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## INSTITUTIONS AND STATE SPENDING: AN OVERVIEW

By Matthew Mitchell and Nick Tuszynski

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# Institutions and State Spending: An Overview

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Matthew Mitchell and Nick Tuszynski<sup>1</sup>

## Abstract

U.S. fiscal policy at the federal, state, and local level is on an unsustainable path. While reformers should look for ways to reduce spending on particular budget items, tomorrow's legislatures may easily reverse these cuts. In contrast, a change in the rules that govern the political process—the “institutions” that shape a budget—can have a lasting effect on spending for years to come. Codified in statutes and in constitutions, these institutions include the rules of budgeting, electioneering, and legislating. They influence the decisions of legislators, governors, presidents, bureaucrats, voters, and even lobbyists. As such, institutional reform can be a more effective and sustainable path to fiscal probity than a one-time budget cut. This paper summarizes the empirical investigations of sixteen state-level institutions. The lesson for both state and federal policy makers is that there are a number of institutional reforms that seem likely to put spending on a more sustainable path.

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## Introduction

U.S. fiscal policy at the federal, state, and local level is on an unsustainable path.<sup>2</sup> While reformers should look for ways to reduce spending on particular budget items, tomorrow's legislatures may easily reverse these cuts. In contrast, a change in the rules that govern the political process—the “institutions” that shape a budget—can have a lasting effect on spending for years to come.<sup>3</sup> Codified in statutes and in constitutions, these institutions include the rules of budgeting, electioneering, and legislating. They influence the decisions of legislators, governors, presidents, bureaucrats, voters, and even lobbyists. As such, institutional reform can be a more effective and sustainable path to fiscal probity than a one-time budget cut.

Justice Brandeis famously referred to the federal system as a “laboratory” in which each state was free to implement novel social and economic experiments.<sup>4</sup> For the social scientist interested in understanding how institutions affect policy outcomes, the metaphor is apt. Each of the 50 states has its own set of institutions and some of these have changed over the course of the last several decades. At the same time, many other factors that might influence outcomes are invariant across the states. In other words, cross-state studies effectively control for factors such as macroeconomic conditions, culture, and the broad legal/constitutional setting in which each state operates. Moreover, researchers are able to employ various econometric techniques to control for the influence of those factors that *are* different across states such as climate or demography. In sum, the setting provides a rich laboratory in which to test the effect of different institutions on spending.

A large number of researchers have performed these tests and this paper reviews this literature, summarizing the effect of more than a dozen institutions on state spending.<sup>5</sup> This paper concentrates on peer-reviewed studies that rely on large data sets and well-accepted econometric techniques. Each of these studies carefully accounts for other factors that have been shown to impact spending such as demography, climate, and the economy.

This paper begins with some of the most-studied institutions, e.g., strict balanced budget requirements, move on to those that have received comparatively less attention, e.g., item-reduction vetoes, and

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<sup>2</sup> For past state spending, see Matthew Mitchell, “State Spending Restraint: An Analysis of the Path Not Taken,” (working paper, Mercatus Center at George Mason University, Arlington, VA, 2010), [http://mercatus.org/sites/default/files/publication/State%20Spending%20Restraint%20An%20Analysis%20of%20the%20Path%20Not%20Taken%20corrected.%2010.1.10\\_0.pdf](http://mercatus.org/sites/default/files/publication/State%20Spending%20Restraint%20An%20Analysis%20of%20the%20Path%20Not%20Taken%20corrected.%2010.1.10_0.pdf). For future state spending, see Jeffrey Miron, “The Fiscal Health of U.S. States,” (working paper, Mercatus Center at George Mason University, Arlington, VA, 2011), [http://mercatus.org/sites/default/files/publication/State%20Spending%20Restraint%20An%20Analysis%20of%20the%20Path%20Not%20Taken%20corrected.%2010.1.10\\_0.pdf](http://mercatus.org/sites/default/files/publication/State%20Spending%20Restraint%20An%20Analysis%20of%20the%20Path%20Not%20Taken%20corrected.%2010.1.10_0.pdf). For future federal spending, see Congressional Budget Office, *Long Term Budget Outlook* (Washington, DC, June 2011), <http://www.cbo.gov/doc.cfm?index=12212>.

<sup>3</sup> The Nobel Laureate Douglass North is often considered the father of modern institutional economics. In his terms, institutions “are the humanly devised constraints that shape human interaction.” Douglass North, *Institutions, Institutional Change and Economic Performance* (New York: Cambridge University Press, 1990).

