

# Forces of Federalism, Safety Nets, and Waivers

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*Inequality is the defining feature of our times. Many argue that it calls for a policy response, yet the most obvious policy responses require legislative action. And if inequality is the defining feature of our times, partisan acrimony and gridlock are the defining features of the legislature. That being so, it is worth considering what role administrative agencies, and administrative law, might play in ameliorating or exacerbating economic inequality. Here, I focus on American safety net programs, many of which are joint operations between federal administrative agencies and state governments. In this context, a central mode of bureaucratic policy innovation comes in the form of administrative waivers, whereby a federal administrative agency waives some statutory requirement that is otherwise binding on state administrators. For example, the Centers for Medicare and Medicaid Services recently granted waivers to allow several states to impose various “personal responsibility” requirements on Medicaid beneficiaries.*

*Faced with a choice between legislative inactivity and policy innovation through waivers, many scholars and policymakers of both parties have tended to favor waivers. The appeal of waivers as a path around legislative gridlock is compelling. However, I argue that this view has neglected the federal structure of American safety net programs, and does not account for the state politics of implementation. Moreover, scholars have not focused on the severe information problems that federal agencies face when issuing waivers; a permissive waiver regime exacerbates these problems. Focusing on Medicaid implementation, I highlight the risks of waivers for American*

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*safety net programs. Before concluding, I discuss possible reforms to administrative procedures, and offer a case study of litigation surrounding one recent waiver application. The case study illustrates many of the theoretical arguments, and further demonstrates the failure of judicial review; it indicates how review might be adjusted to promote more effective use of waivers and diminish their perils.*

## INTRODUCTION

Inequality is the defining feature of our times. Many argue that it calls for a policy response,<sup>1</sup> yet the most obvious policy responses require legislative action. And if inequality is the defining feature of our times, partisan acrimony and gridlock are the defining features of the United States legislature. Congressional productivity is at an all-time low, and the trend, moreover, is toward even less lawmaking. One consequence of this development is that any sort of large-scale scheme affecting inequality that requires statutory revisions is likely to meet its death in a congressional committee; or if not there, on the floor of one house or the other; or if not there, by the veto pen.<sup>2</sup> A corollary of this point is that the moving joints of policymaking, it is increasingly clear, fall predominately at the administrative and state levels. That being so, it is worth examining efforts to reduce or resist increases in inequality at the administrative and state levels.

In this Article, I focus on American safety net programs, many of which represent joint operations between federal agencies and state governments.<sup>3</sup>

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- 1 For example, virtually any important tax reform would require the participation of Congress. For one such thoughtful reform proposal, see, for example, James Kwak, *Reducing Inequality with a Retrospective Tax on Capital*, 25 CORNELL J.L. & PUB. POL'Y 191 (2015) (proposing a capital tax based on historical values, and collecting references for related proposals).
  - 2 For a classic article on legislative gridlock, see Sarah A. Binder, *The Dynamics of Legislative Gridlock, 1947-96*, 93 AM. POL. SCI. REV. 519 (1999).
  - 3 Much of the rise in inequality comes from explosive growth at the top of the distribution, e.g., Anthony Atkinson et al., *Income Inequality in the Long Run*, 49 J. ECON. LIT. 3 (2011), and efforts to study the causes and consequences of inequality will therefore naturally need to pay close attention to what happens on the right tail of the distribution. However, even as the top of the distribution tells much of the story in the rise of economic inequality, it is morally important also to address the left tail of the distribution and those most adversely affected by the forces driving inequality. Safety net programs relate to just this segment of the population.

Medicaid is one such critical safety net program: it is a healthcare program for lower-income individuals that has been shown to yield gains to beneficiaries in terms of reduced mortality, as well as increased education, income, and intergenerational mobility.<sup>4</sup> Reflecting its centrality, the program has indeed been the subject of much recent litigation and political warfare.<sup>5</sup>

Within this context, a focal point of the agency-state interaction, and the topic of extensive academic commentary, is the waiver application. A waiver provision in a statute allows an implementing agency to “waive” certain otherwise binding statutory provisions. In the Medicaid context, for example, the relevant agency — Centers for Medicare and Medicaid Services (CMS) — has granted waivers to states that allow them to use federal funds to purchase private insurance (the “private option”) and to impose various “personal responsibility” requirements on beneficiaries.<sup>6</sup> Without a waiver, the states could not have formed these policies and maintained their federal funding. Waivers introduce discretion into the administrative process, and might, in principle, be used either to enlarge or restrict federal safety net programs. For instance, aside from allowing states to impose personal responsibility requirements on beneficiaries, they also helped the rise of Health Maintenance Organizations (HMOs) in the 1990s,<sup>7</sup> and in the early 2000s they played an important role in launching Massachusetts’s universal healthcare program.<sup>8</sup>

Largely as a result of this potential for policy innovation amid a gridlocked Congress, waivers have attracted adherents from all sides of the political spectrum. President Clinton encouraged states to apply for waivers, particularly

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4 See David W. Brown et al., *Medicaid as an Investment in Children: What Is the Long-Term Impact on Tax Receipts?* (NBER, Working Paper No. 20835, 2015); Rourke O’Brien & Cassandra L. Robertson, *Medicaid and Intergenerational Economic Mobility* (2015) (unpublished manuscript).

5 See, e.g., *Nat’l Fed’n of Indep. Bus. v. Sebelius*, 567 U.S. 1 (2012).

6 JANE B. WISHNER ET AL., ROBERT WOOD JOHNSON FOUND. & URBAN INST., *MEDICAID EXPANSION, THE PRIVATE OPTION, AND PERSONAL RESPONSIBILITY REQUIREMENTS: THE USE OF SECTION 1115 WAIVERS TO IMPLEMENT MEDICAID EXPANSION UNDER THE ACA* (2015), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/2000235-Medicaid-Expansion-The-Private-Option-and-Personal-Responsibility-Requirements.pdf>.

7 See, e.g., Sidney D. Watson, *Out of the Black Box and into the Light: Using Section 1115 Waivers to Implement the Affordable Care Act’s Medicaid Expansion*, 15 *YALE J. HEALTH POL’Y L. & ETHICS* 213 (2015).

8 See, e.g., Abbe R. Gluck, *Our [National] Federalism*, 123 *YALE L.J.* 1996, 2005 (2013); Frank J. Thompson & Courtney Burke, *Executive Federalism and Medicaid Demonstration Waivers: Implications for Policy and Democratic Process*, 32 *J. HEALTH POL.* 971 (2007).

after his healthcare overhaul failed in Congress; President G.W. Bush also pressed waivers; and much the same can be said of President Obama.<sup>9</sup> Particularly lately, legal scholars have likewise advocated the merits of waivers. An influential article by David Barron and Todd Rakoff applauds the rise of waivers, in large part because they open the door to policy innovation.<sup>10</sup> Jonathan Adler, similarly, advocates their use in the environmental context;<sup>11</sup> in like spirit, Samuel Bagenstos argues, on balance, for waivers in healthcare and other policy areas;<sup>12</sup> noting an ineffective Congress, Jessica Bulman-Pozen sees a good case for waivers and other forms of executive federalism;<sup>13</sup> and at least in this polarized world, Gillian Metzger concurs in observing that waivers facilitate policy movement and bipartisan cooperation.<sup>14</sup> These scholars offer thoughtful and balanced views on waivers, but if our concern is inequality and the viability of safety net programs, this Article contends that the literature gives insufficient respect to two points.<sup>15</sup>

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- 9 See, e.g., Samuel R. Bagenstos, *Federalism by Waiver After the Health Care Case*, in *THE HEALTH CARE CASE: THE SUPREME COURT'S DECISION AND ITS IMPLICATIONS* 227 (Gillian Metzger, Trevor Morrison & Nathaniel Persily eds., 2013).
- 10 David J. Barron & Todd D. Rakoff, *In Defense of Big Waiver*, 113 COLUM. L. REV. 265 (2013).
- 11 Jonathan H. Adler, *Letting Fifty Flowers Bloom: Using Federalism to Spur Environmental Innovation*, in *THE JURISDYNAMICS OF ENVIRONMENTAL PROTECTION: CHANGE AND THE PRAGMATIC VOICE IN ENVIRONMENTAL LAW* 263 (J. Chen ed., 2004).
- 12 Bagenstos, *supra* note 9.
- 13 Jessica Bulman-Pozen, *Executive Federalism Comes to America*, 102 VA. L. REV. 953 (2016) (“[T]aking politics into account, there is a strong case for state-differentiated federal policy as compared to the alternatives that emerge from a polarized Congress.”).
- 14 Gillian Metzger, *Agencies, Polarization, and the States*, 115 COLUM. L. REV. 1739 (2015).
- 15 The spirit of these points follows Barry Friedman, *Valuing Federalism*, 82 MINN. L. REV. 317 (1997). Metzger notes a rupture between judicial doctrine in federalism and what we know about decentralization and centralization from social science. See Metzger, *supra* note 14. I also note that others have expressed caution about waivers in the past. See, e.g., Jacob S. Hacker, *Privatizing Risk Without Privatizing the Welfare State: The Hidden Politics of Social Policy Retrenchment in the United States*, 98 AM. POL. SCI. REV. 243 (2004) (“[T]he joint federal-state structure of the program . . . has facilitated cutbacks by fostering interstate competitive pressures in favor of budgetary stringency, while making cutbacks more difficult to identify and assign responsibility for.”). However, this type of consideration is all but absent from the more recent legal literature on waivers; hence this Article.

