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THE LINE ITEM VETO AND PUBLIC SECTOR BUDGETS:  
EVIDENCE FROM THE STATES

Douglas Holtz-Eakin

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ABSTRACT

Recent proposals assume that endowing the U.S. President with a line item veto will reduce spending. Analysis of a rich set of state budget data indicates that long run budgets are not altered by an item veto. In the short run, the item veto's potency is contingent upon the political setting. Governors with political incentives to use an item veto alter spending and revenues in a statistically significant and quantitatively important fashion. These results suggest that adoption of the line item veto, in general, is unlikely to reduce the size of the federal government.

Douglas Holtz-Eakin  
Department of Economics  
Columbia University  
New York, N.Y. 10027  
(212) 280-3680

## 1. Introduction

"We ask the Congress, once again: Give us the same tool that 43 Governors have, a line-item veto so we can carve out the boondoggles and pork -- those items that would never survive on their own."

Ronald Reagan, January 27, 1987<sup>1</sup>

Ronald Reagan is the latest U.S. President to tout the virtues of a line item veto.<sup>2,3</sup> His quote above captures the conventional wisdom concerning the effects of a line item veto: the ability to veto individual spending lines will reduce undesirable, "pork barrel" spending and, thus, reduce overall spending.<sup>4</sup> Due to recent interest in reducing federal spending, some commentators have proposed a line item veto for the U.S. President. (See, e.g. Ross and Schwengel [1982].)

Does the line item veto reduce spending? The purpose of this paper is an empirical assessment of the impact of the line item veto using evidence from state governments. The states have a long time span of experience with the line item veto. Moreover, there is substantial variation across states in the precise nature of the item veto, the political environment, and economic constraints that may permit isolation of the effect of the line item veto. Thus, examination of the states provides an insight into the effects of this fiscal institution and gives a guide to its likely impact at the federal level.

An important feature of the line item veto is that it is not an exogenous constraint on the agents in the government. Rather, the line item veto alters the relative power of the governor

versus the legislature. Analyses which ignore this are will result in incorrect inferences. A key feature of the analysis below is the incorporation of this relative bargaining power into the estimation of the impact of the line item veto on the state budget.

To preview the results, evidence from cross-state averages suggests that long run budgetary behavior is not significantly affected by the power of an item veto. This holds for specifications that incorporate the political composition of the state legislature and governorship and specifications that do not. In the short run, however, the presence of item veto power significantly alters the budgetary package and the size and direction of the effect hinges critically upon the political makeup of the governorship and the legislature. In particular, the impact of the item veto is most pronounced when a governor faces a legislature controlled by the opposing political party, but has the capability of preventing an override of the item veto.

In these circumstances, the power of an item veto serves to reduce deficits, but the mechanics differ by party. Under Democratic governors, current spending is most affected, while under Republican governors capital outlays are reduced. On the revenue side, non-tax revenues are reduced in both instances. Perhaps surprisingly, under both parties the effect of the item veto is to increase both grants-in-aid to local governments and tax revenues.

The paper is organized as follows. The next section reviews previous research on the effects of the line item veto. Section 3 discusses the role of a line item veto in budget determination. The data used in this study and econometric issues are discussed in Section 4. Section 5 contains the empirical results. The final section is a summary and conclusions.

## 2. Previous Research

While there is often a presumption that the line item veto will reduce spending, there is little empirical evidence to either support or refute this proposition. For example, Ross and Schwengel [1982] claim that the item veto has controlled spending in the states, but provide no evidence. In a similar fashion, Zycher [1985] argues that a federal line item veto "will not work", but supports this stance by simply comparing levels of spending (in 1984) between states with and without the veto; ignoring other potentially important determinants of the state (and local) government budget.

In a multiple regression study, ACIR [1986b] concludes that the total number of gubernatorial vetoes significantly reduces spending and regulation. Unfortunately, the study cannot distinguish between line item and other vetoes. Abrams and Dougan [1986] find a negative correlation between spending and the existence of an item veto, but treat the item veto as an exogenous constraint on state governments. While suggestive, these latter two studies employ a single year of cross section

data and cannot distinguish between the effects of a line item veto and unobserved state characteristics which are correlated with the existence of an item veto (e.g. fiscal "thriftiness"). In addition, the results may hinge upon the particular year chosen for study.

In the other direction, some narrow evidence suggests that the primary use of item vetoes is not to control spending at all. Abney and Lauth [1985] survey state budget officers and conclude that item vetoes are primarily employed to obtain "partisan" political objectives. Similarly, Gosling [1986] examines the use of the item veto in Wisconsin and concludes that it has been used primarily for partisan and non-spending policy purposes. These studies, in turn, suggest that a Presidential line item veto would largely serve to shift additional partisan power to support the White House policy agenda.

Given the paucity of evidence, the time seems ripe for a careful empirical look at the effects of the item veto on state revenues and expenditures.

### 3. The Line Item Veto and State Budgets

#### 3.1 Models of Budgetary Determination

How does the line item veto affect the level and composition of state budgets? To begin, one must specify a model of the determination of the public sector activities. Unfortunately, no consensus exists concerning the appropriate specification of

such a model. Among the (not necessarily disjoint) candidates are the median voter model (Black [1948]), models in the "Leviathan" tradition (see, e.g., Oates [1985]), models of interest group activity (see, e.g., Mueller and Murrell [1986]), or general models of the political economy of budgeting (e.g. Craig and Inman [1985]).<sup>5</sup>

In order to motivate the empirical work below, consider the following example. Assume that the government produces two goods. The first is a capital intensive good which requires investment in the present in order to raise future provision. The second is produced directly from current spending. In each of two time periods ( $t=1,2$ ), agents have Cobb-Douglas utility functions over the per capita value of the two government activities and a single, composite private good:

$$(3.1) \quad U_i(S_t, C_t, X_{it}) = \alpha_{i1} \ln(S_t) + \alpha_{i2} \ln(C_t) + (1 - \alpha_{i1} - \alpha_{i2}) \ln(X_{it})$$

where  $i$  indexes agents,  $S_t$  is the capital intensive good per capita,  $C_t$  is the per capita current expenditure on the second good, and  $X_{it}$  is per capita after-tax income available for the purchase of private goods. For simplicity, assume that the flow of  $S_t$  is proportional to the existing capital stock and that the constant of proportionality is set equal to one. Then:

$$(3.1') \quad U_i(K_t, C_t, X_{it}) = \alpha_{i1} \ln(K_t) + \alpha_{i2} \ln(C_t) + (1 - \alpha_{i1} - \alpha_{i2}) \ln(X_{it})$$

Taxes per capita,  $T_1$  and  $T_2$ , are levied in each time period so that:

$$(3.2) \quad X_{it} \equiv Y_t - T_t, \quad t=1,2$$

The capital stock evolves according to<sup>6</sup>:

$$(3.3) \quad \begin{aligned} K_1 &= \hat{K} + I_1 \\ K_2 &= K_1 + I_2 \end{aligned}$$

where  $\hat{K}$  is the initial capital stock and  $I_t$  is the level of investment spending in period  $t$ . The chosen tax/expenditure program must satisfy the present value government budget constraint:

$$(3.4) \quad T_1 + DT_2 \geq I_1 + C_1 + DI_2 + DC_2$$

where  $D \equiv 1/(1+r)$  and  $r$  is the constant real rate of interest.