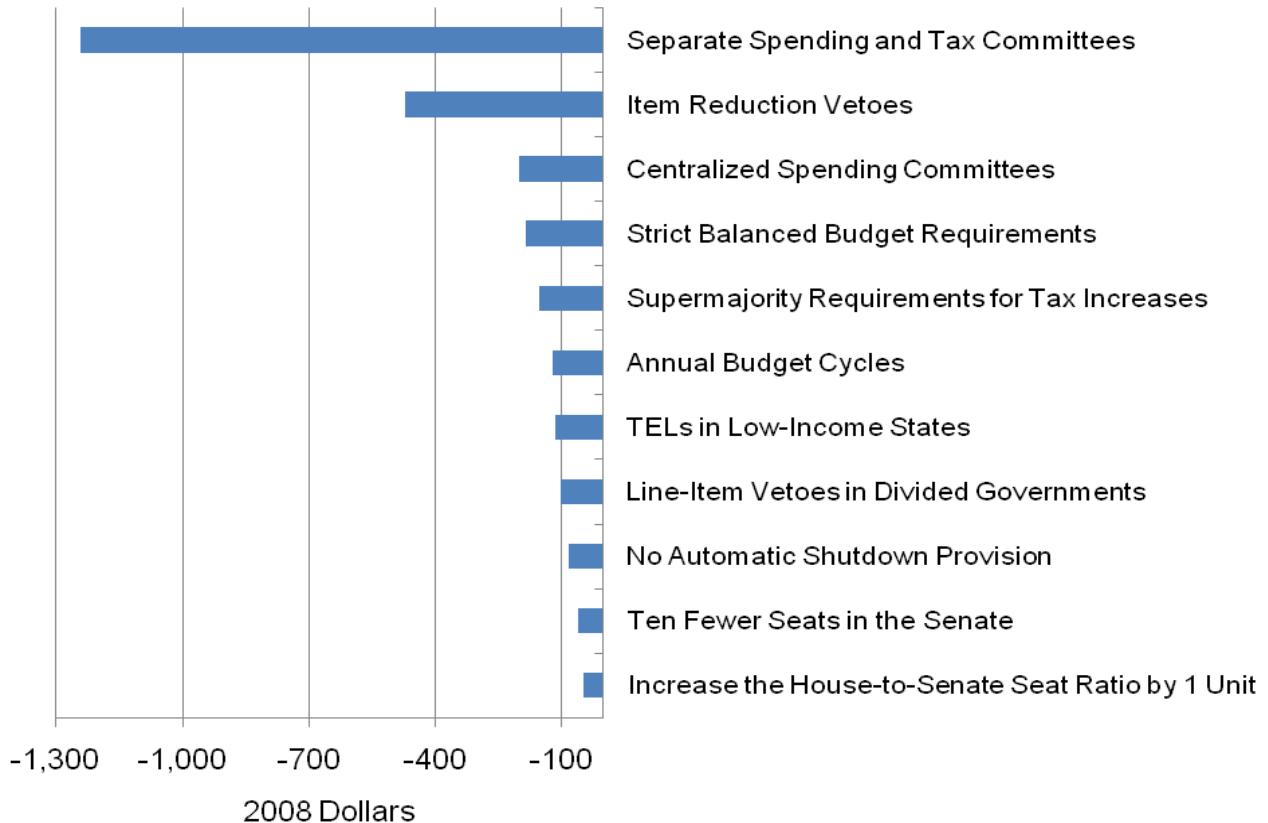
<sup>4</sup> *New State Ice Co. v. Liebmann*, 285 U.S. 262 (1932), <http://caselaw.lp.findlaw.com/scripts/getcase.pl?court=us&vol=285&invol=262>.

<sup>5</sup> Though this paper focuses on the effect of institutions on spending, there is a larger literature focusing on the effect of institutions on a wide variety of policy outcomes. For a review of this larger literature, see Timothy Besley and Anne Case, “Political Institutions and Policy Choices: Evidence from the United States,” *Journal of Economic Literature*, Vol. 41, No. 1 (March, 2003), 7-73, <http://www.jstor.org/pss/3217387>.

concludes with a pair of institutions, the study of which has yielded conflicting conclusions, e.g., direct democracy and term limits. Where possible, this paper presents the findings in terms of the institutions' impact on per capita spending and convert all numbers into 2008 dollars to permit side-by-side comparison. Our hope is that this overview will provide useful insights to state policy makers who may be interested in reform. We also hope it will be helpful to federal policy makers since many of these institutions may be transferred to the federal level.

Figure 1 highlights the results of those studies that present their findings in terms of per capita spending. To put some of these figures in perspective, 2008 state and local per capita expenditures averaged approximately \$5,708.<sup>6</sup> Thus, the studies we review suggest that these institutions can decrease per capita spending anywhere from 1 percent to 22 percent. It is clear that Justice Brandeis's "experiment" has yielded economically significant results.

Figure 1: The Marginal Impact of Institutions on Per Capita Spending



Sources: Separate Committees: Crain and Muris, 1995; Item Reduction Vetoes: Crain, 2003; Centralized Spending Committees: Crain and Muris, 1995; Strict Balanced Budget Requirements: Primo, 2003; Supermajority Requirements for Tax Increases: Crain, 2003; Annual Budget Cycles: Crain, 2003; TELs in Low-Income States: Crain, 2003; Line-Item Vetoes in Divided Government: Besley and Case, 2003; Shutdown Provisions: Primo, 2007; Senate Seats: Gilligan and Matsusaka, 1995; House-to-Senate Ratio: Chen and Malhotra, 2007. The authors have converted all figures into 2008 dollars.

<sup>6</sup> Authors' calculation. State Government Finances, U.S. Census Bureau (2010), [http://www.census.gov/govs/state/historical\\_data\\_2008.html](http://www.census.gov/govs/state/historical_data_2008.html) and Population Estimates, U.S. Census Bureau (2010), <http://www.census.gov/popest/eval-estimates/eval-est2010.html>.