The first is that waivers represent a form of managed devolution, and that forces that operate at the level of state implementation *generally*, even if not *uniformly*, move toward retrenchment. Scholars have long been concerned that jurisdictional competition places downward pressure on benefits levels, as states fear that overly generous benefits will attract beneficiaries from nearby states.<sup>16</sup> Moreover, a common view is that it is more difficult for states to implement counter-cyclical policies;<sup>17</sup> budgets are most pressed during economic downturns, precisely when safety nets have the most importance, and least pressed during times of economic expansion, precisely when safety nets have the least importance. To the extent that this form of managed devolution sensitizes safety net programs to any of these dynamics, it undermines the core purpose of safety nets and threatens increases in inequality. These forces are well known, but they have largely been ignored by the recent waiver literature, which focuses on the possibility of policy innovation rather than the nature of any such innovations.<sup>18</sup>

A second dimension of these waiver-facilitated programs is less well known — but it is at least equally important. Although the bureaucrats working at the agency level have expertise in their policy areas, they also face severe information problems with respect to state waiver applications. States, of course, tend to couch their applications in public-regarding terms that advance the purposes of the statutory scheme: the waiver request represents an “experiment” in healthcare delivery, or an “innovation,” or it is “necessary” to implement the policy under prevailing state economic or political conditions.<sup>19</sup> Yet it is difficult to know what motivates the state’s waiver. The waiver may or may not be “necessary,” for example; such a determination that depends on detailed knowledge of local conditions. A permissive posture on waivers is likely to

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16 See, e.g., PAUL E. PETERSON, *THE PRICE OF FEDERALISM* (1995). One might also be concerned that, even absent this migration-related fear, states with conservative governors may seek waivers to reduce benefits or eligibility as a way to “show” their ideological *bona fides* to a voting public with incomplete information. The fact that Governor John Kasich expanded Medicaid in Ohio under the Affordable Care Act, without a waiver, but is considering seeking a waiver to reduce eligibility now that he is running for president, lends some plausibility to this concern. Either way, the result is similar: a form of competition among states driving down benefits levels.

17 For recent evidence, see GLENN FOLLETTE & BYRON LUTZ, *FISCAL POLICY IN THE UNITED STATES: AUTOMATIC STABILIZERS, DISCRETIONARY FISCAL POLICY ACTIONS, AND THE ECONOMY* (2010), <http://www.federalreserve.gov/Pubs/FEDS/2010/201043/201043pap.pdf>.

18 See *supra* notes 9-14.

19 See *infra* Parts III-IV.

exacerbate the tendency of states to falsely represent their motivations for pursuing a waiver, which may in truth have ideological, partisan, or electoral roots. Particularly when combined with the structural forces, above, that place downward pressure on benefits, this informational problem colors our understanding of how waivers operate and, insofar as one is concerned by economic inequality, encourages skepticism of the administrative tool.<sup>20</sup>

These concerns have not to my knowledge entered the recent waiver debate, but it is clear that — admitting that waivers introduce the possibility of innovation — we might not necessarily applaud all forms of “innovation.” This is particularly true where, as in most theories of federal policy implementation, the direction of the innovation is generally predictable, and where the flexibility that makes room for innovation also weakens the bargaining position of the federal government.<sup>21</sup> Indeed, such downward forces plausibly prompted the need for federally assisted safety net programs in the first instance — local and state efforts proved inadequate absent the presence of federal funding and statutory standards.<sup>22</sup> I stress that these points should be understood as articulating a theoretical and institutional basis for concern, and not necessarily as factual descriptions of the prevailing waiver regime. A major motivation for this Article, that is, is to conceive of waivers as an enduring institution and to try to understand the long-run forces at play, with implications for inequality. This perspective suggests that waivers should not be cheered, but rather eyed with suspicion.

Before closing, I consider how agencies and the courts might respond to these institutional forces, with the twin goals of ensuring flexibility and safeguarding statutory objectives. I do so in part through a case study of litigation surrounding a recent Medicaid waiver for Arizona. This case study vividly illustrates the information problems that agencies face and largely represents a story of failure at levels of both the agency and the court; it shows how neither agencies nor courts can be trusted, without more being done, to ward off unmeritorious waiver requests. In the main, I argue for greater formality in the procedures required to receive a waiver, and for more searching review of the resulting record. At least in the Medicaid context, the Patient Protections and Affordable Care Act (ACA)<sup>23</sup>

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20 See *infra* Sections III.A, IV.B; *infra* Appendix.

21 See *infra* Part II.

22 SHANNA ROSE, *FINANCING MEDICAID: FEDERALISM AND THE GROWTH OF AMERICA'S HEALTH CARE SAFETY NET* (2013).

23 Patient Protections and Affordable Care Act, Pub. Law No. 111-148, 124 Stat. 119 (2010).

took positive steps in this regard, but even here procedural reform remains incomplete.<sup>24</sup>

This Article proceeds as follows. First, using Medicaid as the running example, I discuss in Part I the legal status of waivers, their use over time, and the current perspectives of the literature. In Part II, I present a main concern with the prevailing view: that it ignores the politics of state implementation, and that various forces have a predictable effect on policies. In Part III, I present an argument about how information problems infect state-agency bargaining in the context of various waiver regimes; I include a more formal representation of this argument in the Appendix. In Part IV, I discuss the role of administrative procedures and judicial review in managing waivers. My conclusions follow.

## I. WAIVERS

Waiver authority is delegated from Congress to administrative agencies in the manner of any other delegation of authority. What is different about waivers is that they delegate to agencies the authority to waive or remove, at least temporarily, otherwise binding statutory provisions. Congress has included waiver provisions in statutes at least since the 1960s,<sup>25</sup> and agencies have used them intensively since the G.H.W. Bush administration.<sup>26</sup> Subsequent presidential administrations have routinely employed waivers to give states flexibility in cooperative federal programs and advance policy objectives in the face of congressional gridlock. Indeed, as others have suggested, this timing is likely not coincidental: the fact of congressional gridlock and the increasing use of waivers likely run together.<sup>27</sup>

The scholarly literature on waivers tends to defend them. Scholars acknowledge that this sort of “negative” delegation is unusual, and therefore worthy of consideration, but then tend largely to conclude that, though negative,

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24 *See infra* Section IV.A.

25 As discussed below, perhaps the most common form of waiver — Section 1115 waivers — arrived in the Social Security Act of 1962, Pub. L. No. 87-543, 76 Stat. 172 (1962), and therefore predates Medicaid.

26 DAVID G. SMITH & JUDITH D. MOORE, *MEDICAID POLITICS AND POLICY: 1965-2007*, at 281 (2009).

27 *See, e.g.*, Saundra K. Schneider, *Medicaid Section 1115 Waivers: Shifting Health Care Reform to the States*, 27 *PUBLIUS: J. FEDERALISM* 89 (1997) (noting the turn to Medicaid waivers in the aftermath of President Clinton’s failed healthcare overhaul).



it should be regarded like any other type of delegation by Congress to agencies.<sup>28</sup> Perhaps the most fertile legal consideration invoked in recent debates involves various forms of hypothetical “conditional” waivers, whereby the agency waives some statutory requirement conditional on a state taking some other putatively voluntary action.<sup>29</sup> This form of conditional waiver may be unconstitutional if, for example, the condition is unrelated to the purposes of the federal program in question. However, it is not entirely clear why unconstitutional conditions relate uniquely to waivers rather than to delegations of discretionary authority more generally. Presumably such conditions might attach in relation either to the discretionary imposition of a requirement — do X or we do Y — or the discretionary waiver of a requirement — do X and we undo Y.<sup>30</sup>

Perhaps as a result of this basic equivalence, most of the criticism of waivers comes in various forms of policy or value-based concerns. For instance, some fear that the federal government might abuse waiver authority to the detriment of state autonomy or other rule of law values.<sup>31</sup> However, again, it is not entirely clear that this concern is specific to waivers; much the same might be said of the exercise of any discretionary authority, whether positive, as is usually the case, or negative, as is the case for waivers. More uniquely related to waivers, others express concern that waivers will allow agencies, over time, to “disappear” a statute.<sup>32</sup> Although statutes often place limits on the substantive and temporal scope of agencies’ waiver authority, agencies may undermine these limits by, for example, repeatedly granting

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28 David J. Baron & Todd D. Rakoff, *In Defense of Big Waiver*, 113 COLUM. L. REV. 265 (2013); Zachary S. Price, *Seeking Baselines for Negative Authority: Constitutional and Rule-of-Law Arguments Over Nonenforcement and Waiver*, 8 J. LEGAL ANAL. 235 (2016); Daniel T. Deacon, *Administrative Forbearance*, 125 YALE L.J. 1548 (2016).

29 Derek W. Black, *Federalizing Education by Waiver*, 68 VAND. L. REV. 607 (2015); Price, *supra* note 28.

30 Of course, to the extent that one argues that agencies should not have any discretionary authority, this would equally affect both positive and negative types of actions; my point is that one must seemingly attack that rather larger issue to come out against waivers.

