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**Programmatic Expertise
and Persuasion in the
Intergovernmental Lobby:
Medicaid and the Case of Mixed
Federalism**

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**Programmatic Expertise and Persuasion in the Intergovernmental Lobby:
Medicaid and the Case of Mixed Federalism**

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Abstract: State programmatic expertise is an important asset to federal systems, in that it can help both state and federal actors achieve national goals for programs that are administered jointly by both levels of government. State-level expertise cannot perform this function, however, unless it is persuasive to federal decision makers. I argue that state expertise is persuasive to federal actors only to the extent the interests of state and federal actors are aligned, and to the extent state programs are transparent to federal auditors. I illustrate variation in these conditions using congressional politics over the Medicaid program. I then give a statistical test which demonstrates that states' programmatic expertise regarding Medicaid is less persuasive to congressional committee members compared to other witnesses who are equally knowledgeable. The results suggest a "failure of federalism," where the public good potential of state programmatic expertise often is not realized in the federal system.

Programs that create administrative interdependence between levels of government are common in federal systems. As with any relationship, interdependence can on some occasions lead to cooperation and mutual support, and on others to conflict and distrust. Consequently, maintaining a federal system in practice requires some degree of power and influence at each level of government. In the U.S., the influence of the federal government in intergovernmental relations is assured both by its size and by constitutional design. Like a lower level participant in any organization, states' policy and program-specific expertise can give them influence over the federal government. As "laboratories of democracy," states can maintain their independent influence by their collectively vast administrative capacity, experience with programs, experimentation, and local knowledge. To the extent it is credible to federal level decision makers, state-level programmatic expertise can benefit both levels of government by reducing uncertainties as new policies are proposed and implemented.

I argue that the extent to which state policy expertise is credible to federal actors, and hence the extent to which policy expertise gives states influence in intergovernmental relations, is mediated by two conditions: 1) the degree to which state and federal programmatic interests are aligned, and 2) the ease with which the national government can audit statements states make regarding their programs when the interests of the two levels are not fully aligned. That is, I take the degree of conflict or cooperation between state and federal levels as a continuum (Gormley 2006, Zimmerman 2001). When the state and federal levels have similar policy preferences, and when state programs are transparent to federal auditing, states can use their expertise to persuade federal level actors. State expertise has less capacity to persuade when the interests of state and federal actors are not fully aligned and when state programs are opaque to federal auditing.

To demonstrate the importance of interest alignment and auditing transparency empirically, I examine the influence of the intergovernmental lobby and its capacity to persuade in U.S. congressional politics over the Medicaid program in the first half of the 21st Century. Medicaid is a means tested health insurance program that is administered by the states and funded jointly by federal and state governments (Weissert 1992). Medicaid is a useful topic for studying the influence of states in intergovernmental relations. Since states administer the program and experiment with its provisions, they have considerable experience, administrative capacity, and knowledge of how the low-income insurance program operates (Schneider 1997). At the same time, since the two levels of government share in its costs, the interests of the two levels of government often are not aligned, and the federal government has strong incentives to audit and oversee program elements that affect spending (Anton 1997: 713).

I develop two brief case studies of the interactions between committee members and state-level witnesses in U.S. congressional committee hearings to illustrate variation in the degree of persuasion across the conditions of the model. I then give statistical results which show that overall, state-level lobbyists tend to attract fewer analytical and falsifiable questions from committee members compared to other knowledgeable witnesses, despite their vast programmatic expertise in administering the relevant aspects of the program. In addition, I show that state agency witnesses attract fewer analytical questions when testifying on the Medicaid program, over which state and federal interests often conflict, compared to when they testify on the Medicare program, over which there is little if any federal-state disagreement. The empirical portion of the study thus suggests a collective action problem between federal and state levels, or a “failure of federalism,” where states have vast programmatic expertise that potentially can

benefit both levels of government, but this expertise often is not persuasive in intergovernmental relations and potential program improvements typically are not realized.

Model: The conditions for intergovernmental persuasion

I argue there are two important conditions that mediate when states' programmatic expertise will be persuasive to federal legislators.¹ First, states' expertise will be persuasive to federal politicians when state and federal interests are aligned. Label this case "cooperative federalism." More common, however, is the case of "mixed federalism" where state and federal interests are only partially aligned. In this case, it is possible a policy proposal will make both levels better off, but also possible the proposal will advantage one level of government and disadvantage the other. In the case of mixed federalism, for skeptical federal actors to find states' expert advice persuasive, they must possess the capacity to audit the analytical and empirical statements that state actors make about their programs. The appendix gives a simple game theoretic model that demonstrates how preference alignment and auditing capacity create the conditions where state expertise is persuasive to federal actors in equilibrium, considering in turn the case of cooperative federalism and the case of mixed federalism. Here I summarize the model results.

The case of cooperative federalism is straight forward. In this case, assume there are two possible states of the world: the policy will extend coverage of Medicaid services in a way that does not impose additional cost to the program, saving both levels of government money (or enhancing services without extra costs), or the policy will provide rents to a special interest, needlessly costing both levels of government money. In this case, federal actors may have uncertainty about which state of the world is true, but they also know that they share identical

¹ This model assumes that outcomes matter to the federal actor. Obviously, expertise will never matter to actors who take positions based only on their predispositions.

preferences with state actors who possess considerable programmatic expertise. This case is illustrated in a case study below for a proposal for Medicaid prescription drug payment reform, which considers mechanisms to reduce program costs for both levels of government at the expense of rents to pharmacies and drug companies.

In the case of complete cooperation, if one assumes that federal actors initially are reluctant to adopt a new policy because of a bias in favor of the status quo, in the absence of lobbying there is a collective action problem between federal and state actors since both would be made better off if the federal government adopted the policy. This collective action problem is easily overcome when state and federal interests are fully aligned, though, since in this case the states' expertise is always persuasive to federal actors in equilibrium.

Establishing the conditions for the persuasiveness of states' expertise is not straightforward in the case of mixed federalism. In this case, assume there are two states of the world: either the new policy will benefit both levels of government in the sense above, or the policy is zero-sum and unilaterally will extend services at some cost to the federal government but not to the state government. Assume further that the principal federal decision makers do not at this time wish to expand eligibility, but they are uncertain about which state is true. Finally, assume that there has been some dislocation in the economy, and if the federal government does not intervene, states will suffer in that they will need to reduce discretionary spending in other areas to cover new expenses from Medicaid. In the first state, the interests between the two levels of government are aligned, in the second state they are in conflict.