## Sixteen Institutions and Their Effects on State Spending

### 1. Strict Balanced Budget Requirements

With the exception of Vermont, every state has a balanced budget requirement, but the stringency of these requirements varies widely. For example, in some states, the governor must submit a balanced budget, but the legislature need not pass one. In other states, estimates of the enacted budget need to show balance, but there are no consequences if these estimates prove wrong at the end of the fiscal year and the actual budget is out-of-balance. In some states, the legislature may carry-over a deficit from one year to the next, while in others they may not. Lastly, in some states an independently elected Supreme Court is the ultimate enforcer of the requirement, while in others the legislature appoints the members of the Supreme Court.

Even though balanced budget requirements are designed to ensure only that spending be less than revenue, there is reason to believe these requirements may reduce *both* spending and revenue. The Nobel laureate James Buchanan and his coauthor Richard Wagner explained why this might be when they observed that the ability to buy items for current voters while leaving future voters to pick up the tab systematically biases policy in favor of greater spending.<sup>7</sup>

Indeed, a number of studies have found that states with stricter balanced budget requirements tend to tax and spend less than other states. Henning Bohn of U.C. Santa Barbara and Robert Inman of the University of Pennsylvania, for example, find that per capita spending is about \$189 less in states with strict balanced budget requirements relative to those with only weak requirements.<sup>8</sup> David Primo of the University of Rochester arrives at a remarkably similar result, finding that strict balanced budget requirements reduce per capita spending by about \$184 per capita.<sup>9</sup> If this is the impact of moving from a weak to a strict balanced budget requirement, it is possible that if the federal government were to adopt a balanced budget requirement where none now exists then the impact would be even greater.

Strict balanced budget requirements have other salubrious effects. Bohn and Inman also find that states with strict requirements tend to have larger rainy day funds and larger surpluses and that states with these requirements tend to balance their books through spending reductions rather than revenue increases. Shanna Rose of New York University finds that states without strict balanced budget requirements are more likely to suffer from a “political business cycle” whereby policy makers increase spending just prior to an election, only to cut back following the election.<sup>10</sup>

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<sup>7</sup> James Buchanan and Richard Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (Indianapolis: Liberty Fund, [1977] 1999).

<sup>8</sup> This estimate, like all others reported in this paper, has been converted into 2008 dollars for ease of comparison. When authors report a range of estimates, we have taken the average and then converted that average into 2008 dollars. Henning Bohn and Robert Inman, “Balanced Budget Rules and Public Deficits: Evidence from the U.S. States” (working paper No. 5533, National Bureau of Economic Research, 1996).

<sup>9</sup> David Primo, *Rules and Restraint: Government Spending and The Design of Institutions* (Chicago: University of Chicago Press, 2003). Mark Crain has also corroborated this result. See Mark Crain, *Volatile States: Institutions, Policy and the Performance of American State Economies* (Ann Arbor: University of Michigan Press, 2003).

<sup>10</sup> Shanna Rose, “Do Fiscal Rules Dampen the Political Business Cycle?” *Public Choice* 128, no.3/4 (2006): 407-31.

But there may be some unintended consequences of a strict balanced budget requirement. Economists Noel Johnson, Matthew Mitchell, and Steven Yamarik recently concluded that while such rules limit the likelihood of partisan fiscal outcomes, they increase the likelihood of partisan regulatory outcomes. When Democratic-controlled states were unable to carry a deficit forward to the next fiscal cycle, they were more likely to raise the minimum wage, less likely to adopt a right-to-work statute, and more likely to regulate personal freedoms.<sup>11</sup>

## **2. State Rainy Day Funds**

Some commentators worry that a balanced budget requirement exacerbates the ups and downs of the business cycle. Since state budgets tend to be the tightest at the bottom of an economic downturn, this argument goes, strict balanced budget requirements force states to cut back on spending at the worst time.<sup>12</sup> One institutional answer to this critique is a “budget stabilization fund,” better known as a rainy day fund. States contribute to these funds during good years and then draw on them when the budget is strained due to a downturn or some other event such as a natural disaster. Forty-seven states currently maintain such funds, but like many institutions, their design varies on a state-by-state basis.<sup>13</sup>

Studies of rainy day funds suggest that they can smooth out the spending-cycle, but the details matter. Gary Wagner of Duquesne University and Erick Elder of the University of Arkansas conducted the most-comprehensive recent study of rainy day funds. They find that states whose rainy day funds have strict rules governing deposits and withdrawals tend to experience a \$14 per capita reduction in spending volatility (as measured by the cyclical variability of per capita spending over time).<sup>14</sup>

## **3. Supermajority Requirements for Tax Increases**

Fifteen states require supermajority votes of the state legislature to raise taxes.<sup>15</sup> Depending on the state, these rules require two-thirds, three-fourths, or three-fifths of the legislature to consent to a tax increase. In some states, the supermajority requirement applies to all taxes and in others it applies to a subset of taxes. A number of researchers have found that these rules reduce spending. Economists Mark Crain and James Miller III, for example, find that states with supermajority requirements for tax increases tend to increase spending at a slower pace.<sup>16</sup> A subsequent study by Brian Knight of Brown University finds that the effective tax rate in states with these requirements is between 8 and 23 percentage points lower than in states without such a requirement.<sup>17</sup> The latest and most-comprehensive studies suggest that these

<sup>11</sup> Noel Johnson, Matthew Mitchell, and Steven Yamarik, “Pick Your Poison: Do Politicians Regulate When they Can’t Spend?” (working paper, Mercatus Center at George Mason University, Arlington, VA, 2011), [http://mercatus.org/sites/default/files/publication/Partisan\\_Policies\\_Johnson\\_Mitchell\\_Yamarik\\_WP1128\\_0.pdf](http://mercatus.org/sites/default/files/publication/Partisan_Policies_Johnson_Mitchell_Yamarik_WP1128_0.pdf).