It is straightforward to verify that the optimal first period current spending ( $C_{i1}$ ), capital spending ( $I_{i1}$ ), total spending ( $E_{i1}$ ), and taxes ( $T_{it}$ ) chosen by agent  $i$  are given by:

$$(3.5a) \quad I_{i1} = [\alpha_{i1}(1+r)/(1+\beta_i)r]\{\hat{K} + Y_1 + DY_2\} - \hat{K}$$

$$(3.5b) \quad C_{i1} = \alpha_{i2}/(1+\beta_i)\{\hat{K} + Y_1 + DY_2\}$$

$$(3.5c) \quad T_{i1} = Y_1 - [(1-\alpha_{i1}-\alpha_{i2})/(1+\beta_i)]\{\hat{K} + Y_1 + DY_2\}$$

$$(3.5d) \quad \begin{aligned} E_{i1} &\equiv I_{i1} + C_{i1} \\ &= [(\alpha_{i1}(1+r)+\alpha_{i2})/(1+\beta_i)r]\{\hat{K} + Y_1 + DY_2\} - \hat{K} \end{aligned}$$

where  $\beta_i \equiv 1/(1+\delta_i)$  and  $\delta_i$  is the pure rate of time preference for agent  $i$ .

Clearly, agents will differ in their preferred levels of public sector spending ( $E_1$ ) and taxes ( $T_1$ ), as well as the

composition ( $C_1$  or  $I_1$ ) of any given level of spending. These differences are due to differences in the parameters of their utility functions ( $\alpha_{i1}$ ,  $\alpha_{i2}$ ) and their parameter of time preference,  $\beta_i$ .<sup>7</sup>

What budgetary package will prevail? The simplest approach is to appeal to the median voter model of public provision. Under the appropriate assumptions, the budget adopted is the preferred budget of the median voter. As such, it will be a function of the determinants of demand (income, the relative price of public goods, prices of related goods, etc.) for a single individual: the median voter.

What is the role of a line item veto? If observed budget decisions are the outcome of a single agent's private utility maximization, there is no rationale for institutional mechanisms to control spending. The private sector gets, by definition, what it wants from the public sector.

Suppose, instead, that individual jurisdictions elect representatives and that the median voter model is an accurate description of the outcomes of elections both within each jurisdiction and in the statewide election of the governor. Further, assume that the governor has a line item veto such that he may unilaterally veto any particular line in the budget.<sup>8</sup>

Each representative in the state legislature will reflect the preferences of the median voter of his or her district. The state legislative process will consist of the "votes" (by proxy) of each local median voter. If the legislature votes as a single

body on spending proposals,<sup>9</sup> the bill which passes will be that favored by the median point in the distribution of median voters across the jurisdictions.

The governor, in contrast, will reflect the tastes of the median voter in the statewide distribution of all voters. For an arbitrary distribution of tastes in the population, the desired budget of the legislature and the desired budget of the governor will not necessarily coincide. Here there is a rationale for a line item veto: to restrict the influence of jurisdictions with either unusually high or unusually low tastes.<sup>10,11</sup> Thus, the desire to endow the governorship with a line item veto authority is possible even when politicians passively reflect the preferences of their constituents.

What are the implications of this scenario for budget determination? In this instance, the observed budget will be determined by the governor's preferences. By assumption these coincide with those of the statewide median voter. However, across states spending will differ depending upon the presence of a line item veto power, even after controlling for differences in tastes, incomes, etc. of the median voters.<sup>12</sup>

Finally, consider a bicameral legislature. Following the reasoning above, the proposal by each house of the legislature will be the median preferred budget among the median voters represented. Here, however, the final legislative proposal will be the outcome of a bargaining process between the two houses. As such, it will reflect the relative bargaining powers of the

two legislative bodies. That is, the legislative proposal to the governor will be a weighted average of the preferred amounts in the upper and lower houses, where the weights are determined by the relative strength of the two houses. Again, however, the governor will exercise an item veto the bill if the budget exceeds the median voters tastes and the observed budget will coincide with that desired by the statewide median voter.

Thus far, the discussion has been devoted to the level of total spending in the budget. An important feature of line item veto power is the power to alter the composition of spending and revenue. In terms of the example above, the governor and legislature may differ in their preferred mix of spending for present ( $C_1$ ) and future ( $I_1$ ) public goods, but have similar tastes for the mix between public ( $E_1$ ) and private ( $X_1$ ) spending. Use of the line item veto permits the governor to alter the mix of budgetary activities.<sup>13</sup> Thus, it is possible that empirical research may find no effect on the total level of spending or revenues, but a substantial impact on the composition of the budget.

### 3.2 Econometric Specification

This discussion suggests that empirical research should examine the budget at less than the aggregate level of spending or revenues, employ a specification which includes the determinants of private demand for public goods, and captures the political incentives of the governor and legislature in both the

determination of the budget and exercise of veto power.

With regard to the first of these, this study examines three categories of state expenditure: current expenditure, capital expenditure and transfers of grants in aid to local governments. For completeness, two categories of revenues are also investigated: total tax revenue and total non tax revenue.

For each of these variables, two types of models are estimated. The first, "basic", model is a straightforward extension of a conventional expenditure model to include a dummy variable for line item veto power. The second, "political", model more carefully specifies the political circumstances in which a line item veto might be expected to influence outcomes.

#### A. Basic Model

In this investigation, I choose a relatively small set of economic variables to proxy private demand and focus on the effects of veto power. The demand curve in the analysis is assumed to be a function of state per capita income, population, grant receipts, and beginning of year state financial assets and liabilities. To test for the impact of the line item veto, each equation is augmented with a dichotomous variable which takes a value of one if the governor has line item veto power and is zero otherwise. Thus, for each of the five dependent variables, the equation estimated is of the form:

$$(3.6) \quad Y_{it} = X_{it}\beta + \alpha V_{it} + \mu_{it}$$

where  $Y_{it}$  is the dependent variable (e.g. current expenditure) in state  $i$  during year  $t$ ,  $X_{it}$  is the vector of demand determinants,  $V_{it}$  is the indicator variable for line item veto power, and  $\mu_{it}$  is a random error.