In the case of mixed federalism, the appendix shows it is necessary for the federal government to have a capacity to audit statements that the states make about their programs for states' expert advice to be persuasive to federal actors (see Ainsworth 1993, Rasmusen 1993).

Only the capacity to audit is necessary, however; the audit need not occur for states' advice to be informative to federal actors. Assume that the federal government can audit state programs at some cost. Further, if the audit reveals that the state has attempted to mislead the federal government about the true state of the world, then the federal government will punish the states, say by discounting the future stream of Medicaid funding that comes from a level of distrust in the state-federal partnership.

Note that in the case of mixed federalism, there is a collective action problem only in the case when the new policy is mutually beneficial, but not when the reform is zero-sum. The appendix demonstrates that, even when the interests of both levels in practice are aligned, the federal government's capacity to audit state programs is necessary for state expertise to be persuasive and the collective action problem to be solved. When this capacity exists, the federal government can induce the state to sometimes tell the truth about the state of the world when the truth is not in its favor (that is, when the policy in fact is zero sum), and will always report the truth when the truth is in its favor (when the policy in fact is mutually beneficial). In this case, the state has a limited, but nonzero, capacity to persuade the federal government even when the interests of the two levels of government are only partially aligned. As the cost to audit increases, states will have a higher probability of misreporting the truth when the truth is not in its favor, but at the same time, the federal government typically will find the states' expertise unpersuasive.

Overall, states' expertise will be persuasive to a greater extent and more frequently in the case of cooperative federalism than in the case of mixed federalism. One of the great strengths of a federal system is that the subnational governments can experiment with policies and gain programmatic expertise, expertise that should create a public good for the other states and nation.

Unfortunately, the case of cooperative federalism, where state and federal actors have completely aligned interests is somewhat unusual. More common is the case where federal decision makers have some degree of skepticism regarding the claims of state officials. To the extent that state and federal interest are not aligned, and to the extent that state programs are opaque to federal auditing, conditions are set for a “failure of federalism.” States and the federal government would both benefit from sharing expert advice, but in many cases federal actors will find such expert advice unpersuasive.

Conflict and cooperation in the Medicaid program

Empirically, I demonstrate variation across the conditions of the model, and the relative persuasiveness of state expertise to federal actors across these conditions, using Medicaid politics as observed in U.S. congressional committee hearings. Medicaid is a federal grant-in-aid program that creates financial incentives for each state to set up a low income health insurance program. As a grant-in-aid program, Medicaid is intended to be a partnership between the two levels of government. Within specific constraints established by the federal government, states specify their own eligibility requirements, benefits, and payments levels to providers (Schneider 1993: 369). The federal government matches state expenditures using rates that vary among states, called Federal Medicaid Assistance Percentages (FMAP), which average 57% across all states and range from 50% in Connecticut and New Jersey to 77% in Mississippi (Weissert and Weissert 2006: 265). Overall the program is large and quite costly. In 1990 total expenditures were \$72.5 billion, with \$31.4 billion of that paid by states (Weissert 1992: 97). In addition, as was the case with all public and private health care expenditures, costs have increased at a rapid

rate, with an 11% annual increase between 1990 and 2001 (Weissert and Weissert 2006: 269). By 2005 total expenditures were \$329 billion.

These high costs and the high rate of growth in expenditures have placed a tremendous strain on state budgets. States cannot operate a deficit so growth in Medicaid reduces other essential services such as education and transportation (Weissert 1992: 98). As a result, states have tried experimenting with alternative eligibility, service delivery, and financing methods to improve cost effectiveness. Much of this experimentation has been under the Section 1115 waiver authority that allows states to conduct research and demonstration projects outside of the constraints of federal program requirements (Schneider 1997: 89, Schneider 1998: 171). Most states have experimented with various forms of managed care, a form of health insurance that emphasizes prevention and cost effective services such as immunizations, prenatal care, and disease management (Grogan and Patashnik 2003: 841, Weissert and Weissert 2006: 235).

Despite the rising costs of the program, some states also have experimented with expanding eligibility. Politically, there is considerable public acceptance for expanding Medicaid to extend coverage among low income workers, many of whom do not have insurance benefits from their employers, and for long term care coverage among the elderly (Grogan and Patashnik 2003: 836, Kronebusch 1997, Schneider 1997: 105, Meyers et al. 2002). Support for expansion comes from both liberals and conservatives and the typical ideologically-charged concerns over welfare expansion do not arise. Medicaid offers insurance rather than cash benefits; reimburses physicians and other providers rather than the beneficiary; and there is something of a consensus that access to health care should not be left to the market (Grogan and Patashnik 2003: 822-3, Schneider 1988: 163, Schneider 1993: 372, Schneider and Jacoby 1996).

Through day to day administration of the program and through experiments, states have developed considerable knowledge, human capital, and expertise in administering low income health care financing (Anton 1997: 703, Schneider and Jacoby 1996: 503, 510, Schneider 1988, Schneider 1997: 106). At the same time, there also has been variation in the degree of conflict and cooperation in intergovernmental relations regarding the program. In particular, since costs are shared between the two levels of government, state and federal interest are aligned to the extent states can improve the cost effectiveness of the program. To the extent states wish unilaterally to expand eligibility or shift costs to the federal government, state and federal interests tend to depart (Anton 1997: 696, Weissert 1992: 94).

To the extent there is conflict between state and federal interests, the model expects that states will be limited in their ability to persuade federal actors. Given asymmetries of information between state and federal actors, federal actors will be uncertain whether to agree or disagree with states' expert advice, or whether to find states' expert advice credible. The model further predicts that state expertise will be more credible when the federal government has the capacity to audit state programs, and hence some capacity to assess the veracity of state expert advice. To some extent, Congress has the insitutional capacity to audit state level programs in its support agencies, including the Health Education and Human Services Division of the General Accounting Office (GAO), and the Congressional Budget Office (CBO) Health and Human Resources Division. The federal administration also has auditing capacity for example in the Health and Human Services (HHS) Office of the Inspector General of Centers for Medicare and Medicaid Audits, and the Center for Medicaid and State Operations in the Centers for Medicare and Medicaid Services (CMS). As the case studies below show, however, the transparency of programs to federal auditors varies across the different aspects of the Medicaid program.

When state and federal interests are clearly aligned, or when auditing is transparent, states' expertise will be credible to federal actors. In this case, states' expertise will serve as a public good for both levels of government and help the Medicaid program achieve important national purposes in insuring the health and long term care of low income and elderly Americans. When interests are not aligned and the state programs are not transparent to federal audits, states' expertise will not be credible to federal actors. In this case, the federal system will not realize its potential to use state expertise for national purposes.