<sup>12</sup> Norman Ornstein, “Why a Balanced-Budget Amendment is Too Risky,” *Washington Post*, July 29, 2011, <http://www.aei.org/article/103883>.

<sup>13</sup> Kim Rueben and Carol Rosenberg, “State and Local Tax Policy: What Are Rainy Day Funds and How Do They Work?” in *The Tax Policy Briefing Book*, Tax Policy Center, August 12, 2009, <http://www.taxpolicycenter.org/briefing-book/state-local/fiscal/rainy-day.cfm>.

<sup>14</sup> Gary Wagner and Erick Elder, “The role of Budget Stabilization Funds in Smoothing Government Expenditures Over the Business Cycle,” *Public Finance Review*, Vol. 33, No. 4 (July 2005): 439-65.

<sup>15</sup> Bert Waisanen, “State Tax and Expenditure Limits—2010,” National Conference of State Legislatures, 2010.

<sup>16</sup> Mark Crain and James Miller III, “Budget Process and Spending Growth,” *William and Mary Law Review*, Vol. 3, No. 4 (1990): 1021-46.

<sup>17</sup> Brian Knight, “Supermajority Voting Requirements for Tax Increases: Evidence from the States,” *Journal of Public Economics*, Vol. 76, No. 1 (2000): 41-67. An effective tax rate is the percent of income that an average citizen pays in taxes.

requirements are associated with significantly lower per capita spending levels. Crain, for example, finds that states with these rules spend, on average, \$151 less per capita.<sup>18</sup> Similarly, economists Timothy Besley and Anne Case find that these rules reduce per capita spending by \$103.<sup>19</sup>

#### **4. Tax and Expenditure Limits**

In the last several decades, a number of states have experimented with formal rules that are specifically designed to arrest the rate of growth of government. These so-called “tax and expenditure limits” (TELs) are either codified in the statutes or constitutions of 28 states.<sup>20</sup> The rules bind state spending, taxation, or both through formulas that reference factors such as the personal income of state residents, population growth, the inflation rate, or some combination thereof.

Early studies of these rules concluded that they generally fail to restrain the fiscal growth of government.<sup>21</sup> Newer studies, though, use larger and more detailed data sets and tend to find that these institutions can be effective in certain circumstances.<sup>22</sup> As with balanced budget requirements and rainy day funds, however, the details matter.

A number of studies, noting that TEL formulas are often based on residents’ incomes, examine whether TELs have different effects in high versus low-income states. Crain, for example, finds that TELs in low-income states seem to reduce spending by about \$114 per capita while TELs in high-income states seem to increase spending by about \$534 per capita.<sup>23</sup>

Other studies have focused on the fact that the details of TEL laws vary considerably from state to state. These, too, have tended to conclude that TELs can effectively restrain spending, but only in certain circumstances. Mitchell, for example, found that TELs are more effective when their formula is based on the sum of inflation plus population growth, when they bind spending rather than revenue, when they require a supermajority rather than a simple majority vote to be overridden, when they immediately refund revenue collected in excess of the limit, and when they prohibit unfunded mandates on local governments.<sup>24</sup>

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<sup>18</sup> Crain, *Volatile States: Institutions, Policy and the Performance of American State Economies*.

<sup>19</sup> Besley and Case, “Political Institutions and Policy Choices: Evidence from the United States.”

<sup>20</sup> Waisanen.

<sup>21</sup> See, for example, Burton Abrams and William Dougan, “The Effects of Constitutional Restraints on Government Spending,” *Public Choice*, Vol. 49 (1986): 101-16.

<sup>22</sup> This is not always true, however. One recent study found TELs to be “largely ineffective.” Thad Kousser, Matthew McCubbins, and Ellen Moule, “For whom the TEL Tolls: Can State Tax and Expenditure Limits Effectively Reduce Spending?” *State Politics and Policy Quarterly*, Vol. 8 (2008): 331-61.

<sup>23</sup> Crain, *Volatile States: Institutions, Policy and the Performance of American State Economies*. Crain defines low and high-income states as those whose incomes are one standard deviation above or below the mean. Similar findings were obtained by Ronald Shadbegian, “Do Tax and Expenditure Limitations Affect the Size and Growth of State Government?” *Contemporary Economic Policy*, Vol. 14 (1996): 22-35, and by Matthew Mitchell, “TEL It Like It Is: Do State Tax and Expenditure Limits Actually Limit Spending?” (working paper, Mercatus Center at George Mason University, Arlington, VA, 2010),

<http://mercatus.org/sites/default/files/publication/TEL%20It%20Like%20It%20Is.Mitchell.12.6.10.pdf>.

<sup>24</sup> Mitchell, “TEL It Like It Is: Do State Tax and Expenditure Limits Actually Limit Spending?”