### B. Political Model

In this section, I modify the analysis to incorporate aspects of the political bargaining which determines the observed budget. As in the basic model, the demand curve is assumed to be a function of state per capita income, population, grant receipts, and beginning of year state financial assets and liabilities. However, I assume that the parameters of the demand function differ across political parties. More precisely, I assume that parties are monolithic (i.e. members vote strictly along party lines) and that each political party (Democrat or Republican) has a well defined demand function.

What budget will the legislature propose? If a party has a majority of seats in any house of the legislature, then the budget preferred by that house is assumed to be the preferred budget of the majority party.

If different parties control each house, legislative budgets demand will be a weighted average of the party demands. Should the same party control both houses, the preferred legislative budget is simply the budget of that controlling party. Put formally, the legislative demand is given by:

$$(3.7) \quad Y_{it} = X_{it}\beta + (D_L \cdot X_{it}\beta_D) + (R_L \cdot X_{it}\beta_R)$$

where  $\beta$  is parameter vector of the weighted average of party demands,  $\beta_D$  is the parameters of Democratic party demand,  $\beta_R$  is the parameters of Republican party demand,  $D_L=1$  if Democrats control both houses of the legislature,  $R_L=1$  if Republicans control both houses, and both are zero otherwise.

Observed budgets reflect the tastes of the governor as well. In the event that the governor is of the same party as that controlling the legislature, no modification of (3.7) is necessary.<sup>14</sup> In the event of a "minority governor" -- a governor who is of the opposite party from that controlling the legislature -- the governor can use his political standing, power to veto entire bills, etc. to alter the observed budget. To capture this, equation (3.7) is augmented by a dummy variable to indicate the presence of a minority governor.

Finally, what is the correct empirical measure of the influence exerted on the budget by line item veto power? The simple approach in the basic model is to use a dummy variable equal to one if the governor has a line item veto power and equal to zero otherwise.

But it may be possible to do better than this. First, not all line item vetoes are created equal. Table 1 summarizes the variety of institutions.<sup>15</sup> As shown in column 1, 43 of the state governors have some type of line item veto power.<sup>16</sup> Of these, nearly a quarter (10) have the further ability to reduce the proposed expenditure in lieu of an outright veto. In addition,

the governor of Alabama may submit an entirely new measure for consideration. Finally, 14 governors (column 4) may veto not just an entire line item, but also may strike out language in bills, while retaining the spending amount.<sup>17</sup>

Thus, one might wish to differentiate among these alternative forms of line item veto power. However, preliminary research (Holtz-Eakin [1987]) indicated no significant econometric differences among these alternative forms. Accordingly, below I focus simply upon the presence or absence of some form of line item veto power.

There is a second, political, aspect to the measure of line item veto power. As stressed by Abney and Lauth [1985], item vetoes may be influenced by partisan desires. In the same fashion, they may be restricted by political feasibility. Consider, the extreme case of, say, a Republican governor contemplating the veto of an item in a bill produced by a legislature composed entirely of Democrats. Given the assurance of a legislative override of the veto, in what sense does the governor have a veto "power"? The correct measure of veto power is one in which ability to sustain the veto is considered.

To accommodate this, I detail two degrees of veto power. In the first, the party of governor has sufficient seats in either the upper or lower house of the legislature to prevent an override of the veto; i.e. to sustain the veto. Still, this is not entirely satisfactory. It includes the case in which the same party controls the upper house, the lower house, and the

governorship. In this instance, presumably the executive and the legislature will have the same preferences and there will be no incentive to veto. Thus, I create a second measure in which the opposing party controls both the upper and lower house, but the governor's party has sufficient votes in either house to sustain the veto. This will be referred to as the ability of a minority governor to sustain the veto.

To summarize, the specification of budget determination in the political model is:

$$(3.8) \quad Y_{it} = X_{it}\beta + (D_L \cdot X_{it}\beta_D) + (R_L \cdot X_{it}\beta_R) + \\ \alpha_1(D_G \times V_{it}) + \alpha_2 D_G^M + \alpha_3(D_G^M \times V_{it}) + \alpha_4(D_G^M \times V_{it}^S) + \\ \alpha_5(R_G \times V_{it}) + \alpha_6 R_G^M + \alpha_7(R_G^M \times V_{it}) + \alpha_8(R_G^M \times V_{it}^S) + \mu_{it}$$

where  $P_G$  indicates that the governor is of party  $P$  ( $P=D,R$ ),  $P_G^M$  indicates that the governor is of party  $P$  and that his party is in a minority in the legislature,  $V_{it}$  is a dummy variable for line item veto power, and  $V_{it}^S$  is a dummy variable equal to one if the governor has a sustainable veto power and zero otherwise.

This specification captures the effects of: (i) statutory veto power ( $\alpha_1, \alpha_5$ ), (ii) veto power in the hands of a minority governor ( $\alpha_3, \alpha_7$ ), and (iii) sustainability by a minority party governor ( $\alpha_4, \alpha_8$ ).

#### 4. Data and Econometric Issues

##### 4.1 Data

Three types of data are needed for the analysis: budgetary data for the states, population characteristics of the states, and political make-up of the state governments. Budgetary data are taken from the Bureau of the Census' Governmental Finances, for the years 1965 to 1983. All variables are measured as logarithms of real 1972 dollars per capita. Expenditures are deflated using the Gross National Product implicit price deflator for state-local government purchases. Revenues are deflated using the implicit price deflator for personal consumption expenditures.

Grant receipts are the sum of transfers from the federal and all local governments to the state government. Assets is the per capita real value of state holdings of cash and financial assets at the start of the fiscal year. Similarly, Debts is the real per capita value of outstanding short and long term debt. These variables are converted to constant dollars using the deflator for personal consumption expenditures and are entered as logarithms.

The population characteristics used are the logarithm of total population and the logarithm of real 1972 personal income per capita.

Political data are taken from the Inter-University Consortium for Political and Social Research's data set Partisan

Division of State Governments. This provides the total number of seats in both the upper and lower house of the state legislature, the fraction held by each political party, and the party of the governor.

Means and standard deviations of the data are presented in Table 2. The sample covers the years 1966 to 1983 and includes 48 states. Alaska is excluded due to its unique budgetary patterns and Nebraska is excluded because its unicameral legislature is not consistent with the specification used herein.