Case studies

Congressional hearings on the Medicaid program through the 1990s and 2000s help to illustrate variation in the degree of conflict and cooperation between the two levels of government (Marbach and Leckrone 2002). State-level witnesses typically testify at these hearings, either as employees of state government agencies, or representing a state or local government associations such as the National Governors Association. The give and take between committee members and witnesses at a hearing can reveal a lot about the relative influence of each witness (Esterling 2007). Witnesses whose testimony is more influential will tend to receive more attention from committee members, and hence will tend to receive more questions during the question and answer portion of the committee hearing.

Two cases studies of hearings testimony help to establish variation in the conditions that mediate the persuasiveness of states' programmatic expertise to federal actors. The first case, on average wholesale pricing (AWP) for prescription drugs, demonstrates state expertise is informative when intergovernmental interests are aligned and the program is transparent to state auditors. The second case, on intergovernmental transfers (IGTs) of program funds, shows state

expertise is not persuasive when state interests are not aligned with those of the committee members, and further demonstrates the importance of the federal government's auditing capacity when interests are not aligned.

Average wholesale pricing for prescription drugs: A case of complete interest alignment.

Between 1997 and 2005, Medicaid's expenditures for prescription drugs increased about 18% annually, from \$10.2 billion to \$23.4 billion (CBO 2004: 1). Approximately 23% of these costs went to reimburse pharmacies and wholesalers for dispensing the drugs. In this same time period, the markup paid to pharmacies increased by nearly 60%, rising from an average of \$8.70 to \$13.80 per prescription. Much of this increase came from pharmacies' filling prescriptions using drugs that were newly available as a generic. Among these new generics, the markup averaged about \$32 per prescription.

One of the main factors behind this disparate markup for new generics was the mechanism by which Medicare reimburses pharmacies. Most state programs reimburse pharmacies using a formula based on an average wholesale price (AWP). The AWP is a listing of drug prices set not by market supply and demand, or even the actual cost of the drugs, but instead by the manufacturers themselves. Any discrepancy between the listed AWP and the actual price pharmacies pay creates a markup which profits the pharmacies that dispense the drugs. For newer generic drugs, manufacturers tend to list relatively high prices but then offer steep discounts to pharmacies as an incentive to switch from the name brand drug.

Given the obvious problems with this system, the House Energy and Commerce committee subcommittee on Health, held a hearing entitled, "Medicaid Prescription Drugs: Examining Options for Payment Reform" (June 22, 2005), to examine ways that state Medicaid programs could dispense pharmaceuticals more cost effectively. The hearing considered whether

managed care offered an alternative mechanism to the AWP that might help Medicaid capture more of the savings from newly emerging generic drugs, savings that would accrue to both state and federal governments. Typically managed care plans include a prescription drug benefit and the plan negotiates prices directly with wholesalers and manufacturers. Under this system Medicaid does not need to pay a markup to pharmacies for dispensing drugs since pharmaceutical benefits typically are included in the plan, and managed care plans save money by negotiating the best prices.

Opening statements indicate that both Democrats and Republicans on the committee were interested to find a way for Medicaid to capture the savings from newly emerging generic drugs. Rep. Michael Bilirakis (R-FL), expressing the sentiments of the majority Republican committee members, says “What is clear... is that States and the Federal Government simply cannot continue to pay more than they should for prescription drugs under Medicaid” (p. 4). The Democratic minority members echo the exact same sentiments. Rep. Sherrod Brown (D-OH) states, “no one who understands the concept would confuse the prescription drug market for a competitive free market.” He continues, “Indulging the fantasy that the drug market bears any resemblance to the idealized college textbook free market is a waste of time and money that the American people don’t have” (p. 3). The chair of the subcommittee, Nathan Deal (R-GA), quips AWP stands for “ain’t what’s paid” (p. 1). The committee as a whole clearly was interested in gaining the best information on how best to reform prescription drug payments, and in this case turned to Arizona’s experience for guidance.

The Arizona Health Care Cost Containment System (AHCCCS, pronounced “access”) was established under a 1982 section 1115 waiver, creating a statewide managed care network where providers engaged in competitive bidding to participate in the program (Weissert and

Weissert 2006: 268). The Arizona Medicaid program contracted with the Lewin Group, an independent consulting firm, to compare the cost of prescription drugs in AHCCCS compared to that paid in other state Medicaid programs. The Lewin study showed that Arizona's program filled 70% of prescriptions using generic drugs, with only a \$2 dispensing fee. This compared favorably with other state programs that ranged from 40% to 50% generic, and with \$3 to \$11 dispensing fees. In addition, beneficiary satisfaction with prescription drug services was quite good, with only about 1% of all quality of care complaints centering on prescription drugs.

Assuming the efficiency of Arizona's model would benefit both state and federal levels if adopted more broadly, the interests in this case between state and federal actors were well aligned. In addition, Arizona itself conducted an audit of its own program through the independent Lewin group study, in effect subsidizing the costs to the federal government for auditing the program. On both counts, interest alignment and auditing transparency, the conditions were right for state expert advice to be persuasive to the committee members. And indeed, Arizona's programmatic expertise from administering AHCCCS appeared to be persuasive to members of the Republican majority. During the first panel, Michael Bilirakis noted that AHCCCS appeared to be quite effective at reducing the cost of prescription drugs. This is well illustrated in an exchange between Bilirakis and Douglas Holtz-Eakin, the director of the Congressional Budget Office (CBO).

DR. DOUGLAS HOLTZ-EAKIN [Director of the CBO]. With the wide diversity of experience in the States, I think that is a great laboratory to really look and see where it seems to be the most successful. And the Arizona model is one that certainly stands out. It doesn't look like most of the other Medicaid programs, and accounting for all of the

differences, the heavy reliance on managed care, for example, is something that we would be interested in working with you on.

MR. BILIRAKIS. Well, why aren't the States taking a good look at the Arizona model, or are they?

Chairman Nathan Deal (R-GA) stated at the hearing, "it seems like all we really need to do is sort of patent the Arizona model and that it would work for the rest of the country...." (p. 92).