31 See, e.g., Bagenstos, *supra* note 9 (summarizing policy concerns on the right and left about waivers); Richard A. Epstein, *The Perilous Position of the Rule of Law and the Administrative State*, 36 HARV. J.L. & PUB. POL’Y 5 (2013).

32 Jonathan R. Bolton, *The Case of the Disappearing Statute: A Legal and Policy Critique of the Use of Section 1115 Waivers to Restructure the Medicaid Program*, 37 COLUM. J.L. & SOC. PROBS. 91 (2004).



extensions of waivers.<sup>33</sup> At least in the limit, this is undoubtedly a serious concern regarding waivers.

Though not dismissing such policy-based concerns, most observers evaluate waivers against the backdrop of crippling legislative gridlock. In this context, waivers seem a welcome relief: they permit play in the policymaking joints, allowing states and administrative agencies to tailor and adapt policy to changing circumstances. On this comparative basis, many scholars defend, even if not quite cheer, the rise of waivers as a method of policymaking. Perhaps most prominently, in an article aptly titled *In Defense of Big Waivers*, Barron and Rakoff argue that waivers represent “an institutional innovation that makes possible lawmaking for the sake of the general welfare that would simply be impossible or impracticable otherwise.”<sup>34</sup> Bagenstos, similarly, recognizes the common critiques of waivers, but concludes on balance with a relatively “optimistic view of federalism by waiver.”<sup>35</sup> At least given congressional gridlock, Bulman-Pozen, likewise, argues the “affirmative case for executive federalism,” that is, waiver-like activity, in part because it “offers new routes to bipartisan compromise and negotiation that seem out of reach of Congress.”<sup>36</sup>

As a window into this debate, I focus on Medicaid implementation for most of this Article. Consistent with the view that waivers permit play in the policymaking joints, they have facilitated a range of programmatic policy innovations over the years in this area. During the 1990s, for example, many states received waivers allowing them to use federal funds for managed care programs.<sup>37</sup> Even more programmatically, Massachusetts’s universal healthcare plan — the model for the ACA — emerged in important part through waivers that permitted the state to apply funds to broader categories of the population, and to shift funds between programs.<sup>38</sup> However, waivers have also been used in ways that arguably undermine beneficiaries, imposing cost-sharing

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33 For example, Arkansas, which received a waiver for Medicaid expansion in 2014, is preparing to apply for an extension of its waiver. See State of Ark., Waiver Extension Application (2017) (on file with author).

34 Barron & Rakoff, *supra* note 10, at 340.

35 Bagenstos, *supra* note 9, at 9.

36 Bulman-Pozen, *supra* note 13, at 33-34; see also Jessica Bulman-Pozen, *From Sovereignty and Process to Administration and Politics: The Afterlife of American Federalism*, 123 *YALE L.J.* 1920, 1945 (2014) (“Especially compared to unilateral executive action, big waiver to states fosters transparency, accountability, and political debate . . . .”); Metzger, *supra* note 14, at 1744 (arguing that waivers and other state-agency partnerships can “open[] up opportunities for bipartisanship”).

37 Smith & Moore, *supra* note 26, at 266-71.

38 See, e.g., ALISON MITCHELL, CONG. RESEARCH SERV. RL42865, MEDICAID DISPROPORTIONATE SHARE HOSPITAL PAYMENTS (2013).

requirements, for example, that have been shown to discourage lower-income individuals from participating in the healthcare program.<sup>39</sup> Thus, even as waivers open the door to beneficial compromises and experimentalism, they also invite ideological program retrenchment and cost containment.<sup>40</sup> Moreover, these retrenchments often come in the “guise” of experimentalism and welcomed policy innovation,<sup>41</sup> a feature of waivers discussed in detail below.<sup>42</sup>

Perhaps the most prominent recent example of waivers involves the ACA, a running example for this Article.<sup>43</sup> As a result of the Court’s *NFIB* decision,<sup>44</sup> the ACA’s Medicaid expansion provisions — which would expand Medicaid eligibility up to 138% of the federal poverty level — did not apply unless the state agreed to it. As originally written, the expansion would be folded into existing Medicaid programs, and states’ choice would be either to accept the expansion, or to withdraw from the Medicaid program in its entirety; the Court’s decision permits states discretion with respect to the expansion itself. Along with the decision over whether to set up a state-based exchange, this expansion decision represents one of the main areas of state discretion with respect to the ACA. This means that it was also one of the main areas over which state leaders could demonstrate acquiescence or defiance to the ACA, and by extension to President Obama, endowing the decision with a great deal of political importance, particularly among Republicans.

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39 See, e.g., WISHNER ET AL., *supra* note 6.

40 For a similar observation of this trend, though in the context of AFDC, see PETERSON, *supra* note 16, at 109 (noting that though opportunities to experiment may “seem[] in principle to allow for experimentation in either a more liberal or a more restrictive direction, the proposals for waiver of federal requirements approved by the Department of Health and Human Services have almost always had a conservative cast”).

41 Susan Bennett & Kathleen A. Sullivan, *Disentitling the Poor: Waivers and Welfare “Reform,”* 26 U. MICH. J.L. REFORM 741, 745 (1993) (“[A]spects of some of the state [welfare] reform projects appear merely to be attempts to reduce benefits under the guise of experimentation.”).

42 For a powerful criticism of “democratic experimentalism,” see David A. Super, *Laboratories of Destitution: Democratic Experimentalism and the Failure of Antipoverty Law*, 157 U. PA. L. REV. 541 (2008).

43 Section 10201(i) of the ACA imposed some new procedural requirements waivers, such that they now must be more transparent and undergo a process resembling notice and comment. This procedural reform responds to a consistent criticism that waiver negotiations between states and federal bureaucrats take place under opaque conditions, with little input from the would-be beneficiaries. Patient Protections and Affordable Care Act, Pub. Law No. 111-148, 124 Stat. 119, § 1020(i) (2010).

44 *Nat’l Fed’n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012).

The decision to expand follows predictable partisan contours. To date, thirty-one states have decided to adopt the ACA's Medicaid expansion.<sup>45</sup> The mean 2008 Obama vote share in these states was 55.3 percentage points, and most of these states — twenty-three of them — had a majority of the population supporting Obama in the election. By comparison, the mean 2008 Obama vote share in the states that have decided not to expand was 44.5 percentage points, and majorities in nearly all of these states — fifteen of nineteen — sided with Senator McCain in the 2008 election.<sup>46</sup>

Of the thirty-one states that have elected to expand Medicaid, seven did so only after the CMS gave them a waiver.<sup>47</sup> These waivers have tended to make the Medicaid program more palatable to conservative constituents in two primary ways. The first involves using Medicaid funding to allow beneficiaries to buy private insurance on the state's exchange — the so-called “private option.” The second involves imposing a set of “personal responsibility” requirements on beneficiaries: for example, premium-like payments, including controversially a lockout period in the event of nonpayment, cost-sharing provisions, or mandatory contributions to health savings accounts.<sup>48</sup> The CMS has also rejected a number of highly controversial waiver applications, most notably proposals by Indiana and Pennsylvania to tie Medicaid benefits to whether the beneficiary was working or searching for work.<sup>49</sup> I consider the legal dimension of such waivers toward the end of the Article, but for now note that the standard view is that waivers created enough space between the leaders of the implementing state and the ACA to make Medicaid expansion acceptable for a range of states. Of course, whether they would have expanded in any event is a critical question, interrogated later in this Article.<sup>50</sup>

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45 As of September 1, 2015. See *Status of State Action on the Medicaid Expansion Decision*, HENRY J. KAISER FAMILY FOUND. (Sept. 14, 2015), <http://kff.org/health-reform/state-indicator/state-activity-around-expanding-medicaid-under-the-affordable-care-act/#>.

46 *Id.*

47 *Id.*

48 WISHNER ET AL., *supra* note 6.

49 *Id.*

50 The states that have expanded through waiver tend ideologically to be somewhere between those that unconditionally expand and those that unconditionally decline to expand. The mean 2008 Obama vote share in these waiver states is 50.8 percentage points, almost six percentage points higher than the corresponding figure for those that have declined to expand, and almost six percentage points lower than the corresponding figure for those that unconditionally expanded. For states' expansion status, see *supra* note 45 and accompanying text; for Obama vote shares, see, for example, *Federal Elections 2008*, FED. ELECTION COMM'N,

## II. STATE POLITICS AND SAFETY NET IMPLEMENTATION

Although the flexibility afforded by waivers might, in principle, lead to either more liberal or more conservative policies, I argue that, in general, flexibility conjoined with the forces of state politics leads to a predictable conservative trend in policy implementation. A number of factors make it likely that states will seek waivers that reduce benefits in various ways.

### A. Jurisdictional Competition

The longstanding concern among those who study welfare provision in the United States is that competition between states will depress benefit levels.<sup>51</sup> The logic of this theory of jurisdictional competition is simple and compelling: more generous benefits attract more beneficiaries, resulting in tax burdens that eventually induce capital and labor flight and undermine the state economy. Seeking to avoid this outcome, states engage in a “race to the bottom,” undercutting benefits relative to other states.