## 5. Line-item Vetoes

Like the president of the United States, every governor in the union possesses a veto power. In addition to the simple veto, however, 44 governors possess a “line-item veto.” This allows them to strike specific sections from a bill.<sup>25</sup> At the federal level, a statutory line-item veto was approved by both houses of the Congress and signed by President Clinton in 1996. In 1998, however, the Supreme Court struck down the law.<sup>26</sup> Now, a federal line item veto would either require constitutional amendment, or a carefully-worded statute that ensured the legislative branch retained the final say on the matter.<sup>27</sup>

Early studies of the line-item veto at the state level found that it had no impact on overall state spending.<sup>28</sup> Subsequent research, however, has focused on the impact of the line-item veto in times and places where different parties control the governor’s mansion and the legislature.<sup>29</sup> This line of research has found that the line-item veto can have a large and statistically significant impact on per capita spending. Besley and Case, for example, find that in a state with a divided government the line-item veto reduces per capita spending by about \$100.<sup>30</sup>

## 6. Item-reduction Vetoes

In most cases, when a governor possesses a line-item veto, he must completely defund any budget items he wishes to strike. In twelve states, however, the governor need not zero-out the entire item.<sup>31</sup> Instead, he may write in a lower amount. In such cases, the governor is said to possess an “item-reduction veto.” Theoretically, an item-reduction veto changes the negotiating power between the governor and the legislature by effectively denying the legislature the ability to make the governor a take-it-or-leave-it offer. Mark Crain estimates that this particular variety of veto seems to have a substantial effect on spending, lowering per capita expenditures by \$471.<sup>32</sup>

## 7. Baseline Budgeting

States tend to use one of two different “baselines” when they consider a new budget. On the one hand, they may take the dollars spent in the previous year as the baseline. On the other hand, they may take the level of services that those dollars bought as the baseline. If they take the second approach, then price increases in services are automatically incorporated into the budgetary baseline. A study by economists Mark Crain and Nicole Crain suggests that spending grows about half a percentage point slower in those states that use dollars spent rather than services rendered as the baseline.<sup>33</sup>

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<sup>25</sup> Daniel C. Vock, “Govs Enjoy Quirky Veto Power,” *Stateline, Pew Center on the States*, April 24, 2007, <http://www.stateline.org/live/details/story?contentId=201710>.

<sup>26</sup> For the law, see *Line Item Veto Act of 1996*, Public Law 104-130, 104<sup>th</sup> Cong. (April 9, 1996). For the Supreme Court decision, see *Clinton v. City of New York*, 524 U.S. 417 (1998).

<sup>27</sup> A bipartisan group of over 40 Senators has introduced such a bill. *Reduce Unnecessary Spending Act of 2011*, S. 102, 112<sup>th</sup> Cong., 1<sup>st</sup> sess. (January 25, 2011).

<sup>28</sup> Abrams and Dougan.

<sup>29</sup> Holtz-Eakin was the first to study the line-item veto in such a context. Douglas Holtz-Eakin, “The Line Item Veto and Public Sector budgets: Evidence from the States,” *Journal of Public Economics*, Vol. 36 (1988): 269-92.

<sup>30</sup> Besley and Case, “Political Institutions and Policy Choices: Evidence from the United States.”

<sup>31</sup> Vock.

<sup>32</sup> Crain, *Volatile States: Institutions, Policy and the Performance of American State Economies*, 111.

<sup>33</sup> Mark Crain and Nicole Crain, “Fiscal Consequences of Budget Baselines,” *Journal of Public Economics*, Vol. 67 (1998): 421-36.

### **8. No Automatic Shutdown Provision**

In twenty-two states, the government automatically shuts down if, by the beginning of the fiscal year, policy makers have not reached an agreement on the budget.<sup>34</sup> A similar rule applies to the federal budget.<sup>35</sup> David Primo explains the theoretical effect of an automatic shutdown provision:

The legislature has the bargaining advantage because the governor, when considering a spending proposal, compares it to the outcome that would be obtained if he vetoed the spending proposal.<sup>36</sup>

Under these circumstances, “the legislature will be able to achieve its ideal budget, so long as the governor prefers it to no spending.”<sup>37</sup> In other words, the threat of a shutdown essentially permits the legislature to make a take-it-or-leave-it offer and that is enough to make the governor concede to their spending demands.

Empirical analysis seems to corroborate this theory. According to Primo, states without an automatic shutdown provision spend about \$80 less per capita.<sup>38</sup>

### **9. Separate Spending and Taxing Committees**

Some states allow one legislative committee to have jurisdiction over both spending and taxing legislation. Others divide the two powers between separate committees. Intuitively, those states that keep these functions separate seem likely to spend less than those that combine them. The idea is essentially Madisonian: if one committee has jurisdiction over taxing but not spending then its members—unable to steer spending projects towards their constitutions—will have an incentive to block the interests of other committees with spending authority.<sup>39</sup>

The last researchers to publish on this matter were Mark Crain and Timothy Muris.<sup>40</sup> According to their data (which is from the 1980s), five states combine spending and taxing authority in one committee while the rest keep these two functions separate. They find that states with combined spending and revenue authority tend to spend \$1,241 more per capita than states with separate authorities. As indicated by Figure 1, this is by far the largest per capita effect of the institutions this paper surveys.

