1995) (stating that the Gun-Free School Zones Act exceeded Congress' commerce clause authority because possession of firearms in a school zone was not economic activity substantially affecting interstate commerce).

4. *United States v. Morrison*, 529 U.S. 598, 598 (2000) (holding that the Commerce Clause could not provide Congress the ability to enact civil remedies for the Violence Against Women Act).

5. *Solid Waste Agency of N. Cook County v. U.S. Army Corps of Eng'rs*, 531 U.S. 159, 170 (2001) (holding that extending the definition of "navigable waters" under the Clean Water Act to include intrastate waters inhabited by migratory birds exceeded permissible authority of the Army Corps).

6. *Gonzales v. Raich*, 545 U.S. 1, 3 (2005) (stating that criminalizing the manufacture, distribution, or possession of marijuana by intrastate growers did not violate the Commerce Clause).

7. *Rapanos v. United States*, 547 U.S. 715, 718 (2006) (explaining that "navigable waters" under the Clean Water Act only applies to relatively permanent, standing or flowing bodies of water). A related case, *Carabell v. United States Army Corps of Eng'rs*, was consolidated with *Rapanos*. *Id.* at 764.

8. *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 48 (1937) (determining that intrastate activities may nevertheless be controlled by Congress if the activity is closely and substantially related to interstate commerce).

jurisprudence coincided with advances in legal scholarship in the field of “New Federalism,” which sought to re-address the theoretical underpinnings of federalism, including the “race-to-the-bottom” theory, public choice theory, the “laboratories of democracy” theory,¹⁰ and “economies of scale” theory. These theories were examined with particular reference to environmental policies by a number of scholars.¹¹

Additionally, the takeover of Congress by a Republican majority in 1994 led to a number of developments in the law governing relations between the federal government and the states, foremost of which was welfare reform through the Personal Responsibility and Work Opportunity Reconciliation Act of 1996.¹² At the same time, health care costs rose significantly, leading to a declaration by some of a “health care crisis.”¹³ A significant amount of research followed to address the role of federalism in health policy.¹⁴

This Article integrates these developments in federalism. Its principal contribution comes from its suggestion that analysis of federalism issues should be conducted at the level of individual institutions. Institutions consist of the set of rules and structures that govern human interaction.¹⁵ Public policy is the product of a network of institutions, including enactment, implementation, and enforcement

9. The decision in this case was announced two months after the proposal of the so called “court-packing” Judiciary Reorganization Bill of 1937, in which Franklin D. Roosevelt sought the authority to appoint additional justices to the Supreme Court after the Court’s rulings in *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 551 (1935) (holding that regulating the poultry industry exceeded congressional power under the Commerce Clause), and *U.S. v. Butler*, 297 U.S. 1, 78 (1936) (holding that processing taxes under the Agricultural Adjustment Act were unconstitutional).

10. This theory refers to a quote of Justice Louis Brandeis, dissenting in *New State Ice Co. v. Liebmann*: “It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.” *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)

11. See *infra* Part II.C (discussing environment policy cases, particularly those that relate to the Clean Water Act and the Endangered Species Act).

12. See Pub. L. 104-193, 110 Stat. 2105 (1996).

13. When Bill Clinton accepted the Democratic nomination in 1992, he “vow[ed] to ‘take on the health care profiteers and make health care affordable for every family’” See Public Broadcasting Service, Online Forum, http://www.pbs.org/newshour/forum/may96/background/health_debate_page1.html (last visited Feb. 6, 2009). Others disagreed with the declaration of a health care crisis, including Senator Daniel Patrick Moynihan who stated that “there is ‘no health care crisis.’” *Id.*

14. See *infra* Part II.D (discussing health care literature and health care reform).

15. See Douglass C. North, *Institutions*, 5 J. ECON. PERSP. 97, 97 (1991) (defining institutions as “the humanly devised constraints that structure political, economic and social interaction”).

institutions. Analyzing federalism by looking at the full network can become increasingly complex. This Article clarifies our understanding of federalism by scrutinizing these institutions separately.

In its analysis of individual institutions, this Article also provides a criterion that can serve as an alternative limit to federal power under the Commerce Clause, a limit that the Rehnquist Court seemed to seek in *Lopez* and *Morrison*. Conversely, this Article also provides another criterion as to when federal preemption would be appropriate.¹⁶ Furthermore, while the most recent analyses of federalism's role in policymaking have focused on a single subject area, this Article expands its analysis to examine implications for environmental and health policies.

Starting with a general model, this paper describes a framework for assessing the proper locus of different aspects of a public policy. This framework takes into consideration the multi-institutional aspects of a public policy. Within each institution, this framework uses an efficiency criterion, focusing on tradeoffs between economies of scale and diseconomies of scale.

It then applies this approach to a wide array of public policies, ranging from environmental policies to health policies. Through these applications, this Article demonstrates the importance of considering federalism issues across individual institutions. It also shows the usefulness of considering economies and diseconomies of scale in assessing federalism. Legislators and judges can use these applications as guides to assess the appropriate role of federalism in solving public policy problems at the lowest cost.

The rest of this Article begins with a review of recent "New Federalism" jurisprudence, followed by a review of some of the literature addressing federalism in the context of environmental policy and health care policy. It then offers a framework for analyzing federalism across institutional dimensions. Using this framework, this Article examines federalism issues in a comparison between policies for protecting endangered species and wetlands. After that, we analyze federalism issues in the healthcare policy of using managed care organizations (MCOs) to service Medicaid beneficiaries.

16. Under federal preemption, when the federal government legislates in a particular subject area, this federal legislation preempts state legislation addressing the same subject area. As a result, the state legislation cannot be enforced. For more on preemption, see *Riegel v. Medtronic, Inc.*, 128 S. Ct. 999, 1011 (2008) (holding that FDA pre-approval preempted state common law claims of negligence and strict liability). The author would like to thank Senator Durenberger for suggesting the additional implication of this article.

I. REVIEW OF FEDERALISM, ALONG WITH LITERATURE RELATING FEDERALISM TO ENVIRONMENTAL & HEALTH POLICIES

A. *A Brief History of Federalism in the United States, and the Rehnquist Court's "New Federalism" Decisions in Lopez, Morrison, and Raich*

The rise of a powerful, central federal government was brought about by the Civil War, when the nation's survival depended upon the ability of the federal government to marshal the full resources of the Northern states to defeat the Confederacy. Over the next seventy years, a backlash against that power developed, culminating in the *A.L.A. Schechter Poultry Corp. v. United States*,¹⁷ in which the U.S. Supreme Court ruled that the National Industrial Recovery Act was unconstitutional because Congress had exceeded its authority under the Commerce Clause.

However, shortly thereafter, a sequence of cases including *NLRB v. Jones & Laughlin Steel Corp.*, *United States v. Darby*,¹⁸ and *Wickard v. Filburn*¹⁹ "ushered in an era of Commerce Clause jurisprudence that greatly expanded the previously defined authority of Congress under that Clause."²⁰ These cases were decided against the backdrop of the Great Depression and World War II. As during the Civil War, the all-encompassing nature of these threats to the nation led to a significant increase in the need for a strong federal government. For the next fifty years, the Court did not strike down any federal legislation as exceeding the scope of the Commerce Clause.²¹ During this time, the Court upheld Congress's authority to legislate over civil rights²² and moral wrongs.²³ Almost no issue seemed outside the orbit of Congressional power.

17. *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 551 (1935).

18. *United States v. Darby*, 312 U.S. 100, 125 (1941) (holding that Congress had power under the Commerce Clause to regulate employment conditions).

19. *Wickard v. Filburn*, 317 U.S. 111, 124 (1942) (declaring that even personal consumption of agricultural products affected interstate commerce enough that the Commerce Clause enabled Congress to regulate it).

20. *United States v. Lopez*, 514 U.S. 549, 567 (1995).

21. See Stephen M. McJohn, *The Impact of United States v. Lopez: The New Hybrid Commerce Clause*, 34 DUQ. L. REV. 1, 1-2 (1995) (referring to *Lopez* as a significant break in a line of cases deferring to Congressional action).

22. *Katzenbach v. McClung*, 379 U.S. 294, 304 (1964) (stating that Congress was reasonable in determining that racial discrimination at restaurants that received goods from out of state adversely affected interstate commerce).

23. *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 277 (1964) (finding that, in an effort to fight discrimination, Congress acted well within its Commerce Clause jurisdiction when

However, in the 1995 case, *United States v. Lopez*,²⁴ the Court held that Congress exceeded its constitutional authority when it enacted the federal Gun Free School Zones Act of 1990. The Court found that there were “three broad categories of activity that Congress may regulate under its commerce power:”²⁵ “the use of the channels of interstate commerce,” “the instrumentalities of interstate commerce, or persons or things in interstate commerce,” and “those activities having a substantial relation to interstate commerce.”²⁶ The Court found that the possession of a gun in a school zone did not have a “substantial relation to interstate commerce.” In reaching this conclusion, it found that possession of a gun was “in no sense an economic activity.”²⁷ Also, the court rejected arguments that connected the education process with later commercial activity. Extension of this argument would make it “difficult to perceive any limitation on federal power.”²⁸ Consequently, Congress did not have the authority to enact this law under the Commerce Clause.

In *United States v. Morrison*,²⁹ the Court again looked at whether Congress had authority under the Commerce Clause, this time for 42 U.S.C. § 13981 of the Violence Against Women Act. The Court held that gender-based violence had an insufficient relation to interstate commerce, and held the act unconstitutional. Similar to *Lopez*, the Court held that arguments connecting the effects of a violent crime to every possible effect on interstate commerce “would allow Congress to regulate any crime.”³⁰ It rejected this extension, stating, “[t]he limitation of Congressional authority is not solely a matter of legislative grace.”³¹

In *Gonzales v. Raich*,³² the Court held that regulation of the production and distribution of marijuana could enable enforcement against a completely intrastate activity. It held that the activities of

it passed the Civil Rights Act of 1964).

24. *Lopez*, 514 U.S. at 567.

25. *Id.* at 558.

26. *Id.* at 558–59. Note, these categories were very similar to the three matters proposed by Richard A. Epstein. Richard A. Epstein, *The Proper Scope of the Commerce Power*, 73 VA. L. REV. 1387, 1454 (1987) (“[I]nterstate transportation, navigation and sales, and the activities closely incident to them.”).

27. *Lopez*, 514 U.S. at 567

28. *Id.* at 564.

29. *United States v. Morrison*, 529 U.S. 598, 598 (2000) (defining 42 U.S.C. § 13981 to provide a federal civil remedy for the victims of gender-motivated violence).

30. *Id.* at 599.

31. *Id.* at 616.

32. *Gonzales v. Raich*, 545 U.S. 1, 3 (2005).

growing and distributing marijuana were “quintessentially economic.”³³ As a result, regulation of these activities, even though they might be wholly intrastate, was within the scope of the Commerce Power.

These decisions generated a rebirth of interest in federalism. Some authors examined the theory behind federalism; others looked at the impact these decisions might have on specific subject areas; and yet others did both.

B. Theories on Federalism

Theories on federalism began with the *Federalist Papers*. In *Federalist Paper #51*,³⁴ James Madison posited that a division of power among both state and federal governments would help prevent “factions”³⁵ from using the mechanism of government to take steps contrary to the interest of the general public. It does this by having the two governmental bodies constrain each other.³⁶

Almost 150 years later, Justice Louis Brandeis, dissenting in *New State Ice Co. v. Leibmann*, provided another theory to support federalism: that a state may act as a “laboratory” of democracy.³⁷ Under this theory, the federal system improves long-run welfare by permitting different states to attempt different methods to address a public need, comparing the results of these methods, and then having other states then adopt the more successful methods.

This laboratory might be financed through “cooperative federalism,”³⁸ under which the federal government does not directly

33. *Id.* at 2. Note that Chief Justice Rehnquist, who had written the majority opinions in *Lopez* and *Morrison*, was in the minority in *Raich*.

34. THE FEDERALIST No. 51 (James Madison), available at <http://www.constitution.org/fed/federa51.htm>.

35. For more on “factions,” see THE FEDERALIST No. 10 (James Madison), available at <http://www.constitution.org/fed/federal10.htm>.