The bottom two panels of the table show the interaction of explanatory variables with either Democratic or Republican control of the governorship or both houses of the legislature. Thus, 55% of the observations are for Democratic governors and 38% are for Republicans. Interestingly, in 36% of the cases Democrats controlled both houses of the legislature, while in 12% Republicans had the same power. Thus, fully 48% of the time a single party controls both houses. Further in 29% of the cases, control of the legislature and governorship rested in opposing parties and in nearly all of these instances, the governor had line item veto power. Importantly, however, in only half of these cases (14% of the total sample) did the governor have sufficient party votes in the legislature to sustain a veto.

#### 4.2 Econometric Issues

Perhaps the most convincing evidence that the line item veto per se affects either the level or composition of the public

sector budget would be long run evidence, evidence not dependent on variations in politics, economic setting, or other short run behavior.

To explore this possibility, I use a specification for both the basic and political model in which each variable is expressed the mean value over time for each state. Accordingly, the parameters are estimated, and the effects of the line item veto are evaluated, using only cross-state variation in the data.

This procedure is subject to a potentially important bias, however. To the extent that there exist state-specific attributes which both affect spending and revenues and are correlated with the right hand side variables, the parameter estimates will be biased and inconsistent.<sup>18</sup> It is possible to control for both state-specific and year-specific effects by using a fixed effects estimator. In practice, this requires entering the variables as deviations from state and year means. Thus, the parameters are estimated using a different source of variation: the intra-state variation over time.

Unfortunately, use of deviations from means precludes estimation of the coefficient of any variable which does not vary over time; particularly the coefficient of the dummy variable for a line item veto in the basic model. For this reason, I estimate only the political model using the fixed effects technique.

## 5. Results

In this section I present the results of estimating the

models discussed in Section 3. A full report of the parameter estimates is contained in Tables 3 through 5. Before turning to a discussion the estimated effects of the line item veto, it is worth noting that the estimated models perform quite well in general. The estimated population and income elasticities are consistent with previous research on the demand for public spending.

As a check of the plausibility of the results, one can compute the reaction of the entire budget to an increase in per capita income. Using the income coefficients reported in line 2 of Table 5, one finds that a \$100 increase in income per capita results in a \$2.87 increase in current spending, a \$1.41 increase in capital outlays, and a \$0.69 increase in grants-in-aid. Total spending per capita rises by \$4.97. On the revenue side, the increased income raises tax revenues by \$3.96 and non-tax revenues by \$0.22, for a total rise of \$4.18.

Another interesting comparison is the spending effects of federal aid versus that of income. Using the estimated coefficients in line 3 of Table 5, an increase of \$100 in outside aid per capita increases current spending by \$46.11 and capital spending by \$16.73. Clearly, increases aid per capita are far more stimulative than equivalent increases in income per capita, a result suggestive of the "flypaper effect". (See Gramlich [1977] for a discussion of the flypaper effect.) This is somewhat misleading, however, as the flypaper effect refers to a differential spending impact resulting from identical increases

in the resources of the decisive voter. In this instance, the results are entirely consistent with the absence of a flypaper effect if the decisive voter's share of taxes in the state is larger than his share of income in the state.<sup>19</sup>

Finally, while not the main focus of this research, the tables do indicate that legislatures controlled by Democrats (lines 7 to 12 of Tables 4 and 5) and Republicans (lines 17 to 22) differ significantly from legislatures which are coalitions of the two parties. The estimated differential propensities to spend and tax out of income, assets, and debts are often significantly different from zero in these circumstances.

I leave examination of individual coefficient estimates to the reader and turn to discussing the estimated effects of the line item veto on the observed budgets.

#### 5.1 Cross-State Means

The results of estimating the basic model using cross-state means are presented in Table 3. The conclusion which emerges from an examination of Table 3 is that the line item veto has no significant impact on long run behavior. More specifically, only in the equation for capital expenditure is the coefficient indicating dummy veto power different from zero at conventional levels of significance. Neither is there a consistent pattern to the sign of the impact of the line item veto. Based on this evidence, one would not expect that adding item veto power at the federal level would affect long run budgetary behavior.

Is this the result of ignoring the political setting in which the item veto is embedded? Table 4 presents the results of estimating the political model using cross state averages. The same general result is found: the line item veto is not correlated with variations in average, observed budgets. The only statistically significant coefficient is found in the equation for non-tax revenues in panel (b) of the table. There one finds that minority governors tend to reduce the amount of non-tax revenues. However, minority governors with an item veto tend to raise these revenue sources. The net effect is close to zero.

In sum, the evidence from variations in long run behavior by the states does not lead one to conclude that the line item veto is a potent force in budget determination. At that same time, it sheds doubt on the conjecture that a line item veto for the U.S. president will tend to either reduce the level or alter the mix of spending and revenues.

Still, there are reasons to be cautious about these results. Use of means greatly restricts the number of observations and the estimates may be subject to the biases as discussed above. The next section looks at the results from the fixed effects estimation procedure, which uses many more observations and controls for state-specific attributes.

## 5.2) Fixed Effects

The results of estimating the political model, equation

(3.8), controlling for state-effects are presented in Table 5. Panel (a) contains the results for expenditures and panel (b) for revenues.

How does the line item veto affect spending? States with Democratic governors having a line item veto exhibit lower current and grants expenditures, but greater capital expenditure (line 12). Note, however, that only the latter coefficient is statistically significant. In contrast, states with Republican governors holding a veto power produce significantly more of both current and capital expenditure, but less grants in aid (line 22).

The discussion in Section 3 suggests that the party composition of both the governorship and the legislature will determine the impact of the line item veto on budgets. For Democratic governors, these effects are shown in lines 13 to 15. Democratic governors facing Republican controlled legislatures sign budgets with significantly more current expenditures and significantly less grants in aid (line 13). Importantly, line 14 indicates that in the same situations a governor with a line item veto results in a budget with significantly lower current and capital expenditure and significantly higher grants in aid -- precisely the opposite sign pattern to a governor without the veto power. Line 15 indicates that these budgetary patterns are not significantly altered by the numerical ability of the Democrats in the legislature to sustain a veto.

Lines 22 to 25 of panel (a) contain a similar set of results

for Republican governors. States with Republican minority governors have higher capital and current expenditure, but lower grants in aid. As above, those states in which there is additionally a line item veto result in lower capital expenditure. Unlike the Democratic case, there is no additional statistically significant effect of the line item veto on current expenditure and grants in aid. The final line (line 25) indicates, however, that in those cases where a minority Republican governor can sustain his veto, current expenditure is lower and grants in aid are increased.