If members of the committee were ready to accept the expert advice of states on this question, one would expect to see a fair amount of give and take between the committee members and the state level witness at the hearing. Anthony Rodgers, Director of the AHCCCS, appeared on the second panel of the hearing. Appearing on the second panel alongside Rodgers of AHCCCS were Craig Fuller, President and CEO of the National Association of Drug Store Chains (NADSC), Kathy King, Director of Health Care at the General Accounting Office (GAO), and Jack Calfee, resident scholar of the American Enterprise Institute (AEI). All of these panelists have deep programmatic knowledge about the AWP and state Medicaid prescription drug policies. A count of the number of questions posed to each of these witnesses shows that the most questions were directed to Rodgers of AHCCCS (10 questions), then Fuller of NADSC (9 questions), then King of GAO (4 questions) and Calfee of AEI (1 question). Indeed, most of the questions directed at Rodgers focused on the mechanics of the AHCCCS program and the conditions for its success, including the results of the Lewin Group study. Many of the questions directed to Fuller of the NADSC inquired whether his group had objections to the Arizona model. Calfee, the witness from a research organization, the policy think tank AEI, was almost completely neglected in the questioning. Overall, it appears that Arizona's expertise was quite informative and persuasive to the committee members.

Intergovernmental transfers: A case of partial conflict. The Medicaid program is designed so that state and federal governments share program costs at a set rate. From time to time, however, some states have used various payment mechanisms to draw down federal matching funds without expending their own money, unilaterally shifting some of the cost of the program to the federal treasury (Wiessert 1992: 99, Weissert and Weissert 2006: 267). One means for states to do this is to make a public health care facility eligible for a higher payment rate, triggering higher matching contributions from the federal treasury, and then require that provider to pay a portion of the surplus back to the state in the form of taxes or voluntary contributions. That is, under this mechanism states and providers enter into an agreement that the provider would return surplus payments to the state treasury, enabling the state to draw down money from the federal government without expending its own funds. In some cases, states have diverted this surplus to other, non-Medicaid programs such as for education or transportation.

States have used two programs to make providers eligible for higher payment rates. The disproportionate share hospital payments (DSH payments) program authorizes higher payments to public hospitals and community health centers serving a large number of low income patients (Wiessert 1992: 100). Upper payment limits (UPL) allow states to reimburse some of these providers up to the highest Medicaid reimbursement rate (Weissert and Weissert 2006: 267). Both the DSH and UPL programs are intended to offset the costs of providing care to a large number of low-income Medicaid and uninsured patients. Since many of these providers are state entities, states can recycle these higher payments back to the state treasury through intergovernmental transfers (IGTs), or funds that transfer between different levels of state government. Not all IGTs are evidence of this payment recycling, however, since some states

use local tax dollars to fund some aspects of their Medicaid program. In addition, DSH and UPL are authorized by federal legislation and seen as a legitimate part of the state-federal partnership.

In 2004 the House committee on Energy and Commerce, subcommittee on Health held a hearing to investigate the nature and extent of these IGT practices, entitled “Inter-Governmental Transfers: Violations of the Federal-State Medicaid Partnership or Legitimate State Budget Tool” (March 18 and April 1, 2004). This is the same subcommittee as in the previous case involving the AWP, where both Republicans and Democrats found testimony from a state-level actor persuasive. In this case, however, Republican and Democrat committee members were in strong disagreement over the goals and merits of IGTs, and the discussion quickly became deeply partisan. While the Democratic minority focused on the importance of funding public health care facilities and the legitimacy of IGTs under federal legislation, the Republican majority expressed strong concerns that the IGTs in practice would violate the federal-state collaborative partnership at the heart of the Medicare program.

In this case, the Republican majority was uncertain about the true proportion of IGTs that were needed to actually cover program costs, and the proportion that were simply a ruse to draw down federal funding. For instance, the chair of the full committee, Joe Barton (R-TX), states, “in some instances [IGTs] are legal. It appears in many instances they are abused....” (p. 4), but it is not clear to the committee how to distinguish one from the other. Many members of the majority recognized, however, the problems that would arise if IGTs were restricted indiscriminately. One member of the majority, John Shimkus of Illinois, argues, “I think we can’t lose sight of how those states who have been using the intergovernmental transfer... to help the poor and stressed facilities that are providing needed health care benefits to the poor” (p. 9).

On the minority side, Democrats focused on the legitimate uses of IGTs, along with the importance of the DSH and UPL provisions for adequately reimbursing public health care facilities given their high percentage of low income patients. Like Republicans, Democrats also were concerned with any fraudulent efforts by states to draw down money from the federal treasury. But at the same time, the Democrats on the committee were concerned that the Bush Administration's 2005 budget included provisions to further restrict IGTs as a means to cut \$24 billion from Medicaid over ten years. Bart Stupak (D-MI) links the proposal to restrict IGTs to the Bush Administration's larger goals:

Today we begin to dissect how States finance their Medicaid programs in an effort to find \$23.5 billion in so called 'waste, fraud and abuse.' I am for transparency and honest bookkeeping, but I believe the purpose here is dubious. Certainly there are abuses that need to be addressed, but I find it hard to believe that the states are defrauding the government by \$23.5 billion. I have noticed a pattern that every time the majority starts talking about Medicaid reform they are also pushing for more tax cuts (p. 10).

That is, when Democrats on the committee emphasized the legitimacy of states' IGT practices, they were not favoring states' raiding the federal treasury, but instead they were resisting the Bush administration's back door efforts to restrict Medicaid funding.

The first panel of the hearing focused on two federal audits of state IGT practices, one done by the GAO and one by HHS. But it became apparent how difficult it was for these agencies to distinguish the legitimate from illegitimate uses of IGTs. For instance, George Reeb, Assistant Inspector General for CMS Audits, Office of Inspector General, HHS, stated in his testimony, "We have found that current policies and practices involving intergovernmental transfers severely limit the ability of policy makers to manage, account for, and assess the

benefits of Medicaid dollars” (p. 23). But in response to this Anna Eshoo (D-CA) asked Reeb, “So have you given any estimate in terms of what can be saved relative to the audits and the misuse of funds?” To which Reeb replies, “No, ma’am” (p. 40). Bobby Rush (D-IL), pressed Reeb more specifically about IGT practices in Illinois, noting Illinois increased Medicaid funding by a total of \$27 billion from 1992 to 2003, with IGT funds only totaling \$5.2 billion.

MR. RUSH [D-IL]. Did you try at all to figure out whether or not Illinois was actually diverting IGT funds from health related services to other uses?

MR. REEB [HHS-OIG]. No sir. We do not try to go into the general accounts and try to determine the use. It loses its identity. The Medicaid funds that were returned lost their identity when they go into the general Treasury. So to audit the entire State’s expenditures... would be fruitless.