36. THE FEDERALIST No. 51, *supra* note 34. Madison notes:

[P]ower surrendered by the people is first divided between two distinct governments, and then the portion allotted to each subdivided among distinct and separate departments. Hence a double security arises to the rights of the people. The different governments will control each other, at the same time that each will be controlled by itself.

Id.

37. *New State Ice Co. v. Leibmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

38. For more on cooperative federalism, see Richard B. Stewart, *Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy*, 86 YALE L.J. 1196 (1977) (examining the problems in implementing federal policies through state and local officials and examining the constitutionality of delegation); Joshua D. Sarnoff, *Cooperative Federalism, the Delegation of Federal Power, and the Constitution*, 39 ARIZ. L. REV. 205 (1997) (discussing the political reality and constitutional history of cooperative

regulate behavior, but instead financially supports states that implement policies consistent with federal goals, while at the same time permitting the states to choose the means to achieve those goals. Constitutional authority for this mechanism is provided by the General Welfare Clause.³⁹ In the 1992 case, *New York v. United States*,⁴⁰ the Supreme Court held that there are limits to “cooperative federalism,” namely that Congress cannot “commandeer the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program.”⁴¹ However, Congress may make the receipt of federal funds conditional, and also may “offer States the choice of regulating that activity according to federal standards or having state law pre-empted by federal regulation.”⁴²

Critiquing this decision, Joshua Sarnoff argues that, under certain circumstances, “the Supreme Court should find that the delegation or effective delegation of federal legislative power to states violates the Constitution.”⁴³ To support this, Sarnoff notes that “Congress does not need to delegate legislative power to states to effectuate federal policies, because Congress may delegate broad policymaking powers to federal agencies.”⁴⁴ As a result, he concludes that “the Court should invalidate cooperative federalism statutes when Congress has not demonstrated that they will result in better, more efficient, or more accountable governance.”⁴⁵

In the year following *New State Ice Co.*, Justice Brandeis is credited with providing yet another theory about federalism in another dissent in *Louis K. Liggett Co. v. Lee*: the “race to the bottom.”⁴⁶ Under this theory, an overarching federal power is necessary to protect states from “ruinous competition.”⁴⁷ This theory is an application of game theory’s “Prisoner’s Dilemma.”

federalism, as well as arguing for invalidation of insufficiently supported delegation of federal power to the states).

39. U.S. CONST. art. I, § 8, cl. 1 (“Congress shall have power to . . . provide for the . . . general welfare.”). See also Sarnoff, *supra* note 38, at 206; Jonathan H. Adler, *Judicial Federalism and the Future of Federal Environmental Regulation*, 90 IOWA L. REV. 377, 437 (2005).

40. *New York v. United States*, 505 U.S. 144 (1992).

41. *Id.* at 145 (citing *Hodel v. Va. Surface Mining & Reclamation Assn., Inc.*, 452 U.S. 264, 288 (1981)).

42. *Id.* at 145.

43. Sarnoff, *supra* note 38, at 211.

44. *Id.*

45. *Id.*

46. *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 557–60 (1933) (Brandeis, J., dissenting).

47. See Alvin K. Klevorick, *Reflections on the Race to the Bottom*, in 1 FAIR TRADE AND HARMONIZATION: PREREQUISITES FOR FREE TRADE? 459, 460 (Jagdish Bhagwati & Robert E.

Drawing on Charles Tiebout,⁴⁸ public choice theory provides a response to the “race to the bottom” theory. In a sequence of articles, Richard Revesz explains that competition among states to attract residents leads to an efficient matching process between residents with different tastes for protection and states offering different levels of protection.⁴⁹

Another public choice theory, drawing on Mancur Olson,⁵⁰ suggests that states are more likely to suffer from “regulatory capture.” Regulatory capture is when administrative agencies are “captured” by an industry to the point that the agency makes decisions that, while benefiting the industry, are detrimental to general welfare.

A more general theory is that of “economies of scale.” Under this theory, there are economies of scale in regulation, and so the larger scale of a federal approach would make it more efficient. In contrast, others suggest that due to the benefits of “decentralization” whereby the locus of decision-making is distributed to a number of nodes, a smaller scale such as that of a state government is more efficient.

C. Review of Environmental Policy Cases and Literature

In addition to articles and books examining federalism in general, the cases discussed above led to a particular interest in the application of *Lopez* and *Morrison* to environmental policy. Two areas of environmental policy in particular were thought ripe for a Commerce Clause challenge: wetlands policy under the Clean Water Act and protection of species under the Endangered Species Act. This was because the subject matter regulated under these policies was primarily intra-state. A number of authors examined the impact of the new federalism on both of these environmental policies, including Peter

Hudec eds., 1996).

48. Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 416 (1956) (presenting a model regarding the level of expenditures for local public goods).

49. See generally Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the “Race-to-the-Bottom” Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210 (1992) (discussing environmental regulation at the federal level); Richard L. Revesz, *The Race to the Bottom and Federal Environmental Regulation: A Response to Critics*, 82 MINN. L. REV. 535, 536–45 (1997) (indicting the race to the bottom rationale for federal environment regulation). See also Richard L. Revesz, *Federalism and Environmental Regulation: A Public Choice Analysis*, 115 HARV. L. REV. 553, 558 (2001) (pointing out that the relative strengths of environmental and industry groups at the federal and state levels determine whether the environment is “underregulat[ed]” at the state level, and using empirical data to examine the effectiveness of states as environmental regulators).

50. See MANCUR OLSON, JR., *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* 5 (1965) (looking at the theories surrounding groups and their interests and dispelling previous beliefs).

Swire,⁵¹ Daniel Esty,⁵² Joshua Sarnoff,⁵³ Lori Warner,⁵⁴ David Linehan,⁵⁵ and A. Dan Tarlock.⁵⁶

In the midst of this scholarly debate, two cases appeared on the Supreme Court docket: *Solid Waste Agency of Northern Cook County v. U.S. Army Corps of Engineers (SWANCC)*⁵⁷ and *Rapanos v. United States*.⁵⁸ These cases seemed to provide opportunities for the Court to apply the jurisprudence of *Lopez* and *Morrison* to wetlands. However, the Court instead decided these cases on other grounds.

In *SWANCC*, the Court had the opportunity to determine whether federal jurisdiction in the regulation of intrastate wetlands was appropriate under the Commerce Clause. However, the Court based its decision on statutory interpretation, rather than constitutional authority, holding that the Corps's "migratory bird rule" was not authorized under section 404 of the Clean Water Act.

In *Rapanos*, the Court, although unable to reach a majority, vacated and remanded the judgment of the United States Court of Appeals that favored the Corps' interpretation of the Clean Water Act. Rather than applying federalism principles, the plurality opinion and Justice

51. See Peter P. Swire, *The Race to Laxity and the Race to Undesirability: Explaining Failures in Competition Among Jurisdictions in Environmental Law*, 14 YALE L. & POL'Y REV. 67, 69–70 (1996). This article presents a two-dimensional structure to the question of the "race to the bottom:" laxity versus strictness, and desirable versus undesirable. *Id.* With this structure, it then challenges some of the assumptions of competitive models of the race to the bottom and shows that, under certain conditions, there may be a race to undesirable laxness. *Id.* at 94–105.

52. See Daniel Esty, *Revitalizing Environmental Federalism*, 95 MICH. L. REV. 570 (1996) (arguing that determination of the appropriate scale of environmental regulation depends on the particular characteristics of the environmental challenge that is being addressed).

53. Joshua D. Sarnoff, *The Continuing Imperative (But Only from a National Perspective) for Federal Environmental Protection*, 7 DUKE ENVTL. L. & POL'Y F. 225, 240–51 (1997) (responding to the claim that federal regulation decreases social welfare because states cannot act in keeping with their citizen's preferences).

54. See generally Lori Warner, *The Potential Impact of United States v. Lopez on Environmental Regulation*, 7 DUKE ENVTL. L. & POL'Y F. 321 (1997) (assessing the vulnerability of various environmental statutes).

55. David Linehan, Note, *Endangered Regulation: Why the Commerce Clause May No Longer Be Suitable Habitat for Endangered Species and Wetlands Regulation*, 2 TEX. REV. L. & POL. 365 (1998) (analyzing whether the Clean Water Act and Endangered Species Act are proper exercises under the Commerce Clause, in light of *United States v. Lopez*).

56. A. Dan Tarlock, *The Potential Role of Local Governments in Watershed Management*, 20 PACE ENVTL. L. REV. 149, 171 (2002) (pointing out the consistencies between wetlands and endangered species policies in that they "seek to protect biologically sensitive lands such as wetlands and endangered species habitats by preventing development within the confines of the Court's takings frameworks").

57. *Solid Waste Agency of N. Cook County v. U.S. Army Corps of Eng'rs*, 531 U.S. 159 (2001).

58. *Rapanos v. United States*, 547 U.S. 715 (2006).

Kennedy's concurrence both focused on interpretation of the terms "waters of the United States" and "navigable waters." Kennedy suggested that navigable waters "must possess a 'significant nexus' to waters that are or were navigable in fact."⁵⁹ As a result, the impact of *Lopez* and *Morrison* on the regulation of wetlands remains uncertain.

A number of other authors examined wetlands and endangered species separately. Vickie Sutton⁶⁰ and Jonathan Adler⁶¹ published articles on wetlands protection prior to *SWANCC*. After *SWANCC* failed to conclusively decide the federalism issue for wetlands, a number of other articles discussed this topic, including another by Adler⁶² and one by Edward Fitzgerald.⁶³ Those examining the Endangered Species Act include Omar White,⁶⁴ Bradford Mank,⁶⁵ and Kevin Cassidy.⁶⁶

D. Literature on Health Policies

In the 1990s, health care reform became an important topic. In particular, the Medicaid program grew significantly during the 1980s and 1990s, representing forty percent of federal payments to states by

59. *Id.* at 759.

60. Vickie V. Sutton, *Wetlands Protection—A Goal Without a Statute*, 7 S.C. ENVTL. L.J. 179 (1998) (discussing the idea that a Congressional determination that wetlands must be preserved would provide a constitutional basis for wetlands protection).

61. Jonathan H. Adler, *Wetlands, Waterfowl, and the Menace of Mr. Wilson: Commerce Clause Jurisprudence and the Limits of Federal Wetland Regulation*, 29 ENVTL. L. 1 (1999) (addressing the extent to which *United States v. Lopez* limits the federal government's authority to regulate wetlands).

62. Jonathan H. Adler, *The Ducks Stop Here? The Environmental Challenge to Federalism*, 9 SUP. CT. ECON. REV. 205 (2001) (arguing that *SWANCC* was not an obstacle to environmental protection by the federal government).

63. Edward A. Fitzgerald, *Solid Waste Agency of N. Cook County v. U.S. Army Corps of Eng'rs: Isolated Waters, Migratory Birds, Statutory and Constitutional Interpretation*, 43 NAT. RESOURCES J. 11 (2003) (examining the migratory bird rule in light of the Court's current approach to the Commerce Clause).

64. Omar White, Comment, *The Endangered Species Act's Precarious Perch: A Constitutional Analysis Under the Commerce Clause and the Treaty Power*, 27 ECOLOGY L.Q. 215 (2000) (pointing to the additional authority of the Treaty Power to support the E.S.A.).

65. Bradford C. Mank, *Protecting Intrastate Threatened Species: Does the Endangered Species Act Encroach on Traditional State Authority and Exceed the Outer Limits of the Commerce Clause?*, 36 GA. L. REV. 723 (2002) (examining the impact of the court's decision in *United States v. Morrison* and *Solid Waste Agency of Northern Cook County v. United States Army Corps of Engineers* on the Endangered Species Act).

66. Kevin Cassidy, Comment, *Endangered Species' Slippery Slope Back to the States: Existing Regulatory Mechanisms and Ongoing Conservation Efforts Under the Endangered Species Act*, 32 ENVTL. L. 175 (2002) (analyzing the drafting policy of the endangered species' listing agencies in light of the purpose, language, and legislative history of the Endangered Species Act).

the mid 1990s.⁶⁷ In 1993, the Clinton administration proposed a comprehensive health care reform package.⁶⁸ Although never enacted, this proposal spurred further debate on health care reform. After the *Lopez* decision and the enactment of welfare reform, a number of authors examined the implications of federalism on Medicaid policy.