Thus, the item veto has a significant effect in the hands of minority governors of either party and this effect serves to reverse the budgetary pattern of states with minority governors lacking veto power. Current and capital spending are reduced and grants in aid increased. Lastly, there is evidence suggesting that in this sample the power of Republican governors is more dependent upon the ability of the governor to sustain the veto in the legislature.

The final panel of Table 5 contains the results for the revenue side of the budget. The most prominent feature is that veto power has far fewer significant effects on the composition and level of revenues than on the composition and level of expenditures. Moreover, unlike the expenditure equations, the effects differ by party.

For Democrats, minority governors in states with a sustainable veto produce budgets with significantly more tax

revenues than in those states without a veto power. (See lines 13 and 15 of panel (b).) In contrast, the effect of a sustainable veto in states with Republican minority governors is to reduce non-tax revenues raised by the state (line 25).

### 5.3 Implications

The parameter estimates in Table 5 imply a complicated pattern of spending and revenue raising effects arising from item veto power and the political setting. To simplify the presentation, Table 6 summarizes the total impact of the item veto, on average, under various political circumstances.<sup>20</sup>

The major lesson of Table 6 is that there are no simple truths concerning the impact of the line item veto. In only three of the six possible cases shown does the line item veto result in a reduced budget deficit. Similarly, in only one half the cases does total direct (current plus capital) spending fall due to the presence of the item veto.

At the same time, it does appear that there are differences across parties in the effects of minority governors with a line item veto, sustainable or otherwise. In these cases, Democratic governors tend to have budgets with reduced current spending, while the budgets of Republican governors contain reduced capital spending.

There are similarities across parties as well. Governors of both parties administer budgets with lower levels of non-tax revenues than would otherwise prevail. Perhaps surprisingly,

under there are circumstances in which the item veto in the hands of either party increases both grants-in-aid to local governments and tax revenues.

Finally, the calculations in Table 6 do suggest that the item veto has, at times, a quantitatively important role in the determination of state budgets. For example, a \$22.25 reduction in current spending amounts to a fall on the order of 10% in spending, although not all the results are this large.

#### 6) Summary

There have been several proposals to endow the U.S. President with the power of a line item veto. Some commentators have suggested that the ability to veto individual spending lines will reduce undesirable, "pork barrel" spending; which will result in lower spending, increased cost-efficiency, or both.

This paper uses a rich set of state budget data to assess the empirical foundations of this conjecture. Examination of the states behavior indicates that long run budgetary behavior is not significantly affected by the power of an item veto. This conclusion is not altered by expanding the analysis to incorporate the political composition of the state legislature and governorship. Thus, in general, the line item veto has no significant impact on the budgetary process.

However, in the short run, the potency of the line item veto as a method of budgetary control is contingent upon the political setting. In those settings in which there are political

incentives to exercise such a veto, i.e. governors facing a legislature controlled by the opposition party, existence of the veto power significantly alters the budgetary package.

In particular, the effect is most pronounced when a governor faces a legislature controlled by the opposing political party, but has the numerical capability of sustaining the item veto.

In these circumstances, the effect of the item veto is to reduce deficits, but the mechanisms differ by party. Under Democratic governors, current spending is most affected, while under Republican governors capital outlays are reduced. On the revenue side, non-tax revenues are reduced in both instances. Lastly, under both parties the effect of the item veto may be to increase both grants-in-aid to local governments and tax revenues.

Lastly, the short run results are both statistically significant and, in some cases, quantitatively important. To the extent that the experience of that states is a good guide to federal government behavior, these results suggest that in particular political circumstances the item veto may permit increased control over the budget. The desirability of this control is, of course, in the eye of the beholder.

Table 1

## Gubernatorial Line Item Veto Powers

<u>State</u>	<u>Item Veto</u>	<u>Reduce</u>	<u>Subst.</u>	<u>Lang.</u>	<u>Over.</u>	<u>Over. Type</u>
Alabama	Y	N	Y	N	1/2	Y
Alaska	Y	Y	N	N	3/4	Y
Arizona	Y	N	N	N	2/3	Y
Arkansas	Y	N	N	N	1/2	Y
California	Y	Y	N	Y	2/3	Y
Colorado	Y	N	N	Y	2/3	Y
Connecticut	Y	N	N	N	2/3	Y
Delaware	Y	N	N	N	3/5	Y
Florida	Y	N	N	N	2/3	N
Georgia	Y	N	N	N	2/3	Y
Hawaii	Y	N	N	N	2/3	Y
Idaho	Y	N	N	N	2/3	N
Illinois	Y	Y	N	N	1/2	Y
Indiana	N	N	N	N	1/2	Y
Iowa	Y	N	N	N	2/3	Y
Kansas	Y	N	N	N	2/3	Y
Kentucky	Y	N	N	Y	1/2	Y
Louisiana	Y	N	N	Y	2/3	Y
Maine	N	N	N	N	2/3	N
Maryland	Y	N	N	N	3/5	Y
Massachusetts	Y	Y	N	Y	2/3	N
Michigan	Y	N	N	N	2/3	Y
Minnesota	Y	N	N	N	2/3	Y
Mississippi	Y	N	N	N	2/3	Y
Missouri	Y	Y	N	N	2/3	Y
Montana	Y	N	N	N	2/3	N
Nebraska	Y	Y	N	N	2/3	Y
Nevada	N	N	N	N	2/3	Y
New Hampshire	N	N	N	N	2/3	Y
New Jersey	Y	Y	N	Y	2/3	Y
New Mexico	Y	N	N	Y	2/3	N
New York	Y	N	N	Y	2/3	Y
North Carolina	N	N	N	N	2/3	N
North Dakota	Y	N	N	N	2/3	Y
Ohio	Y	N	N	Y	3/5	Y
Oklahoma	Y	N	N	N	2/3	Y
Oregon	Y	Y	N	N	2/3	N
Pennsylvania	Y	Y	N	Y	2/3	Y
Rhode Island	N	N	N	N	3/5	N
South Carolina	Y	N	N	Y	2/3	N
South Dakota	Y	N	N	N	2/3	Y
Tennessee	Y	Y	N	N	1/2	Y
Texas	Y	N	N	N	2/3	N
Utah	Y	N	N	N	2/3	Y
Vermont	N	N	N	N	2/3	N

Table 5 (cont.)  
 Political Model: Fixed Effects\*

(a)

	<u>Current Expenditure</u>	<u>Capital Expenditure</u>	<u>Grants in Aid</u>
Republican Interactions:			
16) Intercept	1.4646 (.29629)	-.33327 (.74444)	-.01907 (.66350)
17) Population	-.04230 (.01194)	.01516 (.03001)	.02368 (.02674)
18) Income	-.05551 (.05516)	.04362 (.13860)	-.08522 (.12353)
19) Grants	-.08493 (.03682)	-.07397 (.09253)	.05045 (.08247)
20) Assets	-.02184 (.03315)	-.01826 (.08330)	-.00166 (.07424)
21) Debts	.02637 (.01134)	.04397 (.02850)	.02325 (.02540)
22) Veto	.04367 (.01681)	.12124 (.04224)	-.08155 (.03765)
23) Minority Gov.	.00853 (.02540)	.15375 (.06382)	-.13158 (.05688)
24) Veto	.02062 (.02962)	-.22443 (.07443)	.04276 (.06634)
25) Sustainable	-.06692 (.01604)	-.04968 (.04032)	.07565 (.03593)
$\bar{R}^2$	0.74	0.36	0.34
D.F.	772	772	772

\*Standard errors shown in parentheses.