MR. RUSH. So is there any other means and methodology that you could have used other than looking at the entire general budget for the State?

MR. REEB. Well, I think the comments from the State, that is why we put auditee comments into the reports, to make sure that we have the balance of both auditor and the auditee and their comments, in return, said, in effect, ‘I am using the funds for the purposes of health care because look at my expansion in Medicaid (p. 57).

That is, HHS auditing simply cannot track where money goes within state accounts and ultimately requires simply taking the state’s word about the legitimacy of its own practices. And note that, in strong contrast to the AWP case, states in this case are not going to any length to subsidize federal audits or to make their internal accounting practices transparent to federal auditors. As I discuss briefly in the appendix, this pattern is likely to be true as a general principle: since states have considerable control over just how transparent their programs are to

federal auditors, it is likely that the relative transparency of programs to federal auditors and the degree of interest alignment are likely to covary.

Kathryn Allen, Director of Health Care, Medicaid and Private Health Insurance Issues at the GAO, a congressional support agency, also appeared on their first panel, and her testimony reinforced the costs and difficulties involved in auditing IGT flows in state budgeting. Bilirakis asks her, “Are there ways to be able to determine how many of these dollars and to whom they are directed for purposes other than Medicaid, you know, these schemes that we are talking about here?” To which Allen replies, “I would take some good, hard auditing, a lot of resources, but yes, I believe we could” (p. 61). In the exchange between Republican committee members and the two witnesses discussing the federal audits, it is clear how much the Republican majority desires good auditing data to guide its policy decision making, but that it is equally apparent that such data simply do not exist.

Given the misalignment of interests between the majority on the committee and the states, and the high costs of auditing in this case, I expect that the majority on the panel would not find state expert advice credible. On the second panel of the day, Barbara Edwards, Deputy Director, Office of Medicaid, Ohio Department of Job and Family Services, also representing the NGA appeared alongside Dennis Smith, Director of the Center for Medicaid and State Operations, CMS. In contrast to the pattern in the previous case where the state-level witness was the focus of the discussion, Edwards is mostly neglected during the give and take of this panel between witnesses and committee members. Instead, Smith is the focus of attention. Here, members directed 109 questions to Smith and only six to Edwards. Overall, Edwards’s expertise on IGTs appears to gain little to no attention at the hearing.

Notice that neither Democrats nor Republican members direct many questions to Edwards, even though Democrats were somewhat more sanguine about states' use of IGTs. Indeed, among the few questions directed to Edwards came from Republican Heather Wilson, who was somewhat sympathetic to Ms. Edwards since she herself is a former cabinet secretary for the New Mexico Children, Youth and Family Department. This suggests that preference similarity is not in itself sufficient for credibility to arise in the case of mixed federalism in the absence of transparency to federal auditors. Given the near absence of hard auditing information, and committee members' underlying concern that states were trying to expand federal funding without making a commitment of their own resources, the expertise of the state level agency official in this case simply was unpersuasive to both sides of the committee.

Summary of the cases. The formal model suggests that two conditions are important in making state level expertise informative to federal decision makers: the alignment of intergovernmental interest and the transparency of state programs to federal auditors. In the first case on the AWP, both of these conditions are met and the state level witness's expertise appears to be informative. In the second case on IGTs, neither condition is met so the state level witness's expertise appears to be uninformative.

These cases demonstrate the joint, but not the separate, necessity of the conditions. Empirically it is very likely that these state-federal interest alignment and auditing transparency will strongly covary, and their separate effects are likely to be difficult to distinguish in practice. In the IGT case, the fact that even Democrats do not appear to find state-level expertise credible, and that Republicans so deeply lament the absence of hard auditing data, helps to establish the importance of auditing as part of the mechanism for incorporating state administrative experience and expertise into federal policy in the case of mixed federalism.

Statistical model

These two case studies help to illustrate the basic result of the formal model: the less aligned interests are between state and federal actors, the less updating and learning typically will occur among committee members from state level expertise. Federal auditing to some degree can improve the credibility of state expertise in the case of disagreement, but to the extent that interest alignment and auditing transparency covary auditing will not cause all state level expertise to become informative. Thus, it is likely that the federal system cannot fully realize one of its greatest promises, the ability to learn from decentralized program administration and experimentation.

To test this “failure of federalism” hypothesis more systematically, I conduct a statistical test to examine whether or not committee members tend to direct fewer “analytical sentences,” or sentences that are coded as falsifiable, to state-level lobbyists. One useful comparison is to hearings regarding the Medicare program, which is wholly administered and funded at the federal level. No conflicts of interest can occur when state lobbyists offer their expertise to advise federal actors on the Medicare program, while conflicts do occur with some regularity regarding Medicaid. This implies that witnesses from state governments should be less persuasive on average when discussing Medicaid compared to Medicare. As a consequence, I expect fewer analytical sentences directed to state level witnesses when the issue touches on Medicaid than when the issue is Medicare.

Similarly, academic witnesses from universities and think tanks are less likely to have a conflict of interest with committee members, either because they conduct “value neutral” scientific research, or because the committee is free to schedule experts with compatible ideologies. As a result, when discussing Medicaid policy, committee members should direct

more analytical sentences to witnesses from research-based organizations compared to witnesses from states, even though both types of witnesses are likely to have extensive programmatic knowledge of Medicaid administration.

Data. The data come from a random sample of 32 hearings from the population of 133 Medicare and Medicaid hearings in House and Senate between 2000 and 2003, using the CIS descriptors “Medicare,” or both “Medicare and Medicaid,” to define the sampling population.² The unit of analysis is the witness, and the sampling method groups witnesses within hearings. For each witness, I first count the total number of sentences (typically, questions) that committee members direct to the witness in the course of the hearing. In this sample, a total of 112 witnesses received at least one sentence. Among those who received at least one sentence, I then count the number of these sentences that were analytical, where “analytical” is defined as a falsifiable statement.³ These statements typically inquire about the conditions and causes of social problems, or the causal consequences of new interventions or of inaction. That is, falsifiable sentences come from members engaged in policy analytical discourse (Esterling 2007). Categories of sentences that are not falsifiable include statements of opinion, normative assertions, and statements that rely on non-falsifiable anecdotal evidence.

² These data were collected as part of a larger project on Medicare politics. The Medicaid hearings that were sampled into the dataset were ones that happened to discuss both related programs. The consequence though is that the data on Medicaid witnesses are relatively sparse in this dataset.