One author pointed out that devolution of health policy had been “ongoing” for a number of years.⁶⁹ Another explained that the “impact of new federalism” is that “pursu[it of] our national public health agenda” will depend on utilizing the “means” provided by our “federalist system of government, namely the police powers of states.”⁷⁰ A number of analyses were published in *Medicaid and Devolution: A View from the States*, edited by Frank J. Thompson and John J. DiIulio.⁷¹ In one chapter, Thompson examines whether states can accept more responsibility for Medicaid, focusing on their governing and fiscal capacities, along with their commitment to Medicaid. He concludes that devolution should follow “a more incremental, calibrated approach . . . pay[ing] particular attention to implementation . . . and assign[ing] a critical scorekeeping role to the national government.”⁷²

67. Frank J. Thompson, *Federalism and the Medicaid Challenge*, in *MEDICAID AND DEVOLUTION: A VIEW FROM THE STATES* 258, 259 (Frank J. Thompson & John J. DiIulio eds., 1998).

68. President’s Address to the Joint Session of the Congress on Health Care Reform, 29 WEEKLY COMP. PRES. DOC. 1836 (Sept. 22, 1993). See also Health Security Act, H.R. 3600, 103d Cong. (1993).

69. Thomas J. Anton, *New Federalism and Intergovernmental Fiscal Relationships: The Implications for Health Policy*, 22 J. HEALTH POL. POL’Y & L. 691, 691 (1997) (pointing out that significant reform of health policy already had taken place in the states, but reminding of limits to the effectiveness of devolution, due to the benefits of specialization).

70. James G. Hodge, Jr., *The Role of New Federalism and Public Health Law*, 12 J. L. & HEALTH 309, 313 (1998).

71. *MEDICAID AND DEVOLUTION: A VIEW FROM THE STATES*, *supra* note 67.

72. Thompson, *supra* note 67, at 260. Many other authors have analyzed federalism and health care. See, e.g., John D. Blum, *Overcoming Managed Care Regulatory Chaos Through a Restructured Federalism*, 11 HEALTH MATRIX 327 (2001) (arguing that dual regulatory systems by both state and federal governments lead to conflicting policies, duplication, and too-high costs, and then making recommendations to enable more standardization and coordination); Stephen M. Davidson, *Politics Matters! Health Care Policy and the Federal System*, 22 J. HEALTH POL. POL’Y & L. 879 (1997) (commenting on other articles in the symposium and focusing on the role of political constraints on coordination between federal and state governments to solve national health problems); Joan H. Krause, *Forward: Federal-State Conflicts in Health Care*, 3 HOUS. J. HEALTH L. & POL’Y 151 (2003) (reviewing a symposium of articles examining the tensions between federal and state approaches to health care); ROBERT HURLEY & STEPHEN ZUCKERMAN, *URBAN INST., MEDICAID MANAGED CARE: STATE FLEXIBILITY IN ACTION* (2002), available at <http://www.urban.org/UploadedPDF/310449.pdf> (examining the use of managed care for Medicaid and the variations across states including innovations). Another set of analyses was published in 2003 in *Federalism & Health Policy*, edited by John Holahan, Alan Weir, and Joshua M. Wiener. *FEDERALISM & HEALTH POLICY* (John Holahan, Alan Weir & Joshua M.

E. Institutional Transaction Cost Theory

Some of these articles do address the role of economies of scale in comparing the desirability of a federal versus a state approach to these policies. Others have suggested that policies could utilize cooperative federalism to spread responsibilities for these policies across local, state, and federal governments. However, none have provided a structured approach to determining the optimal locus of policies across each of the enactment, implementation, and enforcement institutions.

This Article will do so, utilizing the institutional transaction cost framework.⁷³ Institutional transaction costs are the “costs of the institutions that support public policies,” and “they include the costs of enacting a policy by the legislature, implementing that policy by an administrative agency, and enforcing that policy by the agency and the courts.”⁷⁴ This framework suggests that in comparing policies, one should choose a policy that had the least aggregate sum of compliance costs, enactment costs, implementation costs, and enforcement costs.⁷⁵

Wiener eds., 2003). See also John Holahan, Alan Weir & Joshua M. Wiener, *Which Way for Federalism and Health Policy?*, HEALTH AFF., July 16, 2003, <http://content.healthaffairs.org/cgi/reprint/hlthaff.w3.317v1.pdf> (arguing for the need for additional investment by the federal government to enable increased eligibility for Medicaid by the poor). In addition to these analyses, the Urban Institute began a project, “Assessing New Federalism.” This project has conducted numerous analyses of federalism and health policies. See Anna Kondratas, Alan Weil & Naomi Goldstein, *Assessing the New Federalism: An Introduction*, 17 HEALTH AFF. 17 (1998) (providing an introduction to the ANF project, emphasizing the need to understand state variations to health and social service policies, and the impact of these programs on all low-income Americans).

73. The institutional cost framework was initially described in my dissertation. Dale B. Thompson, *An Examination of the Consequences of Political, Administrative, and Legal Institutions on the Implementation and Performance of Environmental Policies* (2008) (unpublished Ph.D. dissertation, Stanford University) (on file with author). This was later published in the *Natural Resources Journal*. See Dale B. Thompson, *Beyond Benefit-Cost Analysis: Institutional Transaction Costs and the Regulation of Water Quality*, 39 NAT. RESOURCES J. 517 (1999).

74. Dale B. Thompson, *Beyond Benefit-Cost Analysis: Institutional Transaction Costs and the Regulation of Water Quality*, 39 NAT. RESOURCES J. 517, 518 (1999).

75. In my *Beyond Benefit-Cost Analysis* article, *supra* note 73, I split enforcement costs into detection costs and prosecution costs. *Id.* at 534–37. However, in this Article, I refer to only enforcement costs.

II. FRAMEWORK FOR ANALYZING FEDERALISM ACROSS INSTITUTIONS

A. Definitions

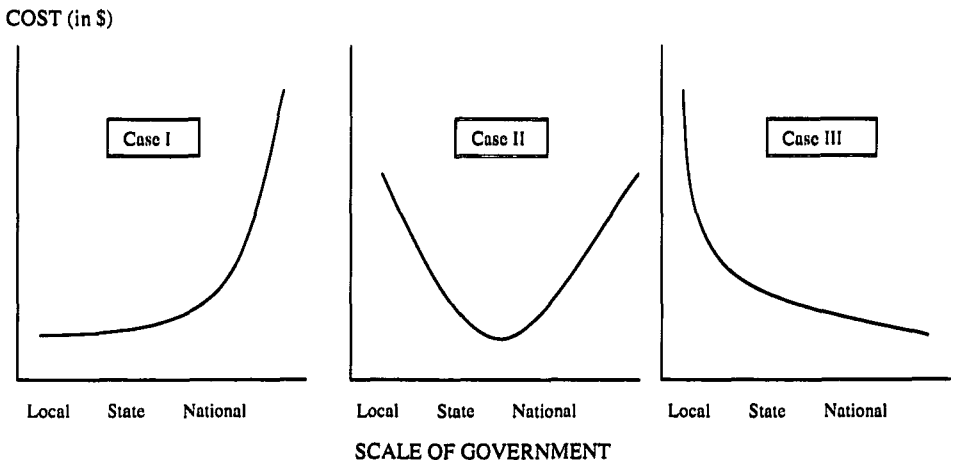
We begin with some definitions:

<i>Policy:</i>	Composed of an Enactment Phase, an Implementation Phase, and an Enforcement Phase.
<i>Enactment:</i>	Determines goals, powers, and constraints of a policy.
<i>Implementation:</i>	Defines mechanisms, incentives, and penalties for those targeted by the policy.
<i>Enforcement:</i>	Monitors and ensures compliance of individuals targeted by policy.
<i>Diseconomies and Economies of Scale:</i>	These arise from the transaction costs of these policies, or from the effects of transaction costs.

This framework uses a comparison of economies of scale with diseconomies of scale. In examining economies and diseconomies of scale, we consider institutional transaction costs. Those policies having rising institutional transaction costs as scale increases have diseconomies of scale, and those having lower institutional transaction costs have economies of scale.

In comparing economies and diseconomies of scale, we can assess the proper scale of an institutional dimension of a policy. Depending on the relative strength of the economies and diseconomies of scale, the cost function of a policy dimension can take different shapes:

Figure 1. Economies and Diseconomies of Scale.



In the first case, the cost of a policy is minimized by having as small a scale as possible. This would suggest that this dimension of the policy should be located at the local level. In the second case, minimization of costs suggests that policy should be located at the state level. And in the last case, minimization of costs occurs at the largest scale, so policy should be located at the national level.

To simplify analysis, the framework presented in this Article looks at only two levels: state and national.⁷⁶ The following describes the general process of using this framework.

B. General Technique

1. Compare single national policy with multiple state policies that have the same general objective [i.e. the combination of state policies achieves the same result as the single national policy].
2. Divide into three sub-comparisons, examining policy at phases of enactment, implementation, and enforcement.
3. At each phase, compare economies of scale with diseconomies of scale for specific policies.
4. If economies of scale are more significant than diseconomies of scale, then the optimal scale is national. If diseconomies are more significant, then the optimal scale is state.

C. Factors Influencing Economies & Diseconomies of Scale

This Part will describe general factors that influence economies and diseconomies of scale for each of the policy institutions. These factors can then guide analysis of specific policies.

This Part begins with the enactment phase. In this phase, legislatures, influenced by interest groups, decide to address a particular policy problem. The legislatures then determine the ultimate purposes of the policy, and specify available mechanisms to achieve these. In examining economies and diseconomies of scale for enactment, the focus is on the legislative process and the balancing of political interests, along with the role of interest groups. This Part also examines financing policies through taxes, and the effects of policy errors.

76. This framework could be extended to local, regional, and international levels.

Enactment Phase	
<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>
Avoidance of replication of legislative effort. [This advantage can be reduced by having a leader state or a "Uniform" approach, rather than independent legislative efforts.]	It will be more difficult to get political agreement, both within interest groups and among interest groups.
Individual states may enact policies where the costs or benefits may accrue to non-constituents. These non-constituents may attempt to influence the drafting of the legislation through lobbying, or by acting as a political entrepreneur. ⁷⁷ They may also challenge the legislation (or lack thereof) through litigation.	A larger scale implies that the interest groups themselves are larger, and this will make it more difficult to get a consensus within the group.
	There will also be more interest groups with the larger scale, and thus will be more difficult to achieve a political agreement.
Possible cost advantages for lobbying when act as constituent.	It will be more difficult to enable flexible approaches.
Avoidance of non-constituent suits.	More costly to anticipate what flexibility is required
	More difficult to achieve political agreement on differential impacts.
Interest groups may require an entrepreneur who will provide the public goods of organization and information. This is more likely to occur with larger scale because an entrepreneur is more likely to contribute because a larger scale policy will have a wider impact.	Errors will be more widespread
	Easier to experiment with smaller scale decision-making.
Taxes can be collected from a broader base, thereby reducing distortionary effects. Also, when economic fluctuation affects certain states harder, it can spread the burden of supporting that state.	Opportunity for subsidized funds to be diverted to less helpful projects, because not bearing full cost of these funds.

77. See Dale B. Thompson, Political Entrepreneurs and Consumer Interest Groups: Theory and Evidence from Emissions Trading (unpublished manuscript, on file with author) ("A political entrepreneur recognizes that a large group of voters, who might be otherwise ignored by the political process, may have substantial political power if they can be effectively mobilized. The entrepreneur then tries to mobilize this group by offering it organization and information. With the group mobilized, the entrepreneur can then direct its political power to further the entrepreneur's own purposes.").

From these, two considerations stand out: achieving a political agreement to achieve the policy, and financing the policy. Scale provides both economies and diseconomies in achieving a political agreement, and the relative magnitudes are context dependent. Meanwhile, the transaction costs from financing a policy generally decline as scale increases, although increasing scale can lead to adoption of less efficient projects, as accountability for costs declines.

This Part now turns to the implementation phase. In this phase, administrative agencies determine the mechanism for achieving objectives of policy. This mechanism specifies what private and public parties must do in order to comply with the policy. In examining economies and diseconomies of scale for implementation, this Part focuses on the processes of implementation and experimentation, along with the talents and knowledge base brought by the administrative staff implementing the policy.