Table 2  
Sample Statistics

	<u>Mean</u>	<u>Standard Deviation</u>
Expenditure (logs):		
Current	5.4259	.38390
Capital	4.2459	.40718
Grants in Aid	4.9350	.48601
Revenues (logs):		
Taxes	5.6254	.28619
Non Tax	4.3283	.51260
Demand Determinants (logs):		
Population	14.822	1.0116
Income	8.3009	.18404
Grants	4.9204	.34095
Assets	6.1589	.44578
Debts	5.2512	.85427
Veto	.84491	.36220
Political Variables:		
Democratic		
Governor:	.54977	.49781
with Veto	.47106	.49945
Minority	.11690	.32148
Veto	.09722	.29643
Sustainable	.06944	.25436
Legislature	.35532	.47889
Republican:		
Governor:	.37616	.48470
with Veto	.31481	.46471
Minority	.17361	.37899
Veto	.15856	.36548
Sustainable	.07060	.25631
Legislature	.12269	.32827

Table 3  
Basic Model: Cross-State Means\*

(a)

	<u>Current Expenditure</u>	<u>Capital Expenditure</u>	<u>Grants in Aid</u>
1) Intercept	1.7875 (1.4659)	6.1050 (2.2422)	-3.3880 (4.3862)
2) Population	-.1312 (.0260)	-.2089 (.0398)	.2252 (.0780)
3) Income	.3682 (.1615)	-.1724 (.2470)	.2621 (.4833)
4) Grants	.4124 (.1203)	.1849 (.1841)	.5031 (.3601)
5) Assets	.0078 (.0705)	.2255 (.1079)	.2074 (.2111)
6) Debts	.0874 (.0266)	.0385 (.0407)	-.1727 (.0797)
7) Veto	-.0117 (.0573)	.1985 (.0877)	-.0444 (.1717)
$\bar{R}^2$	0.76	0.66	0.16
D.F.	41	41	41

(b)

	<u>Tax Revenue</u>	<u>Non-tax Revenue</u>
1) Intercept	-1.2445 (1.8257)	3.9632 (3.5398)
2) Population	.0172 (.0324)	-.2180 (.0629)
3) Income	.4879 (.2011)	.0258 (.3900)
4) Grants	.3059 (.1499)	.1911 (.2906)
5) Assets	.1326 (.0879)	.3335 (.1704)
6) Debts	.0378 (.0332)	.0665 (.0643)
7) Veto	.0503 (.0714)	.0449 (.1385)
$\bar{R}^2$	0.41	0.41
D.F.	41	41

\*Standard errors shown in parentheses.

Table 4  
Political Model: Cross-State Means\*

(a)

	<u>Current Expenditure</u>	<u>Capital Expenditure</u>	<u>Grants in Aid</u>
1) Intercept	-.0627 (3.6028)	2.1801 (6.0857)	-1.8248 (12.1965)
2) Population	-.1605 (.1314)	-.1096 (.2220)	-.4440 (.4450)
3) Income	.7118 (.5278)	.1760 (.8916)	1.5652 (1.7869)
4) Grants	.3872 (.3178)	.1120 (.5368)	.3912 (1.0758)
5) Assets	.2343 (.2119)	.3115 (.3580)	-.5468 (.7175)
6) Debts	-.2825 (.1346)	-.0639 (.2275)	.4055 (.4559)
Democratic Interactions:			
7) Intercept	2.7758 (5.8830)	8.7089 (9.9373)	3.6835 (19.9155)
8) Population	.1148 (.2397)	-.0223 (.4049)	1.0867 (.8116)
9) Income	-1.0227 (.8311)	-1.3465 (1.4039)	-2.5500 (2.8137)
10) Grants	.3420 (.5212)	-.1128 (.8805)	.0936 (1.7647)
11) Assets	-.1076 (.3416)	.0981 (.5770)	-.6472 (1.1564)
12) Debts	.6078 (.2070)	.3670 (.3497)	-.6152 (.7009)
13) Veto	-.2224 (.2105)	.8839 (.3556)	-.5676 (.7127)
14) Minority Gov.	.7489 (.4654)	-.3392 (.7862)	-2.6148 (1.5758)
15) Veto	-.7303 (.4893)	-.5988 (.8265)	2.8186 (1.6565)
16) Sustainable	.1095 (.3426)	.1522 (.5788)	-.0224 (1.1600)

\*Standard errors shown in parentheses.

Table 4 (cont.)  
 Political Model: Cross-State Means\*

(a)

	<u>Current Expenditure</u>	<u>Capital Expenditure</u>	<u>Grants in Aid</u>
Republican Interactions:			
17) Intercept	10.0898 (15.4877)	-26.1598 (26.1611)	19.3767 (52.4299)
18) Population	.1611 (.5040)	-.6962 (.8514)	2.2763 (1.7063)
19) Income	-1.2008 (2.7346)	4.5692 (4.6192)	-8.6442 (9.2574)
20) Grants	.2169 (.9589)	-.0043 (1.6198)	1.0858 (3.2463)
21) Assets	-1.3884 (.7910)	-.1443 (1.3362)	3.0499 (2.6779)
22) Debts	.9432 (.4461)	-.1192 (.7536)	-.8819 (1.5104)
23) Veto	.2413 (.2333)	-.2519 (.3941)	-.6472 (.7899)
24) Minority Gov.	-.6874 (.7291)	2.0882 (1.2315)	-.4095 (2.4682)
25) Veto	.7806 (.6899)	-1.4510 (1.1654)	.7955 (2.3357)
26) Sustainable	-.0207 (.2485)	-.5463 (.4198)	1.4805 (.8413)
$\bar{R}^2$	0.83	0.70	0.23
D.F.	22	22	22

\*Standard errors shown in parentheses.