### **10. Centralized Spending Committees**

Researchers have also examined the effect of centralizing spending authority in one committee rather than dividing it among several separate spending committees. In this case, the theoretical prediction is

<sup>34</sup> National Conference of State Legislatures, *Table 6-4: Procedures When the Appropriations Act is Not Passed by the Beginning of the Fiscal Year*, September 2008, <http://www.ncsl.org/default.aspx?tabid=12616>.

<sup>35</sup> At the federal level, shutdowns can also occur for other reasons. For example, the near-shutdown in August of 2011 was the result of the nation’s statutory debt ceiling.

<sup>36</sup> Primo, 102.

<sup>37</sup> Ibid.

<sup>38</sup> Ibid., 203.

<sup>39</sup> As the principal framer of the Constitution and as its chief advocate through the *Federalist*, James Madison advocated for checks and balances so that “ambition must be made to counteract ambition.” James Madison, “No. 51,” *The Federalist*, by Alexander Hamilton, James Madison, and John Jay, Clinton Rossiter, ed. (New York: Signet, [1788] 1961): 322.

<sup>40</sup> Mark Crain and Timothy Muris, “Legislative Organization of Fiscal Policy,” *Journal of Law and Economics*, Vol. 38, No. 2 (Oct., 1995): 311-33.

different: when a number of different committees have a hand in determining spending priorities, spending is subject to a “tragedy of the commons.” As Crain and Muris put it:

[N]o one committee has the incentive to restrain its spending commitments because the total level of spending is no longer the responsibility of any one committee. To the contrary, the resulting competition among committees to spend results in more spending than would otherwise occur, increasing reliance on deficit financing.<sup>41</sup>

John Cogan of the Hoover Institution and Stanford University examines this question at the federal level and finds that during periods in which the U.S. Congress had decentralized spending authority, spending grew much faster than in other periods.<sup>42</sup>

At the state level, Crain and Muris find that in the 1980s, 24 states had centralized spending authority in one committee, while the rest had spread it out among several committees. Their results corroborate the federal study by Cogan. They find that, on a per capita basis, states with centralized spending authority spend about \$199 less than those with decentralized spending authority.<sup>43</sup>

### **11. Annual Budgeting**

Some state budget cycles last one year while others last two. Given the large number of complex projects that governments currently fund, biennial budgeting would seem to afford legislators the time to carefully scrutinize the budget in order to properly weigh the costs and benefits of different programs.

Indeed, Crain notes:

Since 1977 a number of proposals have been introduced in the U.S. House and Senate to lengthen the federal budget cycle from an annual to a biennial process. The perception behind these proposals is that a federal biennial budget would help curtail the growth of federal expenditures.<sup>44</sup>

But the theoretical relationship is not so clear. According to Paula Kearns of Michigan State University, a biennial budget might on the one hand shift the balance of power from the legislature to the governor. Since governors cannot export the costs of spending to other districts as legislators can, she reasons that this might lead to less spending. On the other hand, she notes that biennial budgeting introduces a measure of durability, which may make it more appealing for special interest groups to lobby for government largesse, thereby increasing spending.<sup>45</sup>

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<sup>41</sup> Ibid., 314.

<sup>42</sup> Spending authority in the U.S. Congress was decentralized from 1886 to 1921 and then again from 1932 until the present. See John Cogan, “The Evolution of Congressional Budget Decision Making and the Emergence of Federal Deficits,” in *The Budget Puzzle: Understanding Federal Spending*, edited by John Cogan, Timothy Muris, and Allen Schick, (Palo Alto: Stanford University Press, 1994). See, also, David Brady and Mark Morgan, “Reforming the Structure of the House Appropriations Process: The Effects of the 1885 and 1919-1920 Reforms on Money Decisions,” in *Congress: Structure and Policy*, Matthew McCubbins and Terry Sullivan ed., (New York: Cambridge University Press, 1987).

<sup>43</sup> Crain and Muris.

<sup>44</sup> Crain, *Volatile States: Institutions, Policy and the Performance of American State Economies*, 102.

<sup>45</sup> Paula Kearns, “State Budget Periodicity: An Analysis of the Determinants and the Effect on State Spending,” *Journal of Policy Analysis and Management*, Vol. 13, No. 2 (1994): 331-62.

Kearns's empirical investigation supports the second hypothesis: a biennial budget cycle seems to increase spending.<sup>46</sup> Crain corroborates this result, finding that states with annual budgets tend to spend about \$119 less per capita than states with biennial budget cycles.<sup>47</sup>

## **12. Small Senates**

A number of researchers have examined whether the size of a legislative chamber affects spending. The expectation has tended to be that larger chambers will spend more because each member has an incentive to spend in his or her own district while spreading the cost among all districts, and as the number of cost-sharing districts increases this incentive grows stronger.<sup>48</sup>

A number of researchers, using data at both the city and the national level, have found that larger unicameral legislatures do tend to spend more.<sup>49</sup> In bicameral legislatures, however, the more-seats-more-spending relationship holds in the upper house only. For example, Thomas Gilligan and John Matsusaka of the University of Southern California find that the number of state House seats has little or no effect on spending, but the number of Senate seats does. State Senates range from 21 to 67 members, and they find that a one-seat increase in membership is, on average, associated with about \$17 more in per capita spending.<sup>50</sup>