Implementation Phase	
<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>
No need for replication of effort across states	Multiple implementations by states would lend itself naturally to experimentation. Furthermore, even if a centralized group did multiple experiments, organizational issues might create barriers to adopt successful mechanisms for future use.
Can group talent to better understand problem. Here, talent can be pooled from across the country, rather than trying to collect it in all states, or in a single state acting as an implementation leader.	More people working on problem can come up with wider diversity of approaches.
A centralized implementation group will develop a knowledge base in implementing many policies.	Implementation might benefit from the use of local knowledge for problems that need locally specific mechanisms. This local knowledge will be more available for decentralized implementation groups.
A centralized implementation group will have access to a broader dataset.	
Easier to provide consistency in regulations. (Even so, policies may be subject to multiple federal agencies.)	

For implementation, there are two primary considerations: opportunities to innovate and experiment, and the locus of knowledge. The optimal size of a firm for enabling innovation has been the topic of a lengthy debate. Some point to the resources available to a larger firm, thereby enabling costly experimentation. Others point to the need for independence to allow innovators to come up with new ideas, which is simpler in a smaller organization.

In a similar manner, the locus of knowledge also leads to both economies and diseconomies of scale. A project with a larger scale can support people with more specialized knowledge. On the other hand, projects with smaller scale imply that those involved have more localized knowledge, and this local knowledge can aid implementation.

The final phase is enforcement. In this phase, administrative agencies monitor compliance with the policy. Noncompliers may be induced to comply with the policy, or may be taken to court. In examining economies and diseconomies of scale for enforcement, we focus on the precedent of establishing enforcement practices, and the knowledge and abilities of enforcement agents.

Enforcement Phase	
<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>
More even enforcement	Decentralized agents more likely to have local knowledge and local presence
More clear precedent if taken to court	More likely to induce compliance
Able to present a more credible punishment threat	More receptive to locally modified approach to compliance
Centralized savings in training enforcement agents	

As before, knowledge is also a key consideration for enforcement, in particular knowledge of local conditions and options. Also, the relationship between the regulator and the regulated entity is important: a regulated entity may be more likely to respond positively to suggestions made by a regulator with whom a working relationship exists. On the other hand, an external enforcement agent may be able to induce a quicker response, as the regulated entity realizes they have few options other than complying.

Thus, for each policy institution, these factors can be used to identify economies and diseconomies of scale associated with a particular policy. We can then balance the economies with the diseconomies to

ascertain the appropriate scale, and thereby determine the optimal locus of policy for each institution.

While it is helpful to consider factors affecting economies and diseconomies of scale in general, in the end, the benefit from the framework comes from applying it to actual policies. To better explain how this is done, this Article will now provide some examples of how the framework applies to specific policies. Legislators and judges can then use these examples to apply this framework to other policies.

III. APPLICATION OF FRAMEWORK TO COMPARISON OF ENVIRONMENTAL POLICIES

The Endangered Species Act (ESA) and its related wetlands protection policies provide a good example of how the framework can be used to assess the proper scale of enactment, implementation, and enforcement institutions. As background, this part will briefly describe how the federal government and the states currently implement these policies. It then uses the federalism framework offered here to compare these policies across their enactment, implementation, and enforcement dimensions.

A. *Current Federal and State Policies to Protect Endangered Species*

In the United States, endangered species are protected at both the federal and state levels. The primary legislation protecting endangered species at the federal level is the Endangered Species Act of 1973 (ESA).⁷⁸ In order for a species to be protected under this act, it must first be “listed” as “endangered” or “threatened” by either the U.S. Fish and Wildlife Service (FWS) or the National Marine Fisheries Service of the Commerce Department (NMFS).⁷⁹ Once listed, it is illegal to “take” a species without a federal permit.⁸⁰ “Take” under the ESA is defined “to harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect or attempt to engage in any such conduct.”⁸¹

In addition to protecting these species directly, the ESA also protects species by designating “critical habitat” of these species.⁸² Critical

78. Endangered Species Act of 1973, 16 U.S.C. §§ 1531–1544 (2006 & West Supp. 2008). See also U.S. FISH & WILDLIFE SERV., *ESA BASICS: MORE THAN 30 YEARS OF PROTECTING ENDANGERED SPECIES* (2008) [hereinafter *ESA BASICS*], available at http://www.fws.gov/endangered/factsheets/ESA_basics.pdf.

79. *ESA BASICS*, *supra* note 78.

80. *Id.*

81. *Id.*

82. *Id.*

habitats are “areas that contain the physical or biological features essential to the conservation of the species and that may need special management or protection.”⁸³ Once designated, federal agencies and other parties operating with federal funding or under a federal permit must avoid “adverse modification” of the critical habitat.⁸⁴

Similarly to federal protection under the ESA, many states protect endangered species under state legislation.⁸⁵ These laws also prohibit taking endangered or threatened species, as designated by the state, unless permitted by the appropriate state agency.⁸⁶ Habitat protection, available under federal law, is generally not available under state law.⁸⁷

Consequently, the current statutory schemes for protecting endangered species provide a parallel, overlapping structure: one at the federal level and others at the state level. Species may be protected at only the state level, only the federal level, or at both the federal and state levels. Depending on the state, there may be significantly larger numbers of species protected at the state level,⁸⁸ and there is the possibility that a species is protected at the federal level but not at the state level.⁸⁹ An advantage of the dual listing structure is that it can ensure a certain baseline level of protection: certain species will be protected across the country, but others may be protected more or less depending upon local conditions.

The decision to list species on a state basis is different than the decision to list at a federal level. At the federal level, listing decisions frequently begin when an interest group such as the Nature Conservancy petitions to have a species protected.⁹⁰ The status of the

83. *Id.*

84. *Id.*

85. For example, see MINN. DEP'T OF NATURAL RES., MINNESOTA'S LIST OF ENDANGERED, THREATENED, & SPECIAL CONCERN SPECIES (2008) [hereinafter MINNESOTA ENDANGERED SPECIES LIST], available at http://files.dnr.state.mn.us/natural_resources/ets/endlist.pdf. See also Protection of Threatened and Endangered Species, MINN. STAT. ANN. § 84.0895.

86. Protection of Threatened and Endangered Species § 84.0895.

87. *Id.* See also Interview with Richard Baker, Minn. Dep't of Natural Res., (Aug. 6, 2007).

88. See MINNESOTA ENDANGERED SPECIES LIST, *supra* note 85 (displaying Minnesota's very lengthy list of endangered, threatened, and special concern species). Worthy of note is that only one of fourteen mammals and three out of twenty-eight birds that are listed at the state level are also listed at the federal level. *Id.* See also Interview with Richard Baker, *supra* note 87.

89. For example, the Canada lynx, American burying beetle, and Eskimo curlew are all protected at the federal level and appear in Minnesota, but are not protected under Minnesota law. See U.S. Fish & Wildlife Serv., Threatened and Endangered Species System: Minnesota, http://ecos.fws.gov/tess_public/StateListing.do?status=listed&state=MN (last visited Mar. 5, 2009); MINNESOTA ENDANGERED SPECIES LIST, *supra* note 85.

90. Interview with T. J. Miller, U. S. Fish and Wildlife Serv. (Aug. 9, 2007).

species is then assessed.⁹¹ During this assessment, it is determined whether the species is globally rare, or rare in a number of states.⁹² An expert scientific panel may be consulted.⁹³ Then, a panel of managers from the FWS may make the final listing decision.⁹⁴

Significant differences at the state level occur primarily due to the more limited scope of state legislation: the state is concerned with the presence of the species within its own territory, and not necessarily across the country or globally. The differences in scope sometimes lead to different decisions as to whether a particular species is listed at the federal level, the state level, or both.

If a species is protected by both the federal ESA and a state act, then a project that may impact that species must obtain permits from both federal and state agencies unless it falls into one of the exceptions.⁹⁵ At the federal level, the FWS is responsible for issuing permits.⁹⁶ One category of permit frequently sought is an “incidental take” permit, which applies to “taking that is incidental to an otherwise lawful activity.”⁹⁷ If a permit is issued, a limited amount of “taking” of the species may occur, as specified by the permit.⁹⁸ Consequently, to protect the species, the reviewing agency must ensure that the impact to the species is avoided and minimized to the extent practical. Additionally, for impacts that cannot be avoided, permit applications must include plans for mitigation, which could include replanting of habitat, relocating affected species, or contribution of land or funds for alternative projects that address the needs of the species.⁹⁹

While listing and permitting decisions follow distinct processes at state and federal levels, there is nonetheless significant coordination between state and federal agencies. One reason for this coordination is the fact that states maintain the databases used to assess species and their habitats, in both listing and permitting decisions.¹⁰⁰ Additionally,

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.*

95. One exception is that no federal permit is required if interstate commerce is not involved. See U.S. FISH & WILDLIFE SERV., PERMITS FOR NATIVE SPECIES: UNDER THE ENDANGERED SPECIES ACT (2008), available at <http://www.fws.gov/endangered/factsheets/permits.pdf>.

96. *Id.*

97. *Id.*

98. *Id.*

99. See U.S. Fish & Wildlife Serv., What Is a Habitat Conservation Plan and Incidental Take Permit?, <http://www.fws.gov/endangered/hcp/hcpplan.html> (last visited Jan. 29, 2009).

100. For example, Minnesota operates the “Natural Heritage Information System” with “information on Minnesota’s rare plants, animals, native plant communities, and other rare

state “biologists often have information available that is pertinent” to the specific habitat or species.¹⁰¹ Coordination is also beneficial when a species is listed at both the federal and state level.¹⁰²

B. Current Federal and State Policies to Protect Wetlands

As with protections for endangered species, legislation protecting wetlands is promulgated at both federal and state levels. At the federal level, wetlands are protected through the Clean Water Act (CWA), sections 404¹⁰³ and 401,¹⁰⁴ the Rivers and Harbors Act of 1899;¹⁰⁵ the Emergency Wetlands Resources Act;¹⁰⁶ and the National Environmental Policy Act. Under the CWA, the primary authority for ensuring compliance is the Environmental Protection Agency (EPA).¹⁰⁷ However, the CWA also designates the United States Army Corps of Engineers (Corps) as being responsible for issuing wetlands permits.¹⁰⁸ The U.S. Fish and Wildlife Service maintains the National Wetlands Inventory.¹⁰⁹

Many states also have laws protecting wetlands. For instance, Minnesota has enacted the Minnesota Wetlands Conservation Act.¹¹⁰ This act establishes a policy of “no net loss in the quantity, quality, and biological diversity of Minnesota’s existing wetlands.”¹¹¹ It also states that activities that adversely impact wetlands should be minimized

features.” Minnesota Department of Natural Resources, Natural Heritage Information, <http://www.dnr.state.mn.us/eco/nhrnp/nhis.html> (last visited Jan. 25, 2009).

101. U.S. FISH AND WILDLIFE SERV. & NAT’L MARINE FISHERIES SERV., ENDANGERED SPECIES CONSULTATION HANDBOOK xxii (1998), available at <http://www.fws.gov/endangered/pdfs/Sec7/handbook/TOC-GLOS.PDF>.

102. See Dennis Lien, *St. Paul Mississippi River / Mussels Get Helping Hand*, PIONEER PRESS, Sept. 25, 2007, http://www.twincities.com/minnesota/ci_6989305 (describing the cooperative federal and state efforts to save the Higgins’ eye mussels).

103. 33 U.S.C. § 404 (2006). Under Section 404, permits are required before discharging dredge or fill material into a wetland.

104. Clean Water Act § 401, 33 U.S.C. § 1341 (2000) (setting water quality standards, and policies affecting wetlands must consider the effects on water quality of the particular affected water body).

105. Rivers and Harbors Act of 1899, 33 U.S.C. § 401 (2000) (regulating construction affecting national waterways).

106. Emergency Wetlands Resources Act of 1986, Pub. L. No. 99-645, 100 Stat. 3582 (1986) (requiring the maintenance of a National Wetlands Inventory, the responsibility for which is given to the U.S. Fish and Wildlife Service).

107. See U.S. Environmental Protection Agency, Wetland Regulatory Authority, http://www.epa.gov/owow/wetlands/pdf/reg_authority_pr.pdf (last visited Jan. 22, 2009).

108. 33 U.S.C. § 1344 (2000).