Let us be clear that the empirical support for this theory is mixed. As a preliminary matter, it is not clear that the migratory mechanism operates as suggested. Much evidence suggests that inter-state migration is relatively infrequent, and that when people move they think primarily of employment and housing opportunities rather than benefits levels.<sup>52</sup> Supporting this idea, a recent study found that the Medicaid expansion states did not experience high in-migration relative to states that did not expand Medicaid — this despite massive differences in benefits between the two sets of states.<sup>53</sup> Indeed, the fact that a major policy concern is benefit take-up — that is, subscribing to benefits within *current* jurisdictions — further substantiates the idea that the migratory patterns of the relevant population may be fairly insensitive to benefits levels.<sup>54</sup> The proposed mechanism, therefore, is somewhat dubious.

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<http://www.fec.gov/pubrec/fe2008/federalelections2008.shtml> (last visited Jan. 10, 2017).

51 See, e.g., PETERSON, *supra* note 16.

52 Robert E.B. Lucas, *Internal Migration in Developed Countries*, in HANDBOOK OF POPULATION AND FAMILY ECONOMICS 647 (Mark R. Rosenzweig & Oded Stark eds., 1997).

53 Aaron L. Schwartz & Benjamin D. Sommers, *Moving for Medicaid? Recent Eligibility Expansions Did Not Induce Migration from Other States*, 33 HEALTH AFF. 88 (2014); see also Jonah B. Gelbach, *Migration, the Life Cycle, and State Benefits: How Low Is the Bottom?*, 112 J. POL. ECON. 1091 (2004).

54 Anna Aizer, *Low Take-Up in Medicaid: Does Outreach Matter and for Whom?*, 93 AM. ECON. REV. 238 (2003).

Studies of policy outcomes also introduce doubt. The typical approach to studying the race to the bottom hypothesis is to examine the sensitivity of benefits levels of a given state to the benefits levels of surrounding states, usually lagged by some interval. Some studies find evidence of such sensitivity,<sup>55</sup> but others do not.<sup>56</sup> This inconsistent pattern may be owing to differences in the programs studied, or to the challenge of selecting the correct policy lag, or to differences in the timing of the studies. In any event, the conclusion that does emerge from this literature is that there is no strong and consistent evidence that states are sensitive to safety net policies of neighboring states.

Notwithstanding the generally mixed evidence, it is impossible to deny that some features of states' policies appear to have been designed to forestall in-migration. For example, California restricted welfare benefits for new migrants. The plain purpose of this provision was to discourage those who would move to generous states, such as California, for the welfare benefits — or give the appearance of attempting to do so. The Supreme Court later invalidated this policy as a violation of the right to travel in *Saenz v. Roe*.<sup>57</sup>

One explanation for the structure of such policies is that politicians are extremely sensitive to the charge that they have opened the door to the state becoming a so-called welfare magnet. That is, even if in-migration is fundamentally not a concern, due for example to frictions of residential mobility, and is unlikely to notably increase tax burdens or result in capital or labor flight, even modest levels of in-migration may have important political consequences. The political opposition may, for instance, express increases in the welfare population in percentage terms, or in terms of the number of additional dollars spent in aggregate, a number that is sure to sound large to voters, even if it is small as a fraction of government revenue. So framed, it is possible that the political consequences of safety net programs outstrip their fiscal consequences, leading in any event to much the same outcome — seeming fears of in-migration and a diminution of the safety net.

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55 See, e.g., Michael A. Bailey & Mark Carl Rom, *A Wider Race? Interstate Competition Across Health and Welfare Programs*, 66 J. POL. 326 (2004).

56 See, e.g., William D. Berry et al., *Reassessing the "Race to the Bottom" in State Welfare Policy*, 65 J. POL. 327 (2003); Frank H. Buckley & Margaret F. Brinig, *Welfare Magnets: The Race for the Top*, 5 SUP. CT. ECON. REV. 141 (1997); Craig Volden, *The Politics of Competitive Federalism: A Race to the Bottom in Welfare Benefits?*, 46 AM. J. POL. SCI. 352 (2002); Thomas Gais & R. Kent Weaver, *State Policy Choices Under Welfare Reform* (Brookings Policy Brief No. 21, 2002).

57 *Saenz v. Roe*, 526 U.S. 489 (1999).

## B. State Budget Pressures

A second way in which state political forces may undermine safety net programs through waiver relates to budget pressures. It is plain that safety nets have the most use in economic downturns, as people lose jobs or otherwise experience reduced incomes.<sup>58</sup> But these same forces naturally also work against state budget health in two ways: the decline in economic activity reduces state tax revenue, and state programs — safety net programs in particular — experience higher demand. So the states face the strongest budget pressure to control spending and decrease services at precisely the time that safety nets have the most value in blunting poverty and inequality.

All governments face this basic problem, but the issue is particularly acute for state governments. Part of the problem for states plausibly relates to the issue above — a limited ability to tax residents due to concerns of jurisdictional competition. A dramatic increase in taxes designed to accommodate an expansion of social services may, over time, induce flight to other states with lower tax burdens. However, state governments also arguably face at least three further related problems that the federal government does not. First, as non-issuers, states cannot adapt monetary policy to changing economic conditions. Second, most states have restrictions on governments' spending or revenue-raising ability,<sup>59</sup> and much the same is true of their ability to borrow.<sup>60</sup> Such provisions likely constrain the ability of governments to expand social services in times of economic downturn. Third, even absent these legal considerations, states face higher borrowing costs than the federal government.<sup>61</sup> Higher borrowing

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58 Micah Hartman et al., *National Health Spending in 2011: Overall Growth Remains Low, But Some Payers and Services Show Signs of Acceleration*, 32 HEALTH AFF. 87 (2013).

59 A 2010 survey by the National Conference of State Legislatures found that four states had revenue restrictions, twenty-three had spending restrictions, and three had some combination of the two types of restrictions. Over half of these restrictions are constitutional rather than statutory. See *State Tax and Expenditure Limits — 2010*, NAT'L CONFERENCE OF STATE LEGISLATION, <http://www.ncsl.org/research/fiscal-policy/state-tax-and-expenditure-limits-2010.aspx> (last visited July 28, 2016).

60 JAMES M. POTERBA & KIM S. RUEBEN, PUB. POL'Y INST. OF CA., FISCAL RULES AND STATE BORROWING COSTS: EVIDENCE FROM CALIFORNIA AND OTHER STATES (1999).

61 For instance, in March 2013, California issued ten-year bonds at a yield of 2.56%, whereas the U.S. Treasury issued ten-year bonds at a yield of 1.96%. *Long-Term Government Bond Yields: 10-year: Main (Including Benchmark) for the United States*, FRED ECON. DATA, <https://research.stlouisfed.org/fred2/series/IRLTLT01USM156N> (last visited July 28, 2016). This difference reflects investors' judgments about the credit worthiness of the different government actors.



costs, likewise, make it more difficult for state governments to implement effective counter-cyclical policies.

Supporting this view, states' policies appear to exhibit sensitivity to economic downturns, reflecting these budget pressures. A recent report by the Government Accountability Office (GAO) indicates that only seven states decreased Medicaid benefits levels in 2008, before they could have adapted to the Great Recession. As the recession hit, the same report reveals, the number of states decreasing Medicaid benefits levels increased to twenty in 2009, twenty-four in 2010, and eighteen in 2011.<sup>62</sup> Moreover, during this same period, the federal government expanded fiscal programs, including assistance to states — though evidently not at a level to forestall programmatic state cuts. Although states do not necessarily need to apply for waivers to decrease benefits levels, a permissive posture on waivers creates the possibility of amplified policy responses to the business cycle that counter the purpose of the safety net program.

### III. AGENCY-STATE BARGAINING

So far, I have argued that a permissive posture on waivers favors a form of devolution that in theory encourages generally retrenching forces of state implementation. This first point interacts with a second, which is that waivers, if permissive, undermine the bargaining position of the federal agency. As I have observed, waivers represent a forum for negotiation between the state and some federal agency. Often, these parties will want different policies: the federal agency, for instance, may view itself as the steward of the statute, wishing to see full implementation of the statutory provisions; the state, by contrast, may be subject to the forces described above, seeking to under-implement the statute in one way or another. The waiver application is a forum for bargaining over these differences.<sup>63</sup>

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62 U.S. GOV'T ACCOUNTABILITY OFFICE, *MEDICAID: STATES MADE MULTIPLE PROGRAM CHANGES, AND BENEFICIARIES GENERALLY REPORTED ACCESS COMPARABLE TO PRIVATE INSURANCE* 18 (2012).

63 Although we might imagine the opposite configuration — with the federal agency wishing to see under-implementation, and the state full implementation — this is less likely for two primary reasons. First, it is unlikely that the state requires a waiver to see full implementation; if the state simply wishes to implement the full terms of the statute, that is, it need not request a waiver from the relevant agency. Second, as argued above, the forces of state implementation generally lean toward limiting benefits or eligibility.