³ To assess the reliability of the coding, a research assistant coded a random sample of sentences (n=578) with a Cohen’s Kappa reliability statistic of 0.57, or 71% agreement rate (32% expected agreement, $p < 0.0001$). All member sentences were double coded by the principal investigator and a research assistant, with the former resolving disagreements. Reliability is not a particularly important issue for this application, since error on the dependent variable simply decreases efficiency.

I expect state level witnesses will attract fewer *Analytical sentences* (mean 14.5 questions, standard deviation 11.8 questions) relative to research organizations when discussing the Medicaid program. In addition, I expect state level witnesses will receive fewer analytical sentences in hearings over the Medicaid program compared to hearings on Medicare. Of the 112 witnesses, 12 appeared on Medicaid panels. I code participation on a *Medicaid panel* to equal one if the hearing panel focuses on Medicaid, zero if on Medicare. Seven were *State-level witnesses* who were either employees of a state agency or were representing the National Governors Association. Thirty seven witnesses in the sample were employed by *Research organizations* such as a university or think tank. For convenience, label the remaining lobbyists from trade associations, firms, hospitals, and voluntary associations as “ordinary lobbyists.”⁴ To test whether participating on Medicaid (as opposed to a Medicare) panel suppresses the count of analytical sentences to either type of lobbyist, I include a term interacting intergovernmental lobbyist with Medicaid panel, and a separate term interacting research organization with Medicaid panel.

For controls, I include a fixed effect for *Panels where at least one witness represented a state interest*, in the event these panels were somehow different from the remaining panels.

⁴ Note that there were relatively few state-level witnesses, since there data were collected for a larger project that focuses on Medicare politics. This low variability on the independent variable has three implications: 1) the model will have low statistical power and will bias against finding statistically significant effects, meaning that larger effects will be required to find statistical differences. The converse is not true, however; one cannot draw conclusions from any insignificant findings. 2) I cannot test more nuanced hypotheses since multiplying the number of design cells with additional interactions will make each cell too sparse. 3) One must be cautious in generalizing even significant findings because of sampling variability; small cell sizes make the results vulnerable to distortions from unusual cases.

Twenty two witnesses were on panels that had at least one state-level witness. I include a fixed effect for *Chamber*; 23 witnesses were in hearings before the Senate. I control for the proportion of *Empirical analytical statements* in witnesses' testimony that was falsifiable and also cited research (11.6% mean, 13.3 standard deviation) to hold constant the actual informativeness of each witnesses. I also control for the *Total number of sentences* addressed to the witnesses (mean of 26 sentences, standard deviation of 22 sentences), which holds constant any latent "attractiveness" of each witness as a recipient of members' attention.

Estimation. Given the structure of the data that groups witnesses by hearings, I estimated a random effects Poisson regression, as implemented in the Stata statistical software (www.stata.com), using the hearing as the level 2 unit. The model assumes an orthogonal random effect that varies across hearings, based on a Gamma distribution with mean zero and freely estimated variance. In the application below, the likelihood ratio test of the null expectation that there is no across hearing variance is rejected ($p < 0.01$).⁵

The estimand of interest in this exponential mean count model with an interaction term is the percentage rate change (see Cameron and Trivedi 1998: 81-82, Esterling 2007) from counterfactually changing the organization type from ordinary lobbyist to state-level witnesses first for Medicaid panels, then for Medicare panels, and then evaluating the statistical differences

⁵ While this model is somewhat complex, the results are very similar to the results I obtain from an ordinary Poisson regression, and retrieves point estimates that similar are similar to the negative binomial specification but the estimates are more efficient. The even more complex random effect negative binomial (RENB) model estimated a zero mean and variance for the random effect distribution and was unstable and poorly conditioned. Further, including the extra variance parameter in the RENB model not significantly improve the likelihood function in a likelihood ratio test.

between these two estimands. I also estimate these same counterfactual changes for research organization witnesses. I estimate the standard errors for these nonlinear functions of the structural parameters by the delta method as implemented in Stata.

Results. The center portion of Table 1 shows the counterfactual effects, or the percent change estimated of changing the witness from an ordinary lobbyist to each of the two other lobbyist types, for both Medicaid and Medicare panels. The first row in the table gives the counterfactual effect of changing the witness from an ordinary lobbyist to a state-level witness, first assuming a Medicaid hearing, then assuming a Medicare hearing. The second row gives the counterfactual changes for research organization witnesses. The outer portion of the table tests for the differences in these effect estimates, including the bottom right cell that tests for a difference in the differences.

Table 1. Percent Rate Changes (standard errors in parentheses)			
	Medicaid Hearings	Medicare Hearings	Row Difference
State-level Witness	-41.7%* (18.2)	30.2% (37.5)	-71.9%+ (40.8)
Research Organization Witness	91.0* (40.7)	7.51 (6.77)	83.5* (41.3)
Column Difference	-133* (41.1)	37.7 (36.6)	-155* (55.3)
* $p < 0.05$, + $p < 0.10$			

On Medicaid panels, state-level witnesses attract 42% ($p < 0.05$) fewer analytical sentences compared to ordinary lobbyists. Since all witnesses attract an average of about 15 sentences, a typical state lobbyist would attract about 6 fewer sentences. In contrast, research organization witnesses attract 91% more analytical sentences ($p < 0.05$) than ordinary lobbyists, for a difference in rates of 133% ($p < 0.05$) between state levels witnesses and research organization witnesses. This means that state government witnesses receive about 20 fewer analytical sentences than research organization witnesses when discussing the Medicaid

program. On Medicare panels, both witness types attract a similar number of sentences as ordinary lobbyists.

The final column of the table shows the effect of participating on a Medicaid as opposed to a Medicare panel, for each witness type. State-level witnesses attract 72% fewer sentences on Medicaid than on Medicare panels ($p < 0.10$), or about 11 fewer analytical sentences, while research organizations attract 84% more ($p < 0.05$), with a difference between these differences equal to 155% ($p < 0.05$).

In summary, state level witnesses tend to receive fewer analytical sentences when the panel focuses on Medicaid as opposed to Medicare questions, and research organizations tend to receive more analytical sentences than do state level witnesses when the panel is on Medicaid. These results are strongly consistent with the proposition that differences in underlying preferences tends to suppress the persuasiveness of state's expert advice to federal level legislators. Qualitatively within the sample, the hearings where state level witnesses received below the median number of analytical sentences were focused on questions of fraud and abuse in Medicaid administration, similar to the second case study, and those above the median were on questions related to less contentious issues surrounding long term care for the elderly. The state level witnesses that testified on the Medicare program discussed means to make the program more efficient in paying for prescription drugs and organizing disease management programs, similar to the first case.