109. See Emergency Wetlands Resources Act of 1986 § 401(a).

110. MINN. STAT. § 103A.201 (2008).

111. *Id.* § 103A.201(2)(b)(1).

where possible, and, when it is not feasible, to “replace wetland values.”¹¹² In Minnesota, this legislation spreads responsibility for protecting wetlands among the Minnesota Department of Natural Resources and the Minnesota Pollution Control Agency, and wetland permits are issued by the Minnesota Board of Water and Soil Resources.¹¹³

Implementation of the federal legislation involves a complex network of guidelines and rules. The EPA establishes general guidelines for permitting in wetlands.¹¹⁴ The Corps provides guidelines in much greater detail.¹¹⁵ Part of the Corps’ task is to develop guidelines for wetlands delineation, i.e. establish what areas are considered wetlands versus “uplands.”¹¹⁶ The Corps has also developed a “hydrogeomorphic classification system—a state-of-the-art method for evaluating ecological functions of wetlands.”¹¹⁷ This system allows the Corps to develop regionally specific guidelines for assessing wetlands.¹¹⁸ This system is consistent with the significant degree of independence of one district office of the Corps from another.¹¹⁹ Additionally, the Corps has established a “Nationwide Permit” program,¹²⁰ whereby certain categories of activities in designated areas¹²¹ may qualify for a permit without undergoing a full permit application and review process.

Furthermore, the Corps frequently coordinates with state agencies responsible for protecting wetlands.¹²² Under section 404, part F, of the

112. *Id.* § 103A.201(2)(b)(4).

113. *See* Minnesota Pollution Control Agency, Wetlands in Minnesota, <http://www.pca.state.mn.us/water/wetlands/index.html> (last visited Jan. 22, 2009).

114. *See generally* 40 C.F.R. § 230 (2008). In particular, see 40 C.F.R. § 230.10 (2008).

115. *See generally* 33 C.F.R. §§ 320–336 (2008). In particular, see 33 C.F.R. § 320.4 (2008).

116. Interagency Memorandum of Agreement Concerning Wetlands Determinations for Purposes of Section 404 of the Clean Water Act and Subtitle B of the Food Security Act, 59 Fed. Reg. 2920 (Jan. 19, 1994).

117. U.S. Army Engineer Research and Development Center, Wetlands Management, <http://el.ercd.usace.army.mil/factsheets/wetland.pdf> (last visited Jan. 22, 2009). For a description of this system, see National Action Plan to Develop the Hydrogeomorphic Approach for Assessing Wetland Functions, 61 Fed. Reg. 42593 (Aug. 16, 1996).

118. There are numerous regional guidebooks explaining the application of this system. For a list of these publications, see U.S. Army Corps of Engineers, Wetland Publications, <http://el.ercd.usace.army.mil/wetlands/wlpubs.html> (last visited Jan. 22, 2009).

119. *See* 33 C.F.R. § 320.1 (2008) (“The Corps is a highly decentralized organization.”); Telephone Interview with Susan Elston, U.S. Env’tl. Prot. Agency, Region V (September 18, 2007).

120. 33 C.F.R. § 330.1 (2008).

121. Water bodies noted as “critical resource waters” are not included in certain parts of this program. *Id.*

122. Interview with David Weirens, Minnesota Bd. of Water & Soil Res. (August 1, 2007).

Clean Water Act, when someone applies for and receives a state wetlands permit, they may be entitled to an exemption from a federal permit requirements. Accordingly, it is essential for the Corps and relevant state agencies to coordinate in establishing consistent permit guidelines. As a result, another set of guidelines established by the Corps in coordination with state agencies are guidelines for mitigation,¹²³ including mitigation banks.¹²⁴

In addition to these rules, both the EPA¹²⁵ and the Corps have centers for conducting experiments related to wetlands. The Corps facility is known as the Waterways Experiment Station and is located in Vicksburg, Mississippi.¹²⁶

At the same time, state agencies also develop locally appropriate guidelines for managing wetlands. Minnesota's Wetland Conservation Plan states, "Local water plans, wetlands plans, and land use plans remain the best way to account for specific local needs and conditions."¹²⁷ In Minnesota, management strategy begins by identifying and describing differences across hydrogeologic zones in the state.¹²⁸ For each of the zones, appropriate management techniques are specified. State agencies use these management strategies to develop "general and specific standards that apply to the evaluation of permits for each type of activity."¹²⁹

Additionally, as noted above, mitigation guidelines are developed in coordination with federal agencies. However, while the federal government maintains experimental labs for wetlands, it is less likely that states will do so.¹³⁰

123. See, e.g., Interagency Memorandum of Understanding: U.S. Army Corps of Engineers & Minnesota Board of Water & Soil Resources, Wetland Mitigation Guidelines (May 20, 2007), <http://www.bwsr.state.mn.us/wetlands/BWSR-COEmemo.pdf> (last visited Jan. 22, 2009) [hereinafter BWSR / USACE Interagency Memorandum of Understanding on Wetland Mitigation].

124. Federal Guidance for the Establishment, Use and Operation of Mitigation Banks, 60 Fed. Reg. 58605-02 (Nov. 28, 1995).

125. Interview with Susan Elston, *supra* note 119.

126. Waterways Experiment Station, <http://www.wes.army.mil/Welcome.html> (last visited Jan. 22, 2009) (housing a wide array of experiments). The wetlands center is known as the Wetlands Research and Technology Center. Wetlands Research Technology Center, <http://el.ercd.usace.army.mil/wetlands/> (last visited Jan. 22, 2009).

127. MINN. DEP'T OF NATURAL RES., MINNESOTA WETLANDS CONSERVATION PLAN, VERSION 1.0, at 27 (1997), available at <http://files.dnr.state.mn.us/eco/wetlands/wetland.pdf>.

128. *Id.*

129. MINN. BD. OF WATER AND SOIL RES., WETLANDS REGULATION IN MINNESOTA 7 (2003), available at <http://www.bwsr.state.mn.us/wetlands/publications/MNRegulations.pdf>. See also MINN. R. 6115.0190-.0232, .0270-.0280.

130. Interview with David Weirens, *supra* note 122.

In the enforcement phase of wetlands policy, local, state, and federal agencies make decisions about granting permits, and these decisions may be appealed. Permits satisfying the requirements of the Clean Water Act are generally issued by the Corps, although a state agency may also be granted authority under certain circumstances.¹³¹ In general, permitting decisions by the Corps are made by district engineers.¹³² Substantive appeals of these decisions may be submitted to a division engineer, while further appeals are handled under the Administrative Procedures Act.¹³³

At the state level, initial permitting decisions may be made by local governmental units, such as county boards or by state agency staff.¹³⁴ Appeals made by agency staff may be made to the heads of commissions, or beyond that, to courts under state administrative law procedures.¹³⁵ Meanwhile, appeals of local government units can generally be made to the state agency that oversees the process under which the local government unit manages wetlands.¹³⁶

C. Policy Comparison

Under the federalism framework offered in this Article, we select a particular goal to achieve, and then consider economies and diseconomies of scale associated with that goal, across different institutions. The goal of the first policy will be to protect the habitat of species listed as endangered or threatened. This goal will provide its principal benefits to citizens across the country, through gains from maintaining biodiversity and existence values.¹³⁷ The goal of the second policy will be to preserve wetlands located near major water bodies. This goal will provide its principal benefits to local and regional citizens who are affected by these water bodies. Wetland protection will improve the water quality, and also serve as a buffer in case of overflow and flooding. Some of these water bodies are intra-

131. Interview with Doug Norris, Minn. Dep't of Natural Res. (August 7, 2007); Interview with Susan Elston, *supra* note 119. For example, one state whose agency has authority to issue permits is Michigan.

132. See 33 C.F.R. §§ 320, 331 (2008).

133. *Id.* Administrative Procedures Act, 5 U.S.C. §§ 500–596 (2000).

134. See MINNESOTA BOARD OF WATER AND SOIL RESOURCES, *supra* note 129.

135. *Id.*

136. *Id.*; Interview with Doug Norris, *supra* note 131.

137. Existence value is “the value someone derives from knowing that a resource exists.” Dale B. Thompson, *Valuing the Environment: Courts’ Struggles with Natural Resource Damages*, 32 ENVTL. L. 57, 58 n.3 (2002).

state, while others cross many states. We now compare these policies across their enactment, implementation, and enforcement dimensions.

1. Enactment

In analyzing economies and diseconomies of scale during enactment, we examine the transaction costs of legislatures, interest groups, and political entrepreneurs. Some of the key aspects are the scope of the benefits and costs. As noted, an endangered species policy provides benefits to citizens across the country. These benefits are very diffuse and not well-understood by many citizens. As a result, a political entrepreneur may be needed to champion the cause of protecting endangered species.¹³⁸ There are significant economies of scale to the activities of these entrepreneurs, because their provision of information and organization can be done at a national level, rather than over multiple, separate state levels.

However, in order to preserve the habitat of the endangered species, development opportunities in the habitat location will need to be curtailed. This will impose more concentrated costs on the locality in which the species's habitat is located. Consequently, there might be a need to compensate affected owners of property on which the habitat lies. A broader tax base should lower distortionary effects of this tax, and so there is an economy of scale here.¹³⁹

In contrast, the benefits from a wetlands policy will accrue to those citizens located near affected hydrogeological systems. As a result, for systems contained completely within one state, it is more likely that those beneficiaries can be more effectively represented at a state level, and so the economies of scale are less here than for the endangered species policy. Additionally, in the end, the interest groups supporting a wetlands policy will be a coalition of groups impacted by water quality and flood-control effects located in different areas. Because this will be a coalition, it may be more difficult to coordinate these groups if they are impacted differently by wetlands policies. This effect is one of diseconomies of scale.

However, to a great extent, most hydrogeological systems are interconnected.¹⁴⁰ As a result, in the case of multi-state hydrogeological systems, beneficiaries exist at a more regional-level. In these instances, in order to enact policies at the state level, regional

138. In my previous article, I split enforcement costs into detection costs and prosecution costs. However, in this Article, I refer to only enforcement costs.

139. See *infra* note 179.

140. Interview with Doug Norris, *supra* note 131.

compacts between the states sharing the water body would be necessary. Such compacts for water policies are currently in force addressing the Great Lakes and the Colorado River.

Other economies of scale remain, as duplicative legislative efforts could make state enactment of a wetlands policy costly. These duplicative efforts could be avoided by a “Uniform” approach, however. The following table summarizes economies and diseconomies of scale in enactment:

Endangered Species		Wetlands	
<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>	<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>
Avoid duplicative legislative efforts	Can have one state lead, or have consortium of states as leader.	Similar economy	Similar diseconomy
May be easier to organize at national level because benefits of policy are more esoteric: the welfare of different endangered species in an area provide benefits through biodiversity, the balance of an ecosystem, ¹⁴¹ and as a proxy for the health of the local ecosystem ¹⁴² (economies of scale of a political entrepreneur)			Easier to explain benefits of wetlands (flood control, water quality) to localities where water bodies are present.
Endangered species interest groups are more willing to support national policies because		To properly address effects of wetlands that service multi-state hydrogeologic	Also may have localized benefits: benefits of policy for an entirely local hydrogeologic

141. See U.S. FISH & WILDLIFE SERV., *ESA BASICS: MORE THAN 30 YEARS OF CONSERVING ENDANGERED SPECIES* (2008), http://www.fws.gov/endangered/factsheets/ESA_basics.pdf (last visited Jan. 25, 2008).

142. See interview with Richard Baker, *supra* note 87, interview with T. J. Miller, *supra* note 90.

<p>impact of policies rises at an increasing rate as scale increases. (survival rate of species increases exponentially as additional habitats are protected, and hence are less subject to having entire species exposed to individual external shocks)</p>		<p>systems, it is much easier to legislate at the national level: simplification of coordination (if done at state level, the legislature must direct that effects on other states are considered, and this must be done through reciprocity negotiations of neighboring legislatures / state compacts)</p>	<p>system flow to local residents. If so, local legislatures may be better in-tune with true value of wetland protection for that body of water.</p>
<p>Easier to manage national environmental groups than fifty individual state environmental groups, because of the wide range of organizational strength of environmental groups across different states¹⁴³</p>		<p>Similar economy</p>	
<p>Can reduce the impact of anti-endangered-species-protection interest groups that are more influential in a small number of specific states.</p>		<p>Similar economy</p>	

Thus, under this framework, one looks for the lowest cost way to enact a particular policy. As seen in the table above, for a given endangered species policy, groups wishing to politically support this policy would encounter economies of scale, while groups opposing this policy would have greater strength at state levels. Although of a different nature, there are also significant economies of scale for policies that protect multi-state hydrogeologic wetland systems. It is

143. See interview with Richard Baker, *supra* note 87.

simpler to coordinate efforts through a single piece of legislation rather than multiple pieces of legislation in different legislatures. In marked contrast, there are considerably fewer economies of scale for a local wetlands policy. Many of the benefits of local wetlands are captured locally, and hence can be properly assimilated in a political “who-bears-costs versus who-benefits” battle within a state.