### A. The Problem

In the service of obtaining a waiver, a standard argument that a conservative state might make is that, given some feature of state politics or finances, it needs the waiver to implement (or continue to implement) *any* version of the policy. For example, states often declare that a waiver is necessary given budget pressures.<sup>64</sup> State posturing around Medicaid expansion under the ACA represents a clear example of this type of dynamic: conservative state administrations have argued that, without a waiver admitting of some personal responsibility requirement, it is politically impossible to move expansion through the relevant state institution; the legislature, for instance, will balk at the notion of expanding Medicaid absent the waiver.<sup>65</sup> This may or may not be true. However, the federal agency, the CMS in this case, has a poor read on whether it is true, and in this sense the bargaining occurs in an environment of incomplete information.

The fact that the waiver application is a forum for agency-state bargaining is nearly self-evident, but this point about information has virtually escaped attention in the literature. Scholars have gestured to the issue: for example, Suzan Bennett and Kathleen Sullivan observe that many state welfare reforms, also proceeding through waivers, “appear merely to be attempts to reduce benefits under the guise of experimentation.”<sup>66</sup> Yet the problem is fundamental to the institution of waivers. Despite being experts in their policy areas, federal bureaucrats face severe information problems with respect to states: critically, they do not know the realities of state politics, and they do not understand state budgets. This means that when a state says that it needs a waiver to implement a federal policy — due to state politics or budget issues — the federal agency will not easily be able to determine the truthfulness of the statement. The state may, in fact, need the waiver; but it is also possible that the state is pursuing the waiver for gratuitous ideological reasons, unrelated to feasibility. In this context, the posture agencies adopt with respect to waiver applications is critical. I present a simple model reflecting this argument in the Article’s Appendix.

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64 See, e.g., *Wood v. Betlach*, 922 F. Supp. 2d 836 (D. Ariz. 2013).

65 See *infra* Section III.B.

66 Bennett & Sullivan, *supra* note 41, at 745.

## B. Bargaining Example

As an illustration of the type of bargaining that might take place in this waiver context, consider Pennsylvania's application for its Medicaid expansion waiver.<sup>67</sup> There, the state argued that "to provide quality, affordable health care services to Pennsylvania's most vulnerable citizens, Pennsylvania must transform its Medicaid program," noting that the program "requires substantial new state revenue on an ongoing basis," and that it places a "burden on the taxpayers" and makes it "difficult to fund other critical program areas, such as education."<sup>68</sup> According to the application, the state wished to continue "its pursuit of innovative reforms"<sup>69</sup> through the waiver, principally by using Medicaid funds to provide premium assistance for private insurance (i.e., the "private option"), and by imposing various personal responsibility requirements on beneficiaries.<sup>70</sup> With respect to personal responsibility, the waiver application most controversially included an "encouraging employment program," which made employment or participation in a job-training program a condition for receiving Medicaid benefits.<sup>71</sup> But it also proposed that beneficiaries pay premiums, and included a "lockout" period of up to nine months for those who failed to pay.<sup>72</sup> These and other concessions, the state maintained, represented "[p]rogram innovations and reforms [that] are necessary to improve health outcomes and ensure sustainability so that an adequate and appropriate health care safety net can be provided for those who need it."<sup>73</sup>

This waiver application thus fits the basic mold: a request to privatize, reduce benefits, or require cost sharing, along with a gloss of program "innovation," combined with ominous references to program sustainability and other budget priorities. The looming implicit feature of this application was Republican control of both the governor's office and state legislature, and the threat that the state would not expand Medicaid under the ACA absent some concessions.<sup>74</sup> The validity of these threats was difficult to discern: was the budget truly

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67 Pa. Dep't of Pub. Welfare, Healthy Pennsylvania 1115 Demonstration Application (2013) (on file with author).

68 *Id.* at 10.

69 *Id.* at 5.

70 *E.g., id.* at 13-14.

71 *Id.* at 13.

72 *Id.* at 90.

73 *Id.* at 6.

74 *See, e.g.,* WISHNER ET AL., *supra* note 6, at 13 (noting that the governor "initially faced significant opposition in the legislature but eventually was able to garner the support he needed [for Medicaid expansion]. He framed the plan as a 'private coverage option.'").

imperiled and was program sustainability in question? If the CMS plays hardball, refusing concessions, would the state fold and expand Medicaid? The state, of course, was in a much better position than the CMS to know the details of the state budget, as well as the personalities and preferences of the relevant local political figures.

Though CMS disapproved of the most controversial components of Pennsylvania's application — notably, the employment condition and the lockout period — it largely approved the fundamentals of the proposal, freeing the state to pursue its version of the “private option” and allowing it to require premiums of beneficiaries.<sup>75</sup> Most observers view the waiver in a positive light; this represents an example of the sort of sorely needed pragmatic bipartisan deal-making that waivers facilitate. Nevertheless, the question presses — were the concessions necessary to win Medicaid expansion in Pennsylvania? Did the budget in fact require the sort of “innovations” contained in the application?

Even in hindsight, these questions remain fraught and uncertain — indeed, that is the nature of the type of informational problem agencies confront. Yet we have at least some strong suggestive evidence that the application played up the problems posed by the standard Medicaid package. Less than a year after Pennsylvania submitted its waiver application, a Democrat, Tom Wolf, won the governorship. Soon after taking office, he produced a timeline for rolling back the waiver and implementing a traditional Medicaid program. The transition to traditional Medicaid was completed in fall 2015.<sup>76</sup> Though not conclusive — perhaps this traditional expansion foretells some future budgetary calamity — it at least suggests that the application overstated its concerns about program sustainability. It also undermines the thesis that state politics could not support expansion under a traditional Medicaid package.

### C. Bargaining Discussion

Though simple, the recognition of this problem provides insight into several important features of waivers and state-agency interactions. The initial

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75 For a comparison of the submitted and approved plans, see Joe Markosek, House Appropriations Comm., *Gov. Corbett's Healthy PA Submitted vs. Approved Plan*, PAHOUSE.COM (Sept. 10, 2014), [http://www.pahouse.com/Files/Documents/Appropriations/series/2817/DPW\\_HealthyPA\\_Comparison\\_FF\\_091014.pdf](http://www.pahouse.com/Files/Documents/Appropriations/series/2817/DPW_HealthyPA_Comparison_FF_091014.pdf).

76 See, e.g., Damon C. Williams, *State Completes Technical Aspect of Medicaid Expansion*, PHILA. TRIB., Sept. 11, 2015, [http://www.phillytrib.com/news/state-completes-technical-aspect-of-medicaid-expansion/article\\_7fba4d5e-1f4d-5109-87c7-f1e0c1e8c7e6.html](http://www.phillytrib.com/news/state-completes-technical-aspect-of-medicaid-expansion/article_7fba4d5e-1f4d-5109-87c7-f1e0c1e8c7e6.html).

observation is in line with the existing literature: waivers can be helpful, both for states and for the federal government. For example, as explained above, and further discussed in the Appendix, the question in the context of the ACA and Medicaid expansion is whether waivers permit conservative states to expand Medicaid when they otherwise would not do so for political or budgetary reasons. If properly calibrated, waivers can filter out the states that require waivers to expand from those that do not, improving outcomes for all involved. However, the problem extends beyond the ACA and characterizes bargaining dynamics when the states and agencies have different preferences — as will often be the case — and the states enjoy an information advantage over some relevant characteristic of the proposal — as again will often be the case. For example, again if properly calibrated, waivers might filter out those states that seek to cut benefits for ideological reasons from those that seek to improve safety net delivery.<sup>77</sup>

As a corollary, however, waivers can at times be distinctly unhelpful if not properly calibrated, a point not sufficiently integrated into this recent literature on waivers. If the government's posture toward waivers is too permissive, it encourages states to misrepresent their intentions — to say they are “innovating” in some relevant respect, but in reality to retrench safety net programs or pursue ideological ends. This process is likely to be encouraged by — and to encourage — forces operating at the state level that generally work against robust safety nets. Moreover, this occurs even if the federal government is a “good actor,” doing its best to approve only the appropriate waivers. It results not from agency malfeasance or sabotage, but from underlying problems of information; the states have much better information about their proposals and the relevant local political and economic factors than the federal government; at least under a permissive waiver regime, this allows the states to sometimes pull one over on the federal government.

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77 To more fully explain the mapping to this scenario, in the Appendix, the federal agency does not know how the proposal will play out in the state; say,  $\omega$  now reflects whether the waiver will improve delivery or simply eliminate benefits, which depends on difficult-to-observe state-level factors. The federal agency only wishes to grant the waiver if the state conditions support improved delivery: granting the waiver to a benefit-cutting state results in less than ideal policy, and denying a waiver to an innovating state also results in less than ideal policy, as the need for innovation may be spurred by changes in the state that make the “standard” policy inadequate. However, the agency does not observe whether the state conditions reflect cost-cutting incentives or innovating incentives, and the states themselves always reference the flexibility afforded by the waiver (but for different reasons). This gives rise to essentially the same analysis, as shown above and in the Appendix, which is targeted to the expansion waiver context.

Another straightforward corollary is that complete opposition to waivers — perhaps on the grounds of national uniformity — is also not the most fruitful approach. This restrictive approach neglects the underlying heterogeneity in state conditions that, at times, call for tailored solutions through waivers. Failing to tailor in this fashion, as suggested above, may result in policy that is worse for both the state and the federal agency, not to mention beneficiaries.

The critical question, then, is how to calibrate waivers so that they encourage requests from the “right” kinds of states and not from the “wrong” kinds of states. I now consider this issue of calibration.