## **13. Large House-to-Senate Ratios**

Why does the size of the House not affect spending? Jowie Chen, now of the University of Michigan, and Neil Malhotra of Stanford University offer one reason. They observe that "lower chamber districts, at least in the United States, are unique because they are geographically embedded within Senate districts."<sup>51</sup> Thus:

[D]ividing each Senate district into more House districts has the effect of shrinking each House member's constituency, *ceteris paribus*. Having a smaller constituency dilutes House members' payoffs from exploiting common pool resources to fund large pork barrel projects.<sup>52</sup>

This means that adding more House seats should not have an affect per se, but increasing the ratio of House-to-Senate seats *should* lead to less spending. They corroborate this theoretical prediction with empirical analysis estimating that decreasing the Senate size by one seat can lower per capita spending by almost \$6, while increasing the House-to-Senate seat ratio by one unit decreases per capita spending by about \$45.

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<sup>46</sup> Ibid.

<sup>47</sup> Crain, *Volatile States: Institutions, Policy and the Performance of American State Economies*, 112.

<sup>48</sup> The idea was formalized by Kenneth Shepsle and Barry Weingast, "Political Preferences for the Pork Barrel: A Generalization," *American Journal of Political Science*, Vol. 26 (February 1981): 96-111.

<sup>49</sup> See, for example, John Bradbury and Frank Stephenson, "Local Government Structure and Public Expenditures," *Public Choice*, Vol. 115 (April 2003): 185-98.

<sup>50</sup> Thomas Gilligan and John Matsusaka, "Deviations from Constituent Interests: The Role of Legislative Structure and Political parties in the States," *Economic Inquiry*, Vol. 33 (July 1995): 383-401.

<sup>51</sup> Jowie Chen and Neil Malhotra, "The Law of k/n: The Effect of Chamber Size on Government Spending in Bicameral Legislatures," *The American Political Science Review*, Vol. 101, No. 4 (Nov 2007): 657-76, 670.

<sup>52</sup> Ibid., 658. Emphasis original.

#### **14. “Citizen” Legislatures**

In some states, legislating is a full-time job. Legislators work year-round, have large professional staffs, and are paid salaries that make outside work unnecessary. In other states, however, the legislative session is short, staffs are small, and legislators are paid too little to make legislating their only means of employment. The theoretical impact of a “professional” versus “citizen” legislature is unclear. A citizen legislator who spends most of his time outside of the capitol building might be more susceptible to the persuasions of interest groups than a professional who gets his information from paid staffers. On the other hand, citizen legislators, because they have other jobs, might not need the legislative job security that comes with appeasing interest groups.<sup>53</sup>

Economists Stephanie Owings-Edwards and Rainald Borck examine this question with an “index of professionalization” which includes factors such as legislative compensation, staff expenditure, and the length of legislative sessions. They find that a one-standard-deviation increase in professionalization increases spending by about 10.2 percent.<sup>54</sup>

#### **15. Direct Democracy**

In the late 19<sup>th</sup> century, a number of states began experimenting with direct democracy by permitting their citizens to directly vote on legislation in statewide ballots.<sup>55</sup> Today, 27 states permit this sort of direct democracy in one form or another.<sup>56</sup>

Early studies of direct democracy at the state level concluded that it either had little effect on spending or that it boosted spending.<sup>57</sup> More recent studies that use larger data sets tend to find the opposite effect. For example, Matsusaka finds that an initiative with a 5-percent signature threshold (the most common threshold) is associated with per capita spending that is \$136 lower.<sup>58</sup> The economists Dale Bails and Margie Tieslau arrive at a similar result, concluding that the initiative tends to decrease per capita spending by about \$158.<sup>59</sup>

More recently, however, Besley and Case, ran a series of regressions and found that in most of them, the initiative had little impact on spending.<sup>60</sup> Matsusaka has suggested one way to reconcile all of these findings. He argues that the effect of direct democracy switched at some point in the last several decades,

<sup>53</sup> There are a number of other reasons on each side of the argument.

<sup>54</sup> Stephanie Owings and Rainald Borck, “Legislative Professionalism and Government Spending: Do Citizen Legislators Really Spend Less?” *Public Finance Review*, Vol. 28, (2000): 210-25.

<sup>55</sup> An issue placed on the ballot by petition is an initiative. When the legislature places it on the ballot, it is a referendum. For an overview, see John Matsusaka, *For the Many or the Few: The Initiative, Public Policy, and American Democracy*, (Chicago: University of Chicago Press, 2008).

<sup>56</sup> For this and other data on direct democracy, see *The Initiative and Referendum Institute*, The University of Southern California, <http://www.iandrinstiute.org/>.

<sup>57</sup> Jeffrey Zax found that initiatives were associated with higher levels of spending. See Jeffrey Zax, “Initiatives and Government Expenditures,” *Public Choice*, Vol. 63, No. 3 (1989): 267-77. Paul Farnham found no impact. See Paul Farnham, “The Impact of Citizen Influence on Local Government Expenditure,” *Public Choice*, Vol. 64, No. 3 (1990): 201-12.

<sup>58</sup> John Matsusaka, “Fiscal Effects of Voter Initiative: Evidence from the Last 30 Years,” *Journal of Political Economy*, Vol. 103, No. 3 (1995): 587-623.