In the end, the framework therefore suggests that policies protecting endangered species and multi-state hydrogeologic wetland systems are relatively less costly to enact at the federal level, while policies protecting local wetlands are better candidates for enactment by individual states.

2. Implementation

In the enactment phase, policy goals are defined. During implementation, an administrative agency develops rules to achieve these policy goals. During enforcement, these rules are applied in particular cases, and then are monitored to ensure compliance.

Both endangered species and wetlands policies are fundamentally about land use and development decisions. Consequently, the implementation phase of these policies can be understood as an agency’s attempt to develop rules protecting endangered species and wetlands while balancing land use and development interests. Rules that need to be developed for endangered species include determination of what species are “listed,” and development of mitigation guidelines. For wetlands, rule development includes scientific assessment and designation of critical waters, development of scientific approaches to categorizing wetlands, development of mitigation guidelines, and determination of appropriate management strategies.

In comparing economies and diseconomies of scale for implementation, we focus on the process of writing rules and guidelines; baseline protection; database management; and both local and centrally developed knowledge. We find the following economies and diseconomies:

Endangered Species		Wetlands	
<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>	<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>
Avoid costs of duplication for developing lists of protected species	Could approach this on a state level using a “Uniform”	Similar duplication avoidance for rules of mitigation guidelines. To a	Similar opportunity for use of “Uniform” method for mitigation

(although not necessary to address species that are not present in a state, and hence there may be less overlap) and rules for mitigation guidelines	method, thereby also avoiding duplication costs	lesser extent, avoidance of duplication of designation of multi-state critical resource waters.	guidelines. Designation of critical resource waters contained within one state would not involve replication in other jurisdictions.
Can more easily assure that there are baseline protections for particular species. ¹⁴⁴ Also, can coordinate rule development for multi-state species. ¹⁴⁵	Knowledge of local conditions may be needed in particular cases for making listing decisions and in developing mitigation guidelines. More likely that this information is possessed by local staff. ¹⁴⁶	Similar economy, whereby we can assure baseline protection for wetlands impacting multi-state hydrogeologic systems. ¹⁴⁷ Can also coordinate rule development for multi-state hydrogeologic systems.	Similar diseconomy, in particular with determining locally appropriate regional management strategies for wetlands.
Development of listing decisions requires databases of information on species and their habitats. Significant economies in coordinating databases of species residing in multiple state jurisdictions.	Record structure of database may need to be inconsistent from one jurisdiction to another jurisdiction, because local circumstances may lead to need to collect different information in different places. Diseconomies of	Need to coordinate collection of National Wetland Inventory.	Difficult to collect all of this information in centralized manner. Easier to allow decision-makers to evaluate wetlands to be measured, and characteristics to be analyzed (i.e. what do you need to know to ascertain the "quality" and "quantity" of the

144. *Id.*145. Interview with T. J. Miller, *supra* note 90.146. *Id.*147. Interview with Doug Norris, *supra* note 131; Interview with Susan Elston, *supra* note 119.

	centralized data collection from managing data of different record structures. Also diseconomy from managing large amount of information about all critical species across the nation. ¹⁴⁸		wetland?).
Can support research through centralized grant system.		Conduct wetlands research through national laboratories. Establish general scientific approach to modeling wetlands that enables adjustment for regionally specific guidelines for assessing wetlands.	Much easier to adapt these models to local conditions with local information.

In this case, one can see significant economies and diseconomies of scale for implementing policies protecting both endangered species and wetlands. There is a critical need for baseline protection, an economy of scale; while at the same time, determination of the appropriate level of additional protection depends on knowledge of local conditions, a diseconomy of scale. There are economies of scale in coordinating protection of multi-state species and wetland systems, but diseconomies in collecting and managing data needed to make implementation decisions. In comparison, wetland protection offers a strong economy of scale in the opportunity to conduct research on wetlands through a national laboratory.

In the end, the existence of both economies and diseconomies of scale suggests that implementation of these policies should be

148. See Interview with Richard Baker, *supra* note 87.

performed at both the state and federal levels. Federal implementation should focus on establishing baseline protection, coordinating rule development for multi-state species and wetlands, and, in the case of wetlands, conducting primary research at a national laboratory. At the same time, states should be responsible for determining rules for protection beyond baselines, and for collecting and managing data for protecting species and wetlands.

3. Enforcement

As mentioned above, enforcement involves applying rules to particular cases, and monitoring to ensure compliance. For endangered species, implementing agencies develop rules about which species and which habitats are protected. In enforcement, these rules are applied to individual permits. In this process, agencies must determine whether any taking of a protected species is justified, and if so, they must ensure that the taking is minimized. The agencies also assess the need for mitigation. Additionally, agencies must monitor projects to ensure that they are complying with the terms of their permits.

Meanwhile, enforcing wetlands protections likewise involves applying rules to individual permit applications. This process may involve assessment of the wetland itself, as well as the effect on the wetland, and may also include mitigation actions. Permit decisions may be appealed.

To examine economies and diseconomies in enforcement, we again must consider baseline protection and the role of information. We also need to look at the number of staff needed to enforce policies; coordination of mitigation projects; and the advantages and disadvantages of external enforcement agents. In comparing these policies, we see the following economies and diseconomies of scale:

Endangered Species		Wetlands	
<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>	<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>
Oversight may be needed to ensure baseline protections of species. This can be achieved through	Issuing permits and monitoring compliance requires large numbers of people,	Similar economy.	Similar diseconomy, to a greater extent because the number of wetland

<p>“memoranda of understanding,”¹⁴⁹ coordinating initial permitting decisions by state agents, followed by routine approval by federal agents.</p>	<p>and there are diseconomies of managing larger numbers of people. Meanwhile, state agencies can utilize large numbers of staff who have a number of other responsibilities in addition to species protection.¹⁵⁰</p>		<p>permits tends to be significantly higher than the number of species permits.¹⁵¹</p>
<p>Similar economy.¹⁵²</p>	<p>Local information is important in assessing the effects on the species, the value of the project proposed, and the usefulness or proposed mitigation. State agents are more likely to have local information.¹⁵³</p>	<p>Federal personnel can act as “gorilla in the closet”: they are less likely to be influenced by local politicians,¹⁵⁴ and as a result, it is less likely that additional appeals (and hence transaction costs) would be necessary for a given wetlands project that could be</p>	<p>Similar diseconomy.¹⁵⁵ In some instances, it may be easier for local enforcement agents to convince affected parties to comply with a permitting decision.¹⁵⁶</p>

149. See BWSR / USACE Interagency Memorandum of Understanding on Wetland Mitigation, *supra* note 123.

150. See Interview with Richard Baker, *supra* note 87; Interview with T. J. Miller, *supra* note 90.

151. Interview with Doug Norris, *supra* note 136; Interview with Susan Elston, *supra* note 119.

152. Interview with T. J. Miller, *supra* note 90.

153. See Interview with Richard Baker, *supra* note 87; Interview with T. J. Miller, *supra* note 90.

154. *Id.*

155. Interview with Susan Elston, *supra* note 119.

156. Interview with Mark Gernes, Minn. Pollution Control Agency (July 31, 2007).

		considered detrimental, but nonetheless could win approval.	
Large advantages in coordinating mitigation projects across state lines. ¹⁵⁷	It may be easier to negotiate reciprocity in mitigation projects for species that cross borders, because border crossing by endangered species normally takes place in both directions.	In multi-state system situations, it will be easier to centrally coordinate mitigation projects, rather than negotiate for reciprocity between states. This is due to the direction of flow limiting the opportunities for reciprocity.	

In comparing enforcement of these policies, we see a significant number of similarities, with some differences. For both policies, there are substantial diseconomies of scale in initially processing permit applications and later in monitoring. This is true both in managing the people performing these tasks, and in the availability of local information. This diseconomy is more significant for wetlands due to the higher number of wetland permits. Another similarity is the usefulness of the "gorilla in the closet," which is an economy of scale. There are also economies of scale in coordinating multi-state mitigation projects. The current overlapping permitting system coordinated through memoranda of understanding between federal and state agencies is a method to capture both economies and diseconomies of scale in enforcement.

In the end, the significant diseconomies of scale for enforcement of both endangered species policies and wetland protection policies suggest that both of these policies should be enforced primarily at the state level. Federal enforcement should have a supporting role,

157. Interview with T. J. Miller, *surpa* note 90.

addressing the need to coordinate multi-state mitigation projects, and to provide oversight in order to ensure baseline protections.

IV. APPLICATION OF FRAMEWORK TO ANALYZE HEALTH CARE POLICY

This Part begins with a description of the Medicaid program. It then explains Medicaid's policy goals, and after that, compares the economies and diseconomies of scale across each policy institution.

A. *The Medicaid Program*

Through Medicaid, states receive federal assistance to finance health insurance plans designed to serve low-income pregnant women, families with children, the elderly, and the disabled.¹⁵⁸ Medicaid was initially created by federal legislation in 1965.¹⁵⁹ Under traditional Medicaid, a state can apply for federal matching dollars (ranging from fifty percent to a maximum of eighty-three percent, depending upon the state)¹⁶⁰ to support its expenditures on medical assistance for certain low-income groups. To qualify for the matching dollars, state plans have to meet certain requirements. Certain services must be provided by these plans. These "benefits extend well into the realm of long-term care and include such interventions as personal care services, respite care, home care adaptation and case management."¹⁶¹ These plans must reflect "freedom of choice," whereby an individual beneficiary of the plan could choose to receive care from any provider.¹⁶² Another requirement is uniformity of benefits across a state, also known as "statewideness."¹⁶³ Furthermore, the state has to limit beneficiaries to certain protected low-income groups: pregnant women, families with children, the elderly, and the disabled.¹⁶⁴ Federal legislation also

158. 42 C.F.R. § 430.0 (2007) ("Federal grants to States for medical assistance to low-income persons who are age 65 or over, blind, disabled, or members of families with dependent children or qualified pregnant women or children").

159. The Social Security Act tit. XIX (1965), 42 U.S.C. § 1396 (2000 & West Supp. 2008).

160. This share is called the "federal medical assistance percentage (FMAP)." ELICIA J. HERZ, CRS REPORT FOR CONGRESS, MEDICAID: A PRIMER CRS-6 (2005), *available at* https://www.policyarchive.org/bitstream/handle/10207/2676/RL33202_20051222.pdf.

161. Sara Rosenbaum & David Rousseau, *Medicaid at Thirty-Five*, 45 ST. LOUIS U. L.J. 7, 13 (2001).

162. *See* HERZ, *supra* note 160, at CRS-4 ("With certain exceptions, beneficiaries must have freedom of choice among health care providers or managed care entities participating in Medicaid.").

163. *See id.* at CRS-3 (stating that "the amount, duration, and scope of benefits must be the same statewide" and labeling this requirement the "statewideness rule").