Discussion and Conclusion

One of the core justifications of a federal system asserts that states serve as laboratories for policy innovation and administrative learning, expertise that should benefit other states and

the federal government as each pursues important national objectives. The extent to which programmatic knowledge of states translates into federal action is limited by a collective action problem, however, when the federal actors are uncertain whether or not their interests in fact are aligned with state interests. I show that there is considerable variation within the Medicaid program in the extent of conflict and cooperation between the levels of government. When state and federal interest are aligned and state programs are transparent to federal auditors, as in the case discussing prescription drug pricing and the AWP, state level expertise is persuasive and hence influential to federal actors. When state and federal interests depart and state programs are opaque to federal auditors, as in the case examining the nature of state IGTs, states' expertise is less persuasive.

Observers of intergovernmental relations within federalist system have noted that the degree of conflict varies across and within policies (Gormley 2006: 525, Zimmerman 2001: 28), assigning labels such “cooperative,” “dual,” “functional,” or “coercive” federalism as descriptions for this variation. The statistical results show that in the aggregate, given the regularity of state-federal conflict, state programmatic expertise often does not help to inform federal policy making. Indeed, the model shows that when discussing the Medicaid program, congressional committee members appear not only to favor the testimony of witnesses from think tanks and other research organizations over that of state agency officials, committee members also appear to favor the testimony of the lobbyists from industry and trade associations over state agency officials who have day-to-day experience administering the program.

The structure of federalism creates limitless possibilities for gaining policy knowledge through decentralized administration and experimentation. But simultaneously the federal structure limits the capacity of the system to act on that knowledge. To the extent

intergovernmental conflict occurs, there is an untapped potential to use state level expertise for national purposes, or a “failure of federalism,” where the public good that comes from sharing state level expertise is not realized in national policymaking.

Appendix

This appendix gives the formal statements of the signaling games summarized in the text. These “cheap talk” models are adapted from McCarty and Meirowitz (2006: 232-234).

The case of complete cooperation (“cooperative federalism”). The game with complete cooperation is illustrated in Figure A1. There are two players, F for federal government actor, and S for state and local government actor. In this case, assume that there are two possible states of the world that could result from a policy if enacted: the policy either will efficiently extend services without additional cost to the program (at either level of government), or the proposal will provide rents to a special interest at some cost to the program (equally shared at both levels).

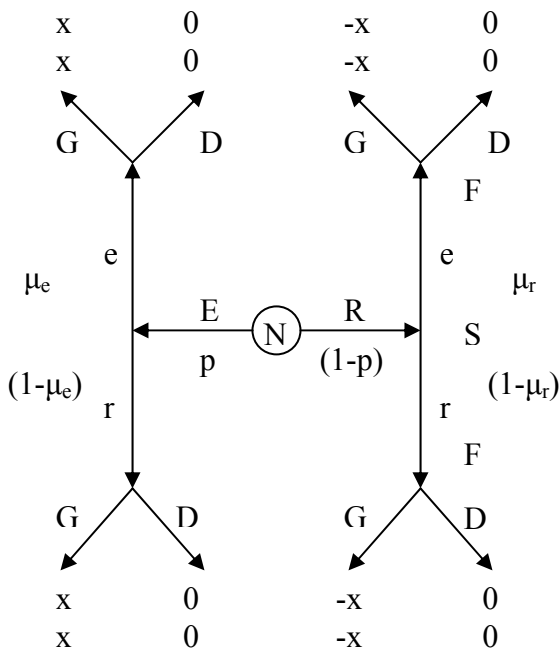


Figure A1. Case of complete cooperation

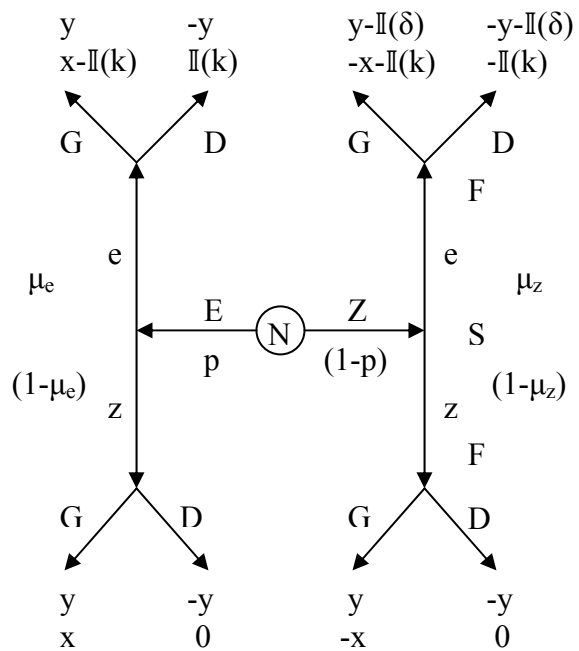


Figure A2. Case of partial conflict

Let G stand for “grant request,” D stand for “deny request”, E stand for “efficient proposal,” and R stand for “rent-providing proposal.” For $i \in \{F, S\}$, let $U_i(G|E) = x$, $U_i(G|R) = -x$, and $U_i(D|\cdot) = 0$, with $x > 0$. The common prior probability of E is $p < 1/2$. S can give one of two messages $m \in \{e, r\}$, where e stands for the message “the program is efficient,” and r stands for the message “the program provides rents to a special interest.” Note the messages are cheap talk in that they do not enter S’s utility function. Denote S’s strategies by the probabilities $\{\mu_e = p(e|E), \mu_r = p(e|R)\}$. F’s posterior belief π that E is true is given by Bayes rule:

$$\pi = \frac{p}{p + \mu_r(1 - p)} \quad (1)$$

Without lobbying, F will vote D because $p < 1/2$. This presents a collective action problem for both F and S when the true state of the world is E, since in that case both would be made better off if F voted G.

Consider the following pure strategy for S, $\mu_e = 1, \mu_r = 0$. In this case $\pi = 1$ upon hearing the message e . The expected utility for choosing D upon hearing the message e equals 0 while the expected utility for choosing G is 1. Since $EU_F(D|e) < EU_F(G|e)$, F chooses G. To show this is a pure strategy equilibrium, note that $EU_S(e|R) = -x < EU_S(r|R) = 0$, so S has no incentive to deviate from its pure strategy. In summary, in the purely cooperative case, S’s expertise is always persuasive to F.