<sup>59</sup> Dale Bails and Margie Tieslau, “The Impact of Fiscal Constitutions on State and Local Expenditures,” *Cato Journal*, Vol. 20, No. 2 (Fall 2000): 255-77.

<sup>60</sup> In one specification, it did seem to be associated with lower levels of income taxation per capita. Besley and Case, “Political Institutions and Policy Choices: Evidence from the United States.”

and that direct democracy was associated with more spending in the early part of the 20<sup>th</sup> century and less spending in recent decades.<sup>61</sup> This may be the result of changing public attitudes toward spending.

### **16. Term Limits**

Does limiting the time a politician can spend in office affect spending? Some proponents of term limits have argued that they break-up the political culture of spending.<sup>62</sup> But not everyone agrees. Some researchers make the case that term limits remove an important check on politicians by freeing them from the necessity of seeking voter approval in their final terms.<sup>63</sup>

The empirical investigations of term limits have not clarified matters. Consistent with the view that term limits lead to more spending, Besley and Case find that Democratic governors tend to spend more in their second terms when they cannot run again.<sup>64</sup> Using a larger dataset, they recently reexamined the question and observe an odd pattern. Like direct democracy, the effect of gubernatorial term limits seems to have changed over time. They conclude that gubernatorial term limits lead to more spending in the 1950s, 1960s, and early 1970s, but seem to be associated with less spending from the mid-1970s onward.<sup>65</sup> Unfortunately, they write, “We can offer no simple explanation for this pattern.”<sup>66</sup>

The effects of *legislative* term limits are no clearer. In their 2000 study, Bails and Tieslau find that legislative term limits reduce per capita spending by about \$173.<sup>67</sup> But a more recent study by the political scientist, Abbie Erler, finds that states with more restrictive legislative term limits actually spend about \$212 more per capita than others.<sup>68</sup> In sum, it seems that the evidence on term limits is decidedly mixed.

### **Conclusion**

Absent policy change, governments at all levels—and those who have come to depend upon them—face a bleak future. According to projections, both federal and state spending growth is unsustainable, threatening to push debt-to-GDP ratios well past 90 percent in a matter of decades.<sup>69</sup> The 90-percent mark is important because that is when research suggests that debt begins to hamper economic growth.<sup>70</sup>

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<sup>61</sup> John Matsusaka, “Initiative and Referendum” in *Encyclopedia of Public Choice*, Charles Rowley and Friedrich Schneider, ed. (USA: Springer, 2004).

<sup>62</sup> On the culture of spending, see James Payne, *The Culture of Spending: Why Congress Lives Beyond Our Means*, (USA: ICS Press, 1991).

<sup>63</sup> Timothy Besley and Anne Case, “Does Political Accountability Affect Economic Policy Choices? Evidence from Gubernatorial Term Limits,” *Quarterly Journal of Economics*, Vol. 110, No. 3 (1995): 769-98.

<sup>64</sup> Ibid.

<sup>65</sup> Besley and Case, “Political Institutions and Policy Choices: Evidence from the United States.”

<sup>66</sup> Ibid., 55.

<sup>67</sup> Bails and Tieslau.

<sup>68</sup> Abbie Erler, “Legislative Term Limits and State Spending,” *Public Choice*, Vol. 133 (2007): 479-94.

<sup>69</sup> According to the CBO’s alternative fiscal scenario (which assumes no change in *policy*), federal debt held by the public will exceed 90 percent of GDP within a decade. See Congressional Budget Office, op. cit. And according to Miron, 17 states will have accumulated net debt levels in excess of 90 percent of GDP by 2030. See Miron, op. cit.

<sup>70</sup> Carmen Reinhart and Kenneth Rogoff, “Growth in a Time of Debt,” (working paper, National Bureau of Economic Research, 2010), <http://www.nber.org/papers/w15639>.

A handful of policies seem to be driving the problem: Medicaid, pensions, and other post-employee benefits loom large.<sup>71</sup> But these policies—like all policies—are themselves the products of the institutions that helped create them, the rules that influence political outcomes at the state level. These institutions and their impact on spending have been the subject of extensive study. This paper reviews this research and highlight more than a dozen institutions that have been shown to limit spending, limit the growth of spending, or limit the volatility of spending.

After converting all per capita estimates into 2008 dollars, it is clear that separate taxing and spending committees and item reduction vetoes have the largest effect on per capita spending. These institutions also happen to be among the least-studied and so further analysis may be warranted. Among the most-studied of institutions are strict balanced budget requirements, supermajority requirements for tax increases, and tax and expenditure limits.

In many cases, subsequent study of institutions has yielded more nuanced results. For example, a number of the institutions this paper discusses are only effective in certain circumstances or when they are designed in a certain way. This suggests that we may still have much to learn about the institutions that have received comparatively less attention, such as item\reduction vetoes. Nevertheless, policy makers interested in arresting the unsustainable growth of government seem to have a number of tools at their disposal.

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<sup>71</sup> State and Local Governments: Fiscal Pressures could Have Implications for Future Delivery of Intergovernmental Programs, *Government Accountability Office*, No. 10-899 (July 2010), <http://www.gao.gov/new.items/d10899.pdf>.

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