#### IV. MANAGING WAIVERS

Waivers represent not simple devolution, but instead managed devolution. They are managed in two important respects. First, the relevant federal agency must approve the waiver. The way in which agencies manage waivers — demanding more or less from applications — represents an important management device, as suggested above. I discuss administrative procedures that might be helpful at the agency level in Section A below, but agency-level management is of limited value if an agency is politically committed to a loose waiver regime or the consequent policy outcomes. For instance, though the Obama administration rejected Pennsylvania’s request to condition Medicaid benefits on employment or job training, it is easy to imagine other administrations endorsing or even encouraging such innovations. Indeed, when Vice President Pence was Governor of Indiana, the state proposed a similar work requirement (also rejected by the Obama Administration).<sup>78</sup> This stresses the question of what the limits on waivers might be. Our response to this question turns on the second form of management — judicial review, which is discussed in Section B.

##### A. Administrative Procedures

The basic objective of administrative procedures in this context is twofold: first, to help agencies overcome informational problems, particularly as relates to the states; and second, to help courts conduct meaningful review of agency actions.

Recently, Congress has taken important steps to improve the procedures surrounding waivers — at least, Section 1115 demonstration waivers, which

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78 *See* Ind. Family & Soc. Serv. Admin., HIP 2.0 1115 Waiver Application (July 2, 2014), <https://www.medicaid.gov/Medicaid-CHIP-Program-Information/By-Topics/Waivers/1115/downloads/in/Healthy-Indiana-Plan-2/in-healthy-indiana-plan-support-20-Waiver-Application-07022014.pdf>.

historically have perhaps been viewed as the most potent form of waivers.<sup>79</sup> Section 10201(i) of the ACA amended Section 1115 of the Social Security Act to require agencies to promulgate regulations that provide for notice-and-comment type procedures at both the state and federal levels for most waivers. The Department of Health and Human Services — the parent agency of the CMS — issued such regulations on February 27, 2012.<sup>80</sup> At the state level, the regulations provide minimum transparency requirements: states must give notice of the waiver application on their website, as well as the state register or in state newspapers; must allow at least thirty days for public commenting; and must hold at least two public hearings.<sup>81</sup> Once the CMS has received the application, the agency, likewise, must give notice of the application by posting it on its website, and notifying parties through list-serves or the like; allow at least thirty days for public commenting; wait at least forty-five days from the date of receipt before approving the application; and maintain an administrative record on its website.<sup>82</sup>

These procedures undoubtedly ameliorate both of the relevant problems: they help level information all around, making agencies more the equal of states, and courts more the equal of agencies. Still, they represent a sort of notice-and-comment “lite,” and they might be further strengthened in a number of ways.<sup>83</sup> Most relevant, they do not sufficiently force the state and federal agencies to consider and justify the merits of the application, thereby diminishing both the deliberative benefits afforded by procedures as well as the ability of courts to conduct meaningful review. For example, the regulations require the state to give public notice only thirty days before submission,<sup>84</sup> and it is unclear how seriously the state agency must take any comments it receives during this short window.<sup>85</sup> The procedures at the federal level seem, if anything, even more slapdash on this deliberative dimension. Again, as at the state level, the deliberative window between the end of the comment period and earliest date of approval is vanishingly short, fifteen days.<sup>86</sup> Even more disturbing, at the

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79 *See supra* note 25.

80 Review and Approval Process for Section 1115 Demonstrations, 77 Fed. Reg. 11,678 (2012).

81 *Id.*, codified at 42 C.F.R. § 431.408.

82 *Id.*, codified at 42 C.F.R. § 431.416.

83 Here, I refer to the procedures for ordinary rulemaking, 5 U.S.C. § 553.

84 42 C.F.R. § 431.408(A)(2)(ii).

85 42 C.F.R. § 431.412(a)(1)(viii) provides that, for initial projects, the state must include a “report of the issues raised by the public during the comment period . . . and how the state considered those comments when developing the demonstration application.”

86 The agency must wait forty-five days from the time the application is received,

federal level, is that the agency disavows any duty to address issues raised in comments: “CMS will review and consider all comments received by the deadline,” the regulations reassure, “but will not provide written responses to public comments.”<sup>87</sup> The agency is, of course, less likely to take comments seriously if it does not have to provide responses to them.

## B. Judicial Review

The case law on waivers is, as yet, fairly thin, particularly post-ACA reforms.<sup>88</sup> As an illustration of how judicial review might falter in the face of weak administrative procedures, though, consider the recent case of *Wood v. Betlach*.<sup>89</sup> The case suggests the ways in which more searching scrutiny of waiver approvals might induce state actors to promote statutory objectives.

By way of background, in 2011, the Secretary approved a waiver application from Arizona seeking to impose higher copayments on a segment of beneficiaries.<sup>90</sup>

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42 C.F.R. § 431.416(e)(1), but is taking comments for thirty of those days, 42 C.F.R. § 431.416(b).

87 42 C.F.R. 431.416(d).

88 An early case, often cited for the view that courts deferentially review waivers, is *Aguayo v. Richardson*, 473 F.2d 1000 (2d Cir. 1973), dealing with the Aid to Families with Dependent Children (AFDC) program, which was subject to the same demonstration project waiver provision as Medicaid. It involved the question of whether the then-operative agency, the Department of Health, Education, and Welfare (HEW), could grant a waiver to New York that conditioned welfare benefits on a work requirement. Several would-be beneficiaries argued, among other things, that the waiver was contrary to the relevant statute; the Secretary disagreed. The court deferred to the agency and rejected the challenge to the waiver. In so doing, Judge Friendly, writing for the panel, nodded to the political issues involved in this case, noting that the Secretary may

properly take into account the growing antagonism to the welfare system and the possibility that, unless the public is satisfied that every reasonable effort is being made to induce employable recipients of assistance to work, pressure on governors and legislatures . . . [might cause additional curtailment in benefits] . . . with far greater ultimate hardship than these [waiver-facilitated] projects may entail.

*Id.* at 1103. This political argument — which relied on the state’s representation of the political environment and presumably informed the subsequent deferential statutory analysis — is strikingly similar to the arguments now advanced in favor of granting waivers to states.

89 *Wood v. Betlach*, No. CV-12-08098-PCT-DGC (D. Ariz. July 26, 2013); *Wood v. Betlach*, 922 F. Supp. 2d 836 (D. Ariz. 2013).

90 These higher payments applied to the expansion population consisting of beneficiaries that states may optionally cover under the Medicaid program.



The beneficiaries who would be subject to these higher copayments sought an injunction against the waiver. Initially, the court approved some aspects of the waiver, and found others wanting under arbitrariness review.<sup>91</sup> The court remanded without vacatur, and on remand the Secretary reaffirmed her decision. Following this agency action, the plaintiffs challenged again, and the court granted summary judgment to the Secretary.<sup>92</sup>

On review, focus tends toward two questions: first, whether the agency had the statutory authority to approve the waiver; and, second, whether the agency behaved arbitrarily in granting a waiver. Post ACA, a third question seems likely to become more important, that is, whether the waiver was granted consistently with the agency's self-generated procedural requirements.<sup>93</sup> This third question, however, is not relevant to this case, as it arrives before the ACA reforms.

*i. Statutory Authority*

On the statutory question, permissibility turns on the particulars of the relevant granted waiver and waiver authority. At least in the context of Section 1115 waivers, the statutory analysis is largely guided by the requirement that, for the Secretary to grant a waiver request, the requested waiver must “in the judgment of the Secretary, [be] likely to assist in promoting the objectives of [the Act].”<sup>94</sup> Notice that this language somewhat limits courts' ability to review the substance of the agency's decision, and so the operative question courts have examined is how searching the Secretary's assessment of the issue was. With respect to the objectives of Medicaid, the Social Security Act provides that the purpose of the program is, in part, “to furnish . . . medical assistance on behalf of families with dependent children and of aged, blind, or disabled individuals, whose income and resources are insufficient to meet the costs of necessary medical services.”<sup>95</sup> This objective clearly admits a large zone

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91 *Betlach*, 922 F. Supp. 2d.

92 *Betlach*, No. CV-12-08098-PCT-DGC.

93 *E.g.*, 42 C.F.R. § 431.416.

94 Social Security Act, 42 U.S.C. § 1315 (2014). In fact, courts have articulated what amounts to a three-prong analysis of waivers, asking whether the Secretary examined: (1) whether the waiver had an experimental or demonstration component; (2) whether the waiver was likely to promote the objectives of the act; and (3) the extent and period necessary for the project. *See Beno v. Shalala*, 30 F.3d 1057 (9th Cir. 1994); *Newton-Nations v. Betlach*, 660 F.3d 370 (9th Cir. 2011). This Article focuses on the second of these prongs, as it is probably the most far-reaching potential management vehicle.

95 42 U.S.C. § 1396-1.

of discretion. For example, a waiver might expand eligibility to new people, but at the cost of reduced benefits for those already covered by the program. The statute does not seem to speak to this tradeoff.