164. *See id.* at CRS-2 to CRS-3 (discussing certain groups that the states "may choose to cover," as opposed to "must" cover).

mandates coverage for certain income levels of some of these groups; for instance, “pregnant women, infants, and children up to age 6 with family incomes up to 133 percent of the [federal poverty level (FPL)].”¹⁶⁵ States could sometimes extend coverage to higher income levels for these groups. However, once these income levels are determined, anyone who falls within these protected groups and meets income requirements is entitled to receive benefits.¹⁶⁶

In 1981, states were given the opportunity to seek waivers from some of these requirements. The most flexible waiver came under section 1115,¹⁶⁷ and it allowed states to seek waivers to continue to receive matching funds to support a “research and demonstration” plan. Under these plans, freedom of choice could be limited, uniformity was not required, and managed care could be applied.¹⁶⁸ Additionally, “Managed Care/Freedom of Choice Waivers” can also be obtained under section 1915(b), and “Home and Community-Based Services Waivers” under section 1915(c).¹⁶⁹

For a time, eligibility for Medicaid depended upon an individual’s receipt of Aid to Families with Dependent Children (AFDC) or Supplemental Security Income (SSI). However, under the 1996 Welfare Reform Act, the previous requirement of receipt of AFDC benefits was removed (AFDC itself was replaced by Temporary Assistance to Needy Families, TANF). With the passage of the 1996 Welfare Reform Act, section 1931 gave additional flexibility to the states in determining income eligibility with respect to whether certain income and assets would apply. A consequence of this was the ability to expand coverage to working parents.¹⁷⁰ Under this section, states can also utilize managed care programs without seeking a waiver.¹⁷¹

165. John Holahan & Mary Beth Pohl, *Leaders and Laggards in State Coverage Expansions*, in *FEDERALISM & HEALTH POLICY*, *supra* note 72, at 179, 181.

166. See 42 U.S.C. § 1396a (2000 & West Supp. 2008), amended by Pub. L. No. 110-275, § 111(a); Pub. L. No. 110-252, § 7001(d)(2)(A), 7001(d)(2)(B), 7001(d)(2)(C), 7001(d)(4), 122 Stat. 2304.

167. 42 U.S.C. § 1315 (2000 & West Supp. 2008).

168. 42 U.S.C. § 1396n (2000 & West Supp. 2008). Under this waiver, a state can require beneficiaries to enroll in a managed care plan. Both of these waivers were created under the Omnibus Budget Reconciliation Act of 1981, Pub. L. No. 97-35, § 2175, 95 Stat. 357 (1981).

169. See CTRS. FOR MEDICARE AND MEDICAID SERV., MEDICAID STATE WAIVER PROGRAM DEMONSTRATION PROJECTS—GENERAL INFORMATION (2005), available at <http://www.cms.hhs.gov/MedicaidStWaivProgDemoPGL/> (“Section 1915(b) Managed Care/Freedom of Choice Waivers Section 1915(c) Home and Community-Based Service Waivers”).

170. See CTR. ON BUDGET AND POLICY PRIORITIES, TAKING THE NEXT STEP: STATES CAN NOW TAKE ADVANTAGE OF FEDERAL MEDICAID MATCHING FUNDS TO EXPAND HEALTH CARE COVERAGE TO LOW-INCOME WORKING PARENTS *passim* (1998), available at

B. Goals

The Medicaid policy considered in this Article will achieve various goals. First, eligibility for medical benefits for a particular group, such as children, should be extended to include higher income levels. Second, total state expenditures should remain the same, and consequently, expansion of coverage would have to be balanced by savings in expenditures elsewhere. To achieve these savings, existing beneficiaries would be moved into a managed care plan (or MCO, which it is assumed would entail lower costs per beneficiary for the same level of services).

C. Enactment

As it currently stands, the enactment process of Medicaid is performed by legislatures at both the federal and the state level. Congress enacted the initial Medicaid legislation and provided federal financial support to state plans that met statutory requirements.¹⁷² Subsequent amendments have provided additional flexibility for states receiving federal financial support.¹⁷³

Meanwhile, authorization of state plans requires legislation enacted by states. The following is a brief description of the different steps that would be necessary to achieve the goals specified above. The legislature would make certain decisions: Would these plans be “mandatory or voluntary?”¹⁷⁴ What services would be included?¹⁷⁵ Would the coverage area be state-wide, or a specific region? Would a state agency “promulgate[] rates” for the managed care plan, or “invite[] competitive bids?”¹⁷⁶ Exactly what income levels would make each

<http://www.cbpp.org/8-20-98mcaid.pdf> (“[T]he federal welfare law enacted in August 1996 contains a little-recognized opportunity for states to expand coverage to poor and near-poor working parents through Medicaid.”). See also 42 U.S.C. § 1396u-1 (2000 & West Supp. 2008) (“Assuring coverage for certain low-income families.”).

171. See 42 U.S.C. § 1396u-2 (2000 & West Supp. 2008) (permitting states to require individuals who are eligible for medical assistance to enroll in a managed care entity).

172. Interview with T. J. Miller, *supra* note 90.

173. See *supra* Part III.A (discussing current federal and state policies to protect endangered species).

174. AM. ACADEMY OF ACTUARIES, MEDICAID MANAGED CARE: SAVINGS, ACCESS AND QUALITY 11 (1996) [hereinafter ACTUARIES REPORT], available at <http://www.actuary.org/pdf/health/medicare.pdf>.

175. Federal requirements include a number of services as mandatory, while others are optional. For examples of mandatory and optional benefits, see HERZ, *supra* note 160, at CRS-3 to CRS-4 (discussing mandatory benefits such as inpatient hospital services and laboratory and x-ray services, and optional benefits such as prescribed drugs and routine dental care).

176. ACTUARIES REPORT, *supra* note 174, at 11.

protected group eligible for coverage? These changes would then be embodied in state legislation authorizing development of a new (or amended) plan.

In drafting this legislation, state agencies would work closely with the federal Centers for Medicare and Medicaid Services [CMS, formerly the Health Care Financing Administration (HCFA)]¹⁷⁷ to ascertain which federal Medicaid statutes would enable the state to recover matching federal dollars to help finance these plans.¹⁷⁸ Eventually, the plan must be submitted to CMS for approval, which will determine whether the state plan or state plan amendment conforms to statutory requirements necessary to receive federal matching support.

From this process, one can identify certain economies and diseconomies of scale, as noted in the following table. In examining these, this section focuses on financing these programs and consequent incentives, benefit provisions, and opportunities for experimentation.

<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>
These programs can be funded through taxation at the national level, and with less distortion under a larger tax base. ¹⁷⁹ Also, coverage for low income groups may be difficult to finance in states with	There may be less incentive to use this funding appropriately, if the localities spending these monies do not utilize their own funds for these programs. ["Medicaid Maximization"] ¹⁸¹

177. More specifically the Center for Medicaid and State Operations within the CMS.

178. Telephone interview with Peggy Clark, Bruce R. Johnson, Gerald Zelinger, staff members, and Donna Schmidt, director of the Div. of Benefits, Eligibility and Managed Care from the Family & Children's Health Programs Group, Centers for Medicare and Medicaid Services, Baltimore, Md. (Aug. 31, 2007) [hereinafter Staff Interview].

179. See EDGAR K. BROWNING & JACQUELENE M. BROWNING, PUBLIC FINANCE AND THE PRICE SYSTEM 331–33 (4th ed. 1994) (examining “labor supply distortion of the income tax” and welfare costs). Also, recall that prior to passage of the Medicaid Act in 1965, which was part of the “Great Society” legislation package of Lyndon B. Johnson, responsibility for low-income health care was traditionally placed on hospitals, counties, and states. However, these responsibilities put severe stresses on states and counties, and so Congress was lobbied for over thirty years to provide federal assistance for low-income medical services. See Kevin C. Fleming et al., *A Cultural and Economic History of Old Age in America*, 78 MAYO CLINIC PROCEEDINGS 914, 917 (2003), available at <http://www.mayoclinicproceedings.com/content/78/7/914.full.pdf+html?sid=3d6e3d3e-f90f-406e-a38b-f60f71b04b82> (“Hospitals increasingly bore the brunt of unpaid health expenses for older people, which came to be viewed as a threat to their existence.”). This history also demonstrates the relevance of the economy of scale for financing Medicaid.

180. This is because, with large proportions of low income groups, these states will have a smaller tax base on which to draw to fund this program.

181. “Medicaid maximization” is the “practice of implementing Medicaid policies designed to expand federal financing.” Teresa A. Coughlin & Stephen Zuckerman, *States' Strategies for*

high proportions of these groups. ¹⁸⁰	
Consistency of benefits: ensure that baseline services are provided. ¹⁸²	Some states may have less need for certain services. ¹⁸³ Local legislators can better assess when this is the case.
	May need to target individual regions of states, or a particular population. ¹⁸⁴ Again, local legislators can better assess when this is the case.
	Allows more experimentation in alternative approaches. ¹⁸⁵

Examining these, there are two principal effects relating to enactment: the economies of a larger tax base versus the diseconomies of specifying exactly which services, regions, and populations would be covered under a policy. The current process of enactment at both the federal and state levels enables Medicaid policy to benefit from both the tax economy of scale by allowing some funding of the programs at the federal level, and also from the flexibility of diseconomy by allowing states to tailor their programs to their needs. Enactment by individual states also permits state plans to serve as “laboratories of democracy.” However, this comparison also suggests that the federal financial support of state Medicaid programs should be designed in a manner to reduce the incidence of “Medicaid Maximization” behavior, and also to ensure the delivery of baseline services.

D. Implementation

After this legislation has been enacted, the principal task will then turn to the agencies for implementation. Implementing a Medicaid policy begins when a state agency seeks a health plan to provide coverage for beneficiaries in particular areas. As noted above, this can be done either by seeking competitive bids, or by setting rates for

Tapping Federal Revenues: Implications and Consequences of Medicaid Maximization, in FEDERALISM & HEALTH POLICY, *supra* note 72, at 145.

182. “[T]he current federal-state system of health insurance provides a base of . . . coverage to the neediest populations. The federal mandates regarding populations and services covered ensure that this base will remain in place.” Alan Weil et al., *Improving the Federal System of Health Care Coverage*, in FEDERALISM & HEALTH POLICY, *supra* note 72, at 399, 401.

183. See Staff Interview, *supra* note 178.

184. See ACTUARIES REPORT, *supra* note 174, at 12 (“[A] Medicaid risk program can be put in place statewide, or introduced as pilot programs set up in specific areas.”).

185. See ANDY SCHNEIDER, THE MEDICAID RESOURCE BOOK 132 (2002), available at <http://www.kff.org/medicaid/2236-index.cfm> [hereinafter YELLOW BOOK] (“States have developed innovative and unique responses to these myriad challenges . . .”).

provided services followed by selecting a plan or plans at those rates.¹⁸⁶ When utilizing a managed care plan, these rates are known as “capitation” rates. Capitation rates are a per-person (“per head”) fee that the health plan receives to provide services for the covered population. It is out of this payment that the plan itself must pay its own providers. This is in contrast to a “fee-for-services” approach, whereby a plan is paid for each service actually delivered.

The capitation rate approach shifts the risk of the cost of delivering health services to the health plan:¹⁸⁷ if participants demand health services of greater cost than covered by the capitation payments, then the health plan will lose money. This possibility provides an incentive for health plans to proactively manage the provision of health care for their participants, so that earlier, less-costly preventive care is encouraged to reduce the costs of later treatment.

After a health plan has been selected, additional negotiation is necessary to draft the contractual agreement between the state and the health plan.¹⁸⁸ This contract will specify exactly what services must be provided. It will also use terminology appropriate to the locality being served.¹⁸⁹

One aspect of this negotiation will be to determine which services should be “carved out” of the capitation payment.¹⁹⁰ As noted above, the risk for providing services for patients will be transferred to managed care plans. Sometimes these risks are extremely high, depending on what service is provided, such as mental health care or substance abuse programs. To reduce these risks for the plan, these services may be “carved out”, whereby the payment the plan receives for their provision is not through the capitation payment, but instead is done on a fee-for-service basis.

186. See *id.* at 139 (“Medicaid managed care takes two forms: primary care case management (PCCM) and managed care organizations (MCOs). Under the PCCM approach, providers are paid on a fee-for-service basis Under the MCO approach, beneficiaries are enrolled in an MCO that receives a monthly capitation payment from the state Medicaid agency”).

187. See Kaiser Commission on Medicaid and the Uninsured, *Medicaid and Managed Care* (1995), available at <http://www.kff.org/medicaid/2043-managed.cfm> (“The contractor assumes the financial risk of providing all of the medically necessary services under the contract (the contractor will often reinsure against the risk of high-cost cases).”).

188. For a sample contract, see MINN. DEP’T OF HUMAN SERV., 2009 FAMILIES AND CHILDREN CONTRACT FINAL MODEL (2009) [hereinafter MINNESOTA CONTRACT], available at http://www.dhs.state.mn.us/main/groups/healthcare/documents/pub/dhs_id_054907.pdf.

189. See Staff Interview, *supra* note 178.

190. See YELLOW BOOK, *supra* note 185, at 141, 165 (discussing that state agencies determine which services will be covered under the capitation plan).