Table 4 (cont.)  
 Political Model: Cross-State Means\*

(b)

	<u>Tax Revenue</u>	<u>Non-tax Revenue</u>
1) Intercept	-3.0453 (6.1324)	.5415 (8.6276)
2) Population	-.1428 (.2237)	-.6025 (.3148)
3) Income	1.3119 (.8984)	1.3553 (1.2640)
4) Grants	.3779 (.5409)	-.0563 (.7610)
5) Assets	-.4007 (.3607)	.9067 (.5075)
6) Debts	.1007 (.2292)	-.6780 (.3225)
Democratic Interactions:		
7) Intercept	4.9702 (10.0136)	10.0341 (14.0879)
8) Population	.1967 (.4080)	.8739 (.5741)
9) Income	-1.4775 (1.4147)	-3.9212 (1.9903)
10) Grants	-.0876 (.8873)	.8390 (1.2483)
11) Assets	.7777 (.5814)	-.2743 (.8180)
12) Debts	.0029 (.3524)	1.3272 (.4958)
13) Veto	-.0555 (.3583)	-.7025 (.5041)
14) Minority Gov.	-.6141 (.7923)	.0250 (1.1147)
15) Veto	.3134 (.8329)	-.2303 (1.1718)
16) Sustainable	.3151 (.5832)	.0302 (.8205)

\*Standard errors shown in parentheses.

Table 4 (cont.)  
 Political Model: Cross-State Means\*

	(b)	
	<u>Tax Revenue</u>	<u>Non-tax Revenue</u>
Republican Interactions:		
17) Intercept	4.4821 (26.3620)	18.1724 (37.0880)
18) Population	.6370 (.8579)	1.2558 (1.2070)
19) Income	-2.7984 (4.6547)	-4.4623 (6.5485)
20) Grants	-.0266 (1.6322)	1.1199 (2.2964)
21) Assets	1.7906 (1.3464)	-2.7743 (1.8943)
22) Debts	-.2520 (.7594)	2.2638 (1.0684)
23) Veto	-.2510 (.3971)	.2510 (.5587)
24) Minority Gov.	.0157 (1.2410)	-3.5746 (1.7460)
25) Veto	.2015 (1.1744)	3.8392 (1.6522)
26) Sustainable	.5098 (.4230)	-.0669 (.5951)
$\bar{R}^2$	0.21	0.64
D.F.	22	22

\*Standard errors shown in parentheses.

Table 5  
Political Model: Fixed Effects\*

(a)

	<u>Current Expenditure</u>	<u>Capital Expenditure</u>	<u>Grants in Aid</u>
1) Population	-.15795 (.01170)	-.17663 (.02940)	.17217 (.02621)
2) Income	.51585 (.05679)	.82219 (.14269)	.20180 (.12718)
3) Grants	.33721 (.02435)	.39207 (.06119)	.23859 (.05454)
4) Assets	.05613 (.02268)	.09656 (.05698)	.17151 (.05079)
5) Debts	.00211 (.00926)	.00225 (.02327)	-.05089 (.02074)
Democratic Interactions:			
6) Intercept	-1.46840 (.27254)	.03846 (.68478)	.65083 (.61033)
7) Population	.01348 (.00929)	-.03106 (.02336)	.05300 (.02082)
8) Income	.11035 (.04206)	.04577 (.10570)	-.14054 (.09420)
9) Grants	.09759 (.02673)	-.07102 (.06717)	.05108 (.05987)
10) Assets	-.02932 (.02225)	.08718 (.05591)	-.08083 (.04983)
11) Debts	.02390 (.00994)	-.04850 (.02498)	-.01848 (.02226)
12) Veto	-.00566 (.01707)	.16986 (.04289)	-.09637 (.03822)
13) Minority Gov.	.06670 (.02355)	.09198 (.05919)	-.21239 (.05275)
14) Veto	-.09224 (.03089)	-.17158 (.07762)	.18851 (.06918)
15) Sustainable	.00062 (.02121)	.01388 (.05329)	.00248 (.04750)

\*Standard errors shown in parentheses.

Table 5 (cont.)  
 Political Model: Fixed Effects\*

(a)

	<u>Current Expenditure</u>	<u>Capital Expenditure</u>	<u>Grants in Aid</u>
Republican Interactions:			
16) Intercept	1.4646 (.29629)	-.33327 (.74444)	-.01907 (.66350)
17) Population	-.04230 (.01194)	.01516 (.03001)	.02368 (.02674)
18) Income	-.05551 (.05516)	.04362 (.13860)	-.08522 (.12353)
19) Grants	-.08493 (.03682)	-.07397 (.09253)	.05045 (.08247)
20) Assets	-.02184 (.03315)	-.01826 (.08330)	-.00166 (.07424)
21) Debts	.02637 (.01134)	.04397 (.02850)	.02325 (.02540)
22) Veto	.04367 (.01681)	.12124 (.04224)	-.08155 (.03765)
23) Minority Gov.	.00853 (.02540)	.15375 (.06382)	-.13158 (.05688)
24) Veto	.02062 (.02962)	-.22443 (.07443)	.04276 (.06634)
25) Sustainable	-.06692 (.01604)	-.04968 (.04032)	.07565 (.03593)
$\bar{R}^2$	0.74	0.36	0.34
D.F.	772	772	772

\*Standard errors shown in parentheses.

Table 5 (cont.)  
 Political Model: Fixed Effects\*

	(b)	
	<u>Tax Revenue</u>	<u>Non-tax Revenue</u>
1) Population	-.01359 (.01234)	-.20679 (.01941)
2) Income	.58151 (.05991)	.11782 (.09421)
3) Grants	.14470 (.02569)	.16653 (.04040)
4) Assets	.05321 (.02392)	.31824 (.03762)
5) Debts	.00756 (.00977)	.03242 (.01536)
Democratic Interactions:		
6) Intercept	-.36514 (.28753)	-2.7482 (.45214)
7) Population	.00966 (.00980)	-.02114 (.01542)
8) Income	-.02709 (.04438)	.37206 (.06979)
9) Grants	.03429 (.02820)	.06756 (.04435)
10) Assets	.03953 (.02347)	-.09805 (.03691)
11) Debts	.00721 (.01049)	.05905 (.01649)
12) Veto	-.00347 (.01800)	-.07318 (.02831)
13) Minority Gov.	-.04551 (.02485)	.07982 (.03908)
14) Veto	-.03762 (.03259)	-.04860 (.05125)
15) Sustainable	.06811 (.02237)	-.02830 (.03518)

\*Standard errors shown in parentheses.