In *Betlach*, the court tripped over this statutory question — if a waiver, on the whole, promotes the objectives of the act, is that enough? Or must every component of a waiver promote its objectives? Or is there some third way of construing the issue? This is a challenging and important set of questions, but the *Betlach* court took the essentially conclusory view that “[it] is not persuaded that copayments challenged as part of a larger demonstration project must independently merit approval under Section 1115.”<sup>96</sup> The court reasoned that “[t]o so hold would mean that any provision of a larger demonstration project could be challenged as not independently warranting approval under Section 1115, notwithstanding that provision’s relationship to and interaction with the project as a whole.”<sup>97</sup> To be fair, I am not aware of any court that considered the issue in more detail than this.

But clearly, on the one hand, requiring each component independently to meet the relevant criteria is likely to defeat virtually any waiver request that involves tradeoffs, for example, lower benefits for expanded eligibility. This seems to be the animating concern in *Betlach*. Still, on the other hand, permitting the Secretary to consider the waiver program as a whole invites states to attach unnecessary ideological, retrenching, or political “riders” to applications that otherwise promote the Act’s objectives. Allowing the Secretary to examine merely the question of whether the waiver would, considered as a whole, promote the Act’s objectives plainly encourages state gamesmanship that itself runs contrary to the Act. This perspective received no airing in the *Betlach* court’s opinion.

I want to suggest that one need not accept either the component-by-component perspective or the as-a-whole perspective. Consider the possibility that the Secretary, and therefore the courts on review, engages in a sort of “severability” analysis.<sup>98</sup> The relevant question, then, in this analysis is whether the component inconsistent with the Act’s objectives may be severed without undermining the other features of the request. Sometimes the contrary feature

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96 *Betlach*, 922 F. Supp. 2d at 843.

97 *Id.*

98 In the statutory context, see, for example, *Alaska Airlines, Inc. v. Brock*, 480 U.S. 678, 107 S. Ct. 1476 (1987). For a recent article considering the administrative context, see Charles W. Tyler & Donald Elliott, *Administrative Severability Clauses*, 124 *YALE L.J.* 2286 (2015) (calling for courts to defer to agencies’ views regarding severability; note that the present context differs in that it seeks to have agencies conduct a severability analysis themselves of states’ proposals).

is necessary to buy the promoting features; but at other times it will not be. Absent such an analysis, at least on important components of the request, the Secretary's approval of the waiver should be deemed arbitrary and capricious.

This sort of analysis was entirely absent from the *Betlach* decision, but it would have led to a different outcome, as the Secretary apparently did not engage in the inquiry.<sup>99</sup> Moreover, substantively, it is likely that the Secretary would have been forced to conclude that the relevant copayment provision was severable. The state justified the copayments by arguing that they were necessary to contain costs and ensure the sustainability of coverage for the relevant segment of the population. If copayments were in fact necessary to ensure program sustainability, they would not be severable; but if they were not, then they should be severed and considered independently.

Most research suggests that, at least for Medicaid beneficiaries, copayments alter behavior but do not reduce state expenditures.<sup>100</sup> A study of a program affecting a population similar to Medicaid beneficiaries in Quebec found that requiring copayments for prescription drugs reduced use of prescription drugs, but also led to higher use of hospitals and emergency rooms;<sup>101</sup> similarly, a study of Oregon's experience with copayments for Medicaid beneficiaries found that they led to decreases in some services, such as prescription drugs, but increases in others, such as inpatient care, with, on average, no change in expenditures per beneficiary.<sup>102</sup> These studies indicate that the copayments rule

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99 In her initial decision, the Secretary did not consider the argument that copayments do not reduce expenditures, and this failing, in part, led to the remand (without vacatur) in *Betlach*, 922 F. Supp. 2d at 850. However, this took place in the generic setting of arbitrariness review, examining whether the Secretary considered evidence presented during administrative proceedings. On remand, the Secretary approved the original waiver application, and this time in her approval letter "reference[d] these objections and conclude[d] otherwise." *Wood v. Betlach*, No. CV-12-08098-PCT-DGC (D. Ariz. July 26, 2013). Of course, this cursory analysis by the Secretary, as conveyed by the reviewing court, begs the question, as the entire issue is whether copayments lead to savings. In any event, the court found this level of consideration — reference plus conclusion — sufficient to overcome arbitrariness review. *Betlach*, No. CV-12-08098-PCT-DGC.

100 See, e.g., LEIGHTON KU & VICTORIA WACHINO, CTR. ON BUDGET & POL'Y PRIORITIES, *THE EFFECT OF INCREASED COST-SHARING IN MEDICAID: A SUMMARY OF RESEARCH FINDINGS* (2005).

101 Robyn Tamblyn et al., *Adverse Events Associated with Prescription Drug Cost-Sharing Among Poor and Elderly Persons*, 285 J. AM. MED. ASS'N 421 (2001).

102 Neal T. Wallace et al., *How Effective Are Copayments in Reducing Expenditures for Low-Income Adult Medicaid Beneficiaries? Experience from the Oregon Health Plan*, 43 HEALTH SERV. & RES. 515 (2008).

should have been severed from the remainder of the application, as they were unlikely to promote cost savings or program sustainability. And considered independently of savings, it is difficult to see how the copayments might promote the objectives of the Act.

This type of severability analysis runs into a problem of information similar to that noted above, that is, that the court does not have good information about what can be severed and what cannot. This is, indeed, why more formal administrative procedures have such importance. The dialog between the agency and the public — segments of which will likely have relevant knowledge — in the administrative record promises to greatly enhance the ability of courts to resolve such questions. This point also illustrates why it is problematic for an agency to opt out of providing responses to comments,<sup>103</sup> a procedural shortcoming that calls for reform.

#### *ii. Arbitrariness*

The second legal question is more garden variety, and represents a longstanding question in administrative law — how searching should the Secretary's analysis be? In the context of waivers, how much evidence should the agency demand of the state before approving a waiver? The *Betlach* court ends up deferring to the agency in this respect, too, seemingly requiring little of the Secretary. But this form of deference is not required of courts, and here it might have led to a different outcome.

Consider the state's justification for the waiver: program sustainability. The Secretary ended up siding with this view. Here, I do not want to question the substantive validity of that view — which may or may not be there — but instead the level of evidence that the Secretary required of the state before siding with its view. It appears that the initial agency approval arrived on the basis of a letter from the Governor of Arizona stating that the state had a budget crisis and that the program must be reformed “to assure its future sustainability.”<sup>104</sup> Outside of this letter, the agency does not appear to have had any other evidence from the state supporting its position that the copayments rule was necessary to save the program: for example, no exhibits from budget experts, no study of the agency budget.

I have already identified one area in which the Secretary's analysis might have been more searching: on the connection between copayments and program savings. To the court's credit, the initial litigation led to a remand, in part, on this basis; but the agency action on remand seems to have approved the waiver with only the barest acknowledgment of the issue, an acknowledgment

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103 42 C.F.R. 431.416(d).

104 *Betlach*, 922 F. Supp. 2d at 849.

that won the agency summary judgment in the subsequent litigation. Given studies finding little connection between copayments and cost savings, the court would have been on solid ground to remand again for a more serious analysis of the issue.

The court's relaxed posture manifests elsewhere, too. One fact to emerge in the course of litigation was that, for the fiscal year preceding the waiver application, the state's Medicaid program, in fact, ran a *surplus* of \$167,000,000.<sup>105</sup> The court brushed off this revelation, on the grounds that "it was not part of the information before the agency at the time of the Secretary's decision."<sup>106</sup> But the agency was plainly in the position to require the state to make some showing — beyond a letter from the Governor — of the pressing budget problems supposedly requiring the imposition of copayments. The approval might easily have been set aside under arbitrariness review on the basis that the agency apparently did little due diligence.

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The problems that manifest in the *Betlach* litigation reflect the concerns of the first portions of this Article. In particular, we have a state wishing to cut back on Medicaid benefits by imposing copayments. The forces driving this state request are likely multiple, but plausibly owe, at least in part, to the considerations in Part II. Even more evident are the information problems discussed in Part III. In the *Betlach* litigation, a core issue was whether the state required the benefits cuts to ensure program sustainability. The state asserted this fact, and the agency, under a permissive waiver regime, seems to have simply believed the assertion. The court followed suit. However, considerable evidence emerged in the course of litigation that, first, the program was not imposing a burden on the budget, and, second, in any event copayments were unlikely to improve the budget situation. Arizona, that is, appears to have failed to support the claimed budget rationale for the cuts, and a permissive approach to waivers allowed benefits cuts to ride on the unsubstantiated rationale. But as I suggest, more demanding doctrinal approaches — particularly if combined with more robust administrative procedures — may well be able to separate states such as Arizona from those that require cuts or other forms of policy innovation to promote the objectives of the Act.

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105 *Id.*

106 *Id.*

## CONCLUSION

Even as the problem of economic inequality is largely one of explosive growth in the right tail of the distribution, the left tail of the distribution also calls for particular attention. It is the left tail that bears the brunt of the economic changes producing inequality; it is the left tail where society has a moral obligation to ensure minimum standards of wellbeing; it is the left tail where we should be particularly eager to see signs of intergenerational mobility.