The case of partial conflict (“mixed federalism”). The case of mixed federalism is illustrated in Figure A2. In this case, assume that there are two possible states of the world: either the program will efficiently extend services at no cost to the program (benefiting both levels of government), or the program is zero sum, extending services at some cost to the federal government but at no cost to the state government. In the former case the interests of F and S are

aligned (“cooperative”) and in the latter case they are not (“conflictual”). Assume further that there has been some dislocation in the state economies, and if nothing is done the states will be made worse off.

The notation for actors, actions, and priors remains the same as the cooperative case, except the states of the world are now E for when the proposal is “efficient” and will support additional services without a cost to the federal government and Z for when the proposal is “zero-sum” and will add additional state level services at some cost to the federal government. In this case, $U_F(G|E) = x > 0$, $U_F(G|Z) = -x$, $U_F(D|.) = 0$, $U_S(G) = y > 0$, and $U_S(D) = -y$. The messages available to the state level actor are e , indicating the policy is efficient, and z , indicating the policy is zero sum. Message e is sent with probability μ_z when Z is true and with probability μ_e when E is true. As above, the messages themselves do not enter into either actor’s utility function. F’s posterior belief π that E is true is given by:

$$\pi = \frac{p}{p + \mu_z(1 - p)} \quad (2)$$

Since there is the potential for conflict in this case, there needs to be an institutional mechanism to generate an informative mixed strategy equilibrium (see Ainsworth 1993, Rasmussen 1993). Assume that F can audit the message that S sends with cost equal to $k > 0$ and discover the underlying state of the world with certainty. To simplify the presentation, define an indicator function $\mathbb{I}(k) = k$ if F conducts the audit, and otherwise equals zero. F will audit only when she hears the message e , and upon hearing e will audit with probability α . If the audit reveals that S had attempted to mislead F, then F will punish S by quantity $\delta > 0$, which could represent either a change in the current policy that sets S at an even further disadvantage, or a discounted future stream of lost revenue that comes from diminishing the trust that F currently holds for S. Define

the indicator function $\mathbb{I}(\delta) = \delta$ if F conducts an audit and discovers a false message, and zero otherwise.

Without lobbying or auditing, F will choose D, S's worst payoff, since $p < \frac{1}{2}$ and $\mathbb{I}(k) \geq 0$. F will choose to audit even without lobbying if $(p)(x) > k$, and will choose G when E is true. That is, the lower the cost to audit, the more likely S will get his preferred outcome when E is true even without lobbying.

There are no pure strategy equilibria that will result in a different outcome from the no lobbying case. In the case of $\mu_e = 1$ and $\mu_z = 1$, the denominator in equation 2 equals one and F's posterior belief equals the prior. In the case of $\mu_e = 1$ and $\mu_z = 0$, the denominator of equation (2) will equal the numerator, and so F will completely update her beliefs given either message. F will choose D upon hearing z and G upon hearing e . As a result, S will deviate to the pure strategy $\mu_z = 1$, so the pure strategy $\mu_z = 0$ cannot be a Nash equilibrium.

Informative mixed strategy equilibria do exist, however, where F chooses α and S chooses μ_z endogenously and sets $\mu_e = 1$. In a mixed strategy equilibrium, S will choose μ_z so that F is indifferent between voting G and auditing upon hearing the message e . This requires $2(\pi)(x) - x = (\pi)(x) - k$, which equates F's posterior expected utility from voting G without an audit, upon hearing the message e , with her posterior expected utility from auditing. Solving this equation for π in terms of x and k , and making use of equation (2) retrieves

$$\mu_z = \frac{pk}{(x - k)(1 - p)} \quad (3)$$

Equation 3 implies that as p and k increase, so does the probability that S will falsely report e when Z is true, but at the same time, the amount that F updates her beliefs decreases as this probability increases. Notice that to make μ_z a probability, k must be constrained so that $(x)(1 - p) < k$.

At the same time, F must set α to make S indifferent between saying e or z when Z is true. When Z is true, S's posterior expected utility from telling the truth is $-y$, since F will update completely upon hearing z (since $1 - \mu_e = 0$, F can completely rule out E is true); and S's posterior expected utility from lying is $(\alpha)(-y - \delta) + (1 - \alpha)(y)$, because F will vote G if she does not conduct an audit. Setting these expected utilities equal and rearranging yields

$$\alpha = \frac{y}{y + \frac{\delta}{2}} \quad (4)$$

Equation (4) implies that as the cost of the punishment increases, the probability of an audit can decrease and still maintain a mixed strategy equilibrium. That is, there is a tradeoff for F between the size of the punishment and the need to audit. Note too that the size of the punishment does not affect the informativeness of the equilibrium (larger prospective punishments do not make S tell the truth more often), since in a mixed strategy equilibrium it is the other player's utilities that affect behavior.

In this equilibrium, F induces S to sometimes tell the truth when the truth is Z , and as a consequence F will sometimes vote G when she hears the message e . S can expect positive utility from this game if two conditions are met:

$$\mu_z < \frac{p}{1 - p} \quad (5a)$$

$$\alpha < \frac{2(y + p)}{2y + \delta} \quad (5b)$$

Condition 5a is less of a constraint as the prior p approaches its upper bound of 0.5. The limit for α as p approaches 0 and δ approaches y is $2/3$. Thus the conditions for the existence of a mixed strategy informative equilibrium are not overly restrictive.

Note that when E is true, the potential for cooperative federalism exists, in that both F and S have aligned interests. In this situation, S's expertise can only be persuasive when F has a

capacity to audit S's statements. Without the audit mechanism, no mixed strategy equilibrium exists since for S to be indifferent between messages z and e when the truth is Z requires F to always vote D upon hearing e . But this implies that F deviates from the mixed strategy, and that S has no incentives to lobby. F does not always exercise its capacity to audit, though. In turn, S sometimes reports the truth when the truth is not in its favor, and always reports the truth when the truth is in its favor. As a consequence, S has limited, but not complete, capacity to use its expertise to persuade F when state and federal interests are only partially aligned.

This analysis takes the cost of auditing as exogenous. As the cost for F to audit decreases, by equation (3) the equilibrium probability of S sending a message e when Z is true decreases, and by equation (2) the extent to which F revises her posterior beliefs increases. In practice, however, states and localities have considerable control over the ease by which the federal government can audit their programs. In a dynamic setting, it is likely the cost to audit itself is endogenous, where one might expect auditing institutions to evolve in a way that the cost to audit is correlated with the degree of state and federal conflict.

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