Table 5 (cont.)  
 Political Model: Fixed Effects\*

	(b)	
	<u>Tax Revenue</u>	<u>Non-tax Revenue</u>
Republican Interactions:		
16) Intercept	.76621 (.31258)	2.4740 (.49153)
17) Population	-.00790 (.01260)	-.02404 (.01981)
18) Income	-.02628 (.05819)	-.15599 (.09151)
19) Grants	-.00578 (.03885)	-.11909 (.06109)
20) Assets	-.08529 (.03497)	-.05939 (.05500)
21) Debts	.01713 (.01197)	.01812 (.01882)
22) Veto	.01075 (.01773)	-.01559 (.02789)
23) Minority Gov.	-.06884 (.02679)	-.01553 (.04214)
24) Veto	.03884 (.03125)	.01456 (.04914)
25) Sustainable	.00661 (.01693)	-.07006 (.02662)
$\bar{R}^2$	0.68	0.47
D.F.	772	772

\*Standard errors shown in parentheses.

Table 6  
Effects of Veto on Budget

<u>Governor:</u>	<u>Democrat</u>	<u>Republican</u>
Current Expenditure	-1.29	9.92
Capital Expenditure	11.86	8.46
Grants-in-Aid	-13.40	-11.34
Tax Revenue	-0.96	2.98
Non-Tax Revenue	-5.55	-1.18
Effect on Deficit	3.68	5.24
 <u>Minority Governor:</u>		
Current Expenditure	-22.25	14.61
Capital Expenditure	-0.12	-7.21
Grants-in-Aid	12.82	-5.39
Tax Revenue	-11.40	13.75
Non-Tax Revenue	-9.23	-0.08
Effect on Deficit	11.08	-11.66
 <u>Minority Governor with Sustainable Veto:</u>		
Current Expenditure	-22.11	-0.60
Capital Expenditure	0.75	-10.68
Grants-in-Aid	13.16	5.13
Tax Revenue	7.49	15.59
Non-Tax Revenue	-11.38	-5.39
Effect on Deficit	-4.31	-16.35

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## Notes

1. This quote is taken from the State of the Union Address as reported by the New York Times, January 28, 1987, p. A16. President Reagan repeated his call for a line item veto in his Address the following year.
2. See Ross and Schwengel [1982] for an review of Presidents' attitudes toward the item veto.
3. The Reagan Administration requested an authority quite similar to the line item veto, an "enhanced rescission authority". Under this system, Congress would be compelled to vote on Presidential requests to delete items from the budget. A simple majority would be necessary to retain the budget line. (See Newsweek, January 12, 1987, pp. 22.)
4. This is not the only possibility. It may be that resources will be used in a more cost-efficient fashion and spending is unchanged.
5. For an excellent survey of the alternative models, see Inman [forthcoming].
6. This ignores depreciation, but this simplification does not affect the substance of the results.
7. Notice that agents may also have differing expectations concerning incomes and interest rates. These are assumed to be identical here in order to focus on the role of preferences.
8. The possibility of veto override is considered below.
9. Only Nebraska has a unicameral legislature.
10. Consider the following simple example. The state consists of 3 districts of 3 voters each. In the "high taste" district the voters prefer, respectively, spending in the amounts \$300, \$200, \$100 per capita. Their elected representative will reflect the median voter and "prefer" \$200. In the "medium taste" district the voters preferences are for \$200, \$150, and \$100 per capita and their representative will prefer \$150. Finally, in the "low taste" district the preferred amounts are \$100, \$50, and \$25. In the legislative "vote" the outcome will pit spending amounts of \$200, \$150, and \$50; with the outcome being a proposal of \$150. On the other hand, the governor will reflect the median voter of the entire distribution and prefer \$100. Thus, there is an incentive for the governor to reduce spending by a method such as the line item veto.

11. The usual assumption is that the line item veto will be used to reduce spending; i.e. that it is the influence of high taste districts which must be controlled. Notice that if spending is too low, the governor may simply reject the entire bill.

12. Notice, however, that there is no prediction concerning the sign of the item veto effect.

13. This points out a more general legislative strategy in the face of an effective line item veto: reduce the number of "lines" by bundling together objectionable (from the governor's viewpoint) and desirable spending items. To the extent that this is possible even when the governor can sustain a veto, the methods used below will not reveal the influence of a line item veto. Of course, this suggests another empirical test: is the number of budget lines inversely correlated with the ability of the governor to successfully employ a line item veto?

14. This follows from the assumption that parties are monolithic and have well-defined demands.

15. The data in Table 1 are as of 1985. In general, gubernatorial item veto power is quite old. The President of the Confederacy had (but did not exercise) item veto power during the Civil War and 28 states (of a total of 45) adopted a line item veto between 1860 and 1900. By 1930, 41 of the 48 states had a provision for line item veto power. The governors of Iowa and West Virginia acquired line item veto power in 1969. See Benjamin [1982] for a discussion of the growth of veto power.

16. Of the remainder, only six can veto a bill at all. The governor of North Carolina has no veto powers.

17. Differences exist even within these categories. See ACIR [1986a] for details.

18. An instrumental variables procedure will yield consistent parameter estimates, but it is difficult to find satisfactory instrumental variables.

19. To see this, consider the budget constraint of the decisive voter in a simplified model:

$$(19.1) \quad y^d = x^d + T^d$$

$Y$  is income,  $X$  is private consumption,  $T$  is taxes paid, and the superscript "d" identifies the decisive voter. Using lower case letters to denote per capita terms, the government budget is:

$$(19.2) \quad e = t + a$$

where  $e$  is expenditures,  $t$  is taxes, and  $a$  is aid. Define

$\tau \equiv T^d/t$ , solve (19.2) for  $T^d$ , substitute into (19.1) and rearrange. The result is:

$$(19.3) \quad Y^d + \tau a = X^d + \tau e$$

Finally, define  $\phi \equiv Y^d/y$ , where  $y$  is income per capita; yielding:

$$(19.4) \quad \phi y + \tau a = X^d + \tau e$$

Suppose that a \$1 increase in resources to the decisive voter induces \$a in additional spending. Notice that a \$1 increase in income per capita translates into a \$ $\phi$  increase in income to the decisive voter, resulting in \$a $\phi$  in spending. In contrast, a \$1 increase in aid per capita is equivalent to a \$ $\tau$  increase in resources to the decisive voter and produces \$a $\tau$  in additional spending. In these estimates \$a $\tau$  > \$a $\phi$ , which may simply reflect  $\tau > \phi$  and not the presence of a flypaper effect.

20. The entries in Table 6 are calculate using the estimated parameters in Table 5 without regard to their statistical significance.