In the United States, states and the federal government jointly set many aspects of social service policy — they jointly set the policies, that is, that target the left tail of the distribution. As a window into this policymaking environment, I have examined Medicaid implementation, and in particular Medicaid expansion following the ACA. Medicaid holds great interest due to the size of the policy program — over 500 billion dollars in 2015<sup>107</sup> — as well as its association with improvements in health, education, income, and intergenerational mobility in beneficiaries.<sup>108</sup> At core, the question in this implementation architecture is whether we want more or less flexibility in the state-federal relationship given concerns over inequality. Of late, scholars have taken a relatively positive view of flexibility in the policymaking system.

A critical vehicle of policymaking flexibility is the administrative waiver, the subject of much discussion in academic and policy circles. Through this device, an implementing federal agency might waive statutory requirements that otherwise are binding on states. Those on both the left and the right have lauded the device: it opens a door to bipartisanship and permits policy innovation in the face of a gridlocked Congress. Waivers indeed offer a tempting alternative to the grind and rancor of legislation.

Yet insofar as one focuses on the vitality of safety net programs, waivers should be watched with a wary eye rather than cheered. The forces that operate at the level of state implementation tend to work towards cuts, and due to information problems federal administrators will have difficulty filtering out the meritorious applications from the non-meritorious applications. Moreover, as illustrated by litigation surrounding a recent waiver granted to Arizona, courts hardly represent a failsafe to protect statutory objectives. Recent reforms to administrative procedures hold promise, but they remain incomplete and should be amplified.

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107 See *Total Medicaid Spending, Fiscal Year 2015*, HENRY KAISER J. FAMILY FOUND., <http://kff.org/medicaid/state-indicator/total-medicaid-spending/?dataView=0&currentTimeframe=0> (last visited Dec. 9, 2016).

108 See Brown et al., *supra* note 4.

## APPENDIX

This Appendix contains a simple formal model illustrating how information problems affect state-agency bargaining. The particular problem that agencies face is that they cannot easily determine the veracity of state justifications for their waiver requests.

### A. Bargaining Setup

To illustrate this point, consider a simple bargaining model involving a liberal federal agency and a state. The state implementation,  $P$ , may be either full,  $F$ , low,  $L$ , or absent,  $A$ ; that is,  $P \in \{F, L, A\}$ . The prevailing state conditions,  $\omega$ , support either full,  $F$ , or low,  $L$ , levels of implementation (ie,  $\omega \in \{F, L\}$ ). As detailed below, the state prefers to implement the policy  $L$  regardless of state conditions, perhaps a nod to the fact that many lower-income people do not vote or the other forces articulated above. The federal agency, by contrast, wishes to see the state implement the highest level of policy supported by state conditions.

The sequence of the interaction is as follows:

*First*, nature draws the state conditions,  $\omega$ , with  $\Pr(\omega = F) = \pi$ , and therefore  $\Pr(\omega = L) = 1 - \pi$ . The state observes  $\omega$  but the agency does not.

*Second*, the state decides whether to request a waiver to change policy from  $F$  to  $L$ ; note that policy begins fully implemented, and the state then requests a waiver to implement some policy “innovation” that renders policy to  $L$ . If the state requests a waiver, it incurs a cost that reflects the difficulty of complying with the application procedures. An important but sensible assumption is that this cost is (weakly) lower for states when  $\omega = L$  than when  $\omega = F$  so that when the state conditions truly require  $P = L$  it is easier to substantiate this fact than when state conditions would, in fact, support  $P = F$ .<sup>109</sup> Let  $k$  represent the waiver cost when  $\omega = F$  and  $k - t$  represent the waiver cost when  $\omega = L$ , where  $k \geq 0$  and  $t \in [0, k]$ . These cost parameters represent the permissiveness of the federal government’s waiver policy, and a central objective is to understand how bargaining behavior is conditioned on them.

*Third*, the agency grants or denies the waiver request. If the waiver is granted, then the policy is set to  $L$  and players receive payoffs. If the waiver is denied, the policy is set to  $F$  if  $\omega = F$ , such that the state can sustain the policy, and to  $A$  if  $\omega = L$ , such that the state cannot in fact sustain the

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<sup>109</sup> In other words, it is somewhat harder to lie than to tell the truth and maintain the appearance of integrity in an application.



policy. Players then receive payoffs.

The policy payoffs thus depend on the policy selected and the underlying state conditions, as follows, first for the federal government, G:

$$U_G = \begin{cases} 1 & \text{if } P = F \\ 0 & \text{if } P = L \\ -1 & \text{if } P = A \end{cases}$$

And likewise for the state, S:

$$U_S = \begin{cases} 1 & \text{if } P = L \\ 0 & \text{if } P = F \\ -1 & \text{if } P = A \end{cases}$$

Thus, neither the agency nor even the state wants to see the policy abandoned, but as indicated above they have different views on how generous to make the safety net program: the agency wants the most possible given state conditions; the state wants the lowest level of policy regardless of state conditions. Note that P defaults to A if the state-agency negotiation results in a policy choice that the state cannot support.

The objective of the analysis is to consider salient perfect Bayesian equilibria of this state-agency bargaining interaction under various waiver regimes, where the regimes, again, find definition in the request costs.

## B. Overly Permissive Waiver Regime

Consider initially the problems with an overly permissive waiver regime. Behaviorally, the defining characteristic of this waiver regime is that states in both conditions find it equally attractive to request waivers. This characteristic would follow, for instance, if  $k = t = 0$ , so that neither type of state incurs a cost for requesting a waiver. More generally, any time that  $k < 1$  the incentives generating these equilibria prevail.

That states of both types pool and find it worth requesting waivers gives rise to the possibility of a troubling equilibrium in which the federal agency indiscriminately accepts all applications. In particular, if  $\pi < \frac{1}{2}$ , an

equilibrium exists in which states in both conditions request waivers, and the agency indiscriminately accepts the requests. The agency does so because, even though the application is uninformative, there is a good chance  $(1 - \pi)$  that the state condition is  $\omega = L$  and that the application is

truthful; for these states, rejecting the application would lead to an unappealing abandonment of the policy. Of course, this equilibrium is not particularly attractive for the federal government because, in many cases, states under-implement the statute when they are in a position to fully implement it. Yet the agency cannot easily ferret out these under-implementing states, and so ends up granting all waivers.

To see this more clearly, note that the agency cannot update beliefs due to the pooling strategies of states, so it must act based on priors. Under the candidate strategy of accepting the applications, it faces a payoff of 0, that is, because  $P=L$ . However, if the agency rejects the application, it faces a payoff of  $\pi - (1 - \pi)$ , such that we have  $P=A$  if  $\omega = L$ , and  $P=F$  if  $\omega = F$ .

Thus, so long as  $\pi < \frac{1}{2}$ , the agency faces no incentive to deviate from the strategy of indiscriminately accepting all applications. The states, likewise, plainly face no incentive to deviate, as they are able to under-implement the statute, as is their preference, and the cost of applying,  $k$ , is less than 1.

If  $\pi > \frac{1}{2}$  and  $k < 1$  there is also an equilibrium in which the L states

always request waivers, and the F states mix, applying with probability  $\frac{1-\pi}{\pi}$ , and the agency accepts the request with probability  $k$ . Note that the

F-type state is indifferent between applying and not, and thus faces no incentive to deviate: that is, applying yields  $\rho + (1 - \rho)(0) - k$ , where  $\rho$  is the probability that the agency accepts the waiver; and not applying yields 0; thus, if  $\rho = k$ , the F-type state is indifferent. The agency, meanwhile, is also indifferent: accepting the application yields 0; and denying it yields,  $\pi\psi(1) + (1 - \pi)(-1)$ , where  $\psi$  is the probability that the F-type state applies; so that when  $\psi = \frac{1-\pi}{\pi}$ , the agency is indifferent between accepting and rejecting the application. The L-type state, it is clear, faces no incentive to deviate.

### **C. Overly Harsh Waiver Regime**

On the other side of regimes, consider a harsh waiver regime in which it is incredibly difficult for states to request waivers. Indeed, this might be thought of as a no-waiver regime. But to maintain the focus on request costs, let  $k - t > 1$ ; this means that, even for states in condition  $\omega = L$ , the costs of seeking a waiver exceed any possible benefit.

The relevant strategies to consider in this regime are straightforward: for states in both conditions, do not request a waiver. As suggested, the costs of

doing so exceed any possible benefit, and as a result neither state faces an incentive to deviate from these do-not-request strategies. The downside of this equilibrium, of course, is that some states truly require a waiver to operate the safety net program, and in this way refusing waivers results in an unnecessary diminution of the program.

#### **D. Effective Waiver Regime**

An effective waiver regime lies between the two extremes above: it neither encourages all states to request, nor does it discourage all states to request. Rather, it encourages the right kind of states to request a waiver. In the running example of this model, that is, it encourages states in condition  $\omega = L$  to apply, and those in condition  $\omega = F$  not to apply. This form of effective waiver regime, therefore, is moderate, neither permissive nor harsh.

This regime is characterized by request costs that have two features: first,  $k > 1$ , which has the effect of discouraging the states in condition  $\omega = F$  from requesting a waiver, and, second,  $k - t < 1$ , which has the effect of encouraging states in condition  $\omega = L$  to request a waiver. The states formulate strategies to this effect, and the federal agency, then, on seeing a waiver, knows that it is from a state that cannot effectively implement the full benefits program, and therefore grants the waiver. As can be readily verified, no type of state has an incentive to deviate from this equilibrium.