Other factors arising during these contract negotiations include developing standards to assure the quality of care provided; determining methods for monitoring the plans to ensure that these standards are met; and developing database structures for services provided for participants.¹⁹¹ Focusing on the knowledge embedded in implementation staff, the following are economies and diseconomies of scale from implementing this health care policy:

<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>
	Less knowledge of plans to serve as contracting partners. This is significant in first finding plans, and then in working out details of the contract.
	Difference in local knowledge of providers, and their rates (essential for doing bids, setting contract rates)
Can have model contract, applicable to all states.	Difference in language of provided services, by locality. ¹⁹² Hence, model contract may not be appropriate depending on differential language.
	Determining what services will need to be “carved out” depends on knowledge of local beneficiary base, and operation of local health care provision.

Examining these, it is clear that there are significant diseconomies of scale for implementing a Medicaid plan. Local knowledge about plans and providers is essential in setting rates and negotiating the contract. It is also essential to ascertain when it is appropriate to carve out certain services. As a result, implementation of a Medicaid program at a state level seems clearly preferable.

E. Enforcement

After contracting with the managed care plan, the state agency then needs to enroll beneficiaries in the plan. To better enroll beneficiaries, the agency must educate them about the opportunities.¹⁹³ Once beneficiaries are enrolled in plans, there are additional steps of investigating the quality of care provided, and handling appeals.¹⁹⁴

191. See MINNESOTA CONTRACT, *supra* note 188 *passim* (providing a model contract).

192. Staff Interview, *supra* note 178.

193. See ACTUARIES REPORT, *supra* note 174, at 12–13 (“The state Medicaid agency and the health plans need to help both [providers and beneficiary communities] understand the benefits of applying managed care to the Medicaid program.”).

194. See State of Minn. Office of the Ombudsman for Mental Health and Developmental Disabilities, *Who’s Who in the Health Care System: A Resource Guide for Minnesotans* (2008),

The plans report data on service utilization by their enrollees.¹⁹⁵ This data is known as “encounter data.” The states then must process this data, and submit additional data to the federal government. This data is used to assess conformity of the state’s plan with federal requirements.¹⁹⁶ The federal government also conducts audits of both the state and their health plan partners, to ensure compliance with Title XIX.¹⁹⁷ Additionally, payments are processed based on this data.¹⁹⁸ These payments are made to providers, plans, and the states themselves, through the federal matching grant. One concern that may arise is with respect to “Medicaid Maximization.”¹⁹⁹

Furthermore, this encounter data is used to determine the sufficiency of the capitation payments to the plans.²⁰⁰ The capitation rates are based on a predicted level of service utilization by enrollees; however, the plans may end up serving populations requiring higher levels of services. Since federal legislation requires payments to plans to be “actuarially sound,” adjustments to capitation rates must be made based on actual use.²⁰¹ There is a cap to these adjustments, however: capitation payments cannot exceed the “upper payment limit” applied to a fee-for-service delivery of the same services.²⁰²

In this case, economies and diseconomies relate to economies of scope, data management, and knowledge:

available at <http://www.ombudmhdd.state.mn.us/who/default.htm> (discussing the grievance/complaint and appeals process). See also YELLOW BOOK, *supra* note 185, at 133 (“reviewing the quality of care in managed care organizations”).

195. See YELLOW BOOK, *supra* note 185, at 133.

196. Staff Interview, *supra* note 178.

197. See YELLOW BOOK, *supra* note 185, at 134–37 (discussing the federal and state responsibilities of the jointly administered Medicaid program).

198. See *id.* at 135, 142 (examining the systems for payment processing).

199. See *id.* at 134 (describing the “guaranteed tension” between states and the federal government).

200. Interview with George Hoffman and Shawn Welch, Staff Members, State of Minn. Dep’t of Human Serv. (August 14, 2007) [hereinafter Hoffman-Welch Interview].

201. *Id.* See also YELLOW BOOK, *supra* note 185 at 142 (“While there are no federal ‘public process’ requirements . . . the federal Medicaid statute does require that MCOs be paid on an ‘actuarially sound basis.’”).

202. See JOHN HOLAHAN ET AL., MEDICAID MANAGED CARE PAYMENT METHODS AND CAPITATION RATES: RESULTS OF A NATIONAL SURVEY 3 (1999), available at <http://www.urban.org/publications/309064.html> (“[S]tates contend that they are limited by the ‘upper payment limit’ which restricts their ability to pay more than fee-for-service expenditures for comparable populations.”). See also YELLOW BOOK, *supra* note 185, at 141–42 (“subject to the fee-for-service upper payment limit, which CMS has specified in regulation”).

<i>Economies of Scale</i>	<i>Diseconomies of Scale</i>
	Economies of scope in enrollment, and appeals: services already provided by other state agencies. ²⁰³ Also, more experience in working with particular groups.
There are some areas where data should be consistent across states. ²⁰⁴ Oversight of data is also needed to protect against Medicaid Maximization.	Encounter data suffers from similar problem as differences in contract language: records of data will have a different structure from state to state, as each locality adapts database to local conditions. ²⁰⁵
	Recognition of “red flags” indicating a need to investigate further to protect against possible fraud may depend on local knowledge. ²⁰⁶

As with implementation, there are again significant diseconomies of scale in enforcing a Medicaid policy. Enforcement here involves working with individual beneficiaries to enroll in these plans, and economies of scope apply to give a state agency an advantage over a federal one. Meanwhile, localized knowledge also helps in properly analyzing encounter data, and recognizing whether additional audits are necessary.

F. Summary

In the end, this federalism framework suggests that the current division of Medicaid policy takes advantage of existing economies and diseconomies of scale. The federal government’s role in Medicaid is one of providing financing and oversight to ensure states limit “Medicaid Maximization” behavior. While additional constraints should be applied to further reduce Medicaid Maximization behavior, it is appropriate that the locus of these constraints is at the federal level. Meanwhile, there are diseconomies of scale in specifying which populations are served and what services are provided; in negotiating with plans to provide these services; in enrolling individual

203. Hoffman-Welch Interview, *supra* note 200.

204. State Medicaid management information systems (MMIS) are required to meet certain federal requirements relating to compatibility with Medicare information, and giving information on “beneficiaries and paid claims.” YELLOW BOOK, *supra* note 185, at 144.

205. Staff Interview, *supra* note 178. See also YELLOW BOOK, *supra* note 185, at 131–32 (pointing out that although there are some consistencies, there remains a “lack of accurate, timely, and reliable Medicaid policy and program data at the national level”).

206. Hoffman-Welch Interview, *supra* note 200. See also YELLOW BOOK, *supra* note 185, at 143 (“States are required to operate a Medicaid fraud and abuse control unit”).

beneficiaries; and in collecting encounter data. These all suggest that the primary responsibility for implementing and enforcing Medicaid policy is properly placed with state governments. This example illustrates how this federalism framework can be used to allocate responsibility for enactment, implementation, and enforcement of a policy between the federal government and the states.

V. CONCLUSION

When it comes to federalism, many people agree with Lee Hamilton, former Congressman from Indiana and vice chairman of the 9/11 Commission,²⁰⁷ who wrote, “Early in my congressional career, I discovered a simple truth about our [federalist] governmental system: it’s confusing.”²⁰⁸ This Article attempts to make the daunting task of understanding federalism more manageable by separating our analysis into the individual institutions behind policy. It presents a framework that divides federalism analysis into components of enactment, implementation, and enforcement. This framework then provides the opportunity to consider how responsibility for different phases of an individual policy should be divided between federal and state governments. In making this assessment, economies of scale for these individual phases are compared with diseconomies of scale. The technique for performing this analysis is demonstrated with a comparison between environmental policies for endangered species and wetlands, and with an analysis of a health care policy.

Our comparison of environmental policies suggests that economies of scale in enactment mean that there is a clearer need for enacting protection of endangered species at a federal level. The interplay of both economies and diseconomies for implementation suggests that the principal federal role should be to establish baseline protections, while states should be responsible for establishing additional levels of protection and for data collection relevant to protecting species and wetlands. Finally, the presence of significant diseconomies of scale in enforcement suggests that primary responsibility for issuing both species and wetlands permits should lie with the states.

Furthermore, our analysis of the health care policy, Medicaid, suggests that the existing division of responsibility between federal and

207. For more on the 9/11 Commission, also known as the National Commission on Terrorist Attacks upon the United States, see <http://www.9-11commission.gov/> (discussing the commission, its history, and its duties).

208. Lee Hamilton, *Why Federalism Works* (2003), http://congress.indiana.edu/radio_commentaries/why_federalism_works.php.

state government is consistent with the relative importance of economies and diseconomies of scale. The primary federal roles of providing financial support and oversight for Medicaid correspond to the principal economies of scale in enactment. Meanwhile, the significant diseconomies of scale in implementation and enforcement lead to state control of contracting with health plans to serve Medicaid populations, enrolling beneficiaries, and collecting encounter data to properly set capitation payments.

These analyses of environmental and health care policies demonstrate that there are certain key considerations in analyzing economies and diseconomies of scale across institutions. For enactment, one must determine the economies and diseconomies related to the political effects of the distributions of benefits and costs, along with the ability to reduce social losses through increases in the tax base. For implementation, one should consider the benefits of establishing broad baselines, the collection of information and storage in databases, and the role of local knowledge in determining rules. And for enforcement, one again must recognize the significance of local information in applying rules, along with economies of scope that arise in staffing.

The analyses also provide guidance for legislatures and courts as they address issues of federalism. While some claim that delegation of federal power could be considered unconstitutional,²⁰⁹ this Article provides a positive political economic theory that can serve as a foundation for the constitutionality of federalist delegation. A legislature considering a new policy needs to determine the appropriate locus for the policy, across each of the enactment, implementation, and enforcement institutions. The legislature could start with a single policy analysis, as was done with health care, identifying economies and diseconomies of scale. If an existing policy has similar characteristics to the proposed policy, the legislature could leverage its understanding of the economies and diseconomies of the existing policy through a comparison of the proposed policy with the existing policy.

Where economies of scale are dominant, the appropriate locus would be at the federal level; while where diseconomies of scale are dominant, the appropriate locus would be at the state or local level. In instances where there are both significant economies and diseconomies, a structure involving both federal and state levels may be appropriate. Performing this analysis at each level would thereby permit the legislature to properly structure responsibility for enactment,

209. See Sarnoff, *supra* note 38, at 209 (“[T]he delegation of federal power to states poses more substantial accountability concerns.”).

implementation, and enforcement. In doing so, a federal legislature should recognize the need for federal oversight when it devolves responsibility for implementation or enforcement to state and local governments. It should also recall the requirements for properly structuring federal oversight to conform to the holding in *New York v. United States*.²¹⁰

One implication of this framework is to provide a criterion for determining when federal preemption would be appropriate. When economies of scale are significantly larger than diseconomies of scale for each of the enactment, implementation, and enforcement institutions, it will be more efficient to carry out policy at the national level, and hence, federal law should preempt state law. Thus, if economies of scale in regulating medical devices were clearly larger than diseconomies of scale, it would be appropriate for federal law to preempt state tort claims, as the court held in *Riegel v. Medtronic*.

Courts can also utilize this framework to provide some limit to federal power. As seen in the analyses performed above, the framework does not always provide a bright-line classification for the appropriate locus of policies. Nonetheless, a limit to federal power may be drawn when the policy considered involves relatively minimal economies of scale. For wetlands, while there were significant economies of scale for wetlands that are part of a multi-state hydrogeological system, there were only minimal economies of scale for wetlands affecting systems completely contained in one state. As a result, a case like *Rapanos* could be decided on federalism grounds using this framework, where the court could distinguish constitutional federal action to protect wetlands that are part of multistate systems, from unconstitutional federal action to protect wetlands that are part of only local systems.²¹¹ Thus, the federalism framework presented here provides a comprehensive and yet comprehensible mechanism for legislatures and courts to structure the responsibility for enacting, implementing, and enforcing policies to take advantage of economies and diseconomies of scale, thereby enabling the achievement of these policies at the lowest cost.

210. See *supra* text accompanying notes 40–45 (discussing *New York v. United States*).

211. Recall, however, that the interconnectedness of most hydro-geological systems means that there would be relatively few wetlands that would fit in the latter category.