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Statement of

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on

"Tools to Combat Deficits and Waste: Enhanced Rescission Authority"

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Mr. Chairman and members of the Subcommittee, I am pleased to appear before you today on behalf of the nation's governors on the issue of state line item veto rules.

Economic Risks Associated with Increasing Debt

The timing of this hearing is interesting as just last week I was on a panel at the 2009 Caplin Conference on the World Economy "Governing through Debt and Deficit" hosted by the Miller Center of Public Affairs at the University of Virginia. The bottom line of this conference was that most countries around the world have taken on huge amounts of new debt due not only to the long-term trend toward additional public debt, but due to the recent financial crisis. This has led many nations to reevaluate their budget rules to eliminate the bias for more spending and in fact to find additional ways to limit spending over the long-run. This is obviously also true of the United States, who is currently running an all-time high deficit for this fiscal year of $1.4 trillion and now has an outstanding debt of well over $12 trillion with much of it held by foreign governments, many that are not particularly friendly to the U.S. The risk of this situation and ultimately to economic growth and the real income of United States citizens is huge.

There are essentially three major economic risks to the U.S. First, there is the risk that foreign individuals or governments will no longer want to hold U.S. bonds and they sell existing ones on the market. This could trigger a rapid fall in the value of the dollar followed by huge falls in the value of both equities and bonds worldwide. To stabilize the situation the U.S. would have to dramatically increase interest rates, which could trigger a national and perhaps even world recession. Second, the interest on the public debt is now about $700 billion, which not only takes away from spending on other needs but it is transferring a huge debt to our children. Third, the huge debt is forcing us to cut research and development, infrastructure and education spending, which we need to maintain and increase U.S. competitiveness.

State vs. Federal Budget Processes

In evaluating the usefulness of the line item veto authority, it is important to stress that there are substantial differences between budget rules and procedures in most states and the federal government. For example, all states with the exception of Vermont have either constitutions or laws that require balanced budgets. Most states also have capital and operating budgets while the federal government only has the latter. Also, there are a number of states that have prohibitions against any debt. There are also differences in both transparency of information and the relative powers of the executive vs. the legislative branch. For example, many states require agency budget requests to be published in the executive budgets. Also, 38 states allow the governor to make budget cuts without legislature approval to meet balanced budget requirements. There are, however, some restrictions on this authority. For example, Connecticut only allows the executive to do this for 1 percent of the budget. Similarly, Iowa only allows across-the-board cuts without legislative approval. The important point here is that the entire processes are different and thus care must be exercised in analyzing the impact of any one tool.

State Line Item Veto Authority

Forty-one states have line item veto authority of appropriations. In addition, 15 states have item veto authority of selected words while 4 have the ability to change the meaning of words. Some of these powers do, however, have restrictions. For example, in Hawaii the governor may veto judicial and legislative appropriations bills only in their entirety. Six states do not have any form of line item veto. These governors can only veto the entire legislation, not portions of it. About 15 governors can actually both adjust the dollar amount and statutory language in legislation. Line item vetoes can be overridden by super majorities of the legislature, but this seldom happens.

The Evidence on Line Item Veto

There have been several academic studies on the value and impact of the state line item vetoes. One of the more in-depth studies was by Reese and Lauth in Georgia, which covered several decades during which seven governors served prior to the current governor Sonny Perdue. The governors that were interviewed all indicated that the mere threat of the line item veto was important and that it really did not need to be exercised frequently to maintain budget discipline.

There has also been numerous statistical studies that have attempted to quantify the impact. One of these by Holtz-Eakin concluded that it did have an impact on short-run budget decisions, but not on long-run spending. He also indicated that it may be most useful where the governor's political party does not hold a majority in the legislature. Also, the frequency of use was limited during good times but its use increased dramatically during periods of fiscal stress.

The Experience of Two States

To provide a little more realism to this issue, it is important to provide some additional detail on the experience of two states – Missouri and Wisconsin.

Missouri – The history in this state is that most governors have relied heavily on the line item veto and past governors believe that the threat of it is critical in maintaining budget discipline. It is generally used less when state revenue growth is robust and much more when times are difficult from a fiscal standpoint.

Over the last year, Governor Nixon has used the veto 50 times all of which have had budget impacts and totaled about $105 million on a revenue base of about $8 billion. In good economic times the line item veto is used more when the governor is actually opposed to the policy that underlies the appropriations. During hard fiscal times it is often used to eliminate low priority items. Many of these are for construction projects that are low priority. Some of the items have been higher education construction. Here the governor is not opposed to its purpose, but it is just a low priority at the time. One of the items that was vetoed was to increase the reimbursement rate for Medicaid health care providers. Here again it something that the state could not afford.

Wisconsin – An analysis of the state's experience over the last twenty years show substantial use by the various governors. It went from a high of 457 vetoes in 1991 during the economic downturn to a low of 33 at the end of 2007, which was the end of the economic boom period. This is similar to Missouri where the line item veto was used extensively during economic downturns, but far less during economic prosperity. The veto was used against 6 tax increases over this period with some as high as $271 million in 1993. With respect to how much was saved each year, this varied from $200 million as a high to as little at $1-2 million for several years in the middle of the 1990s.

Conclusion

The economic risk of continuing deficits is increasing at an alarming rate. Several international groups have and are studying this issue in order to determine what debit level is too high. Some of these groups, like the European Common Market, have indicated that anything over 60 percent of GDP is increasingly risky. Yet, the U.S. is now approaching that number. Given the risk, it now appears to be time to give the President all the tools available to reduce spending.

Not only is the U.S. debt increasing rapidly, but the number of specific "earmarks" has also been growing very dramatically, particularly in appropriations bills as well as the transportation bills. The line item veto would be a great tool for a President to have to reduce the number of earmarks.

The experience of the states with the line item veto seems to be applicable to the federal government. First, governors believe that it is a very important tool for fiscal discipline. The mere threat of the veto is very powerful, particularly when the number that are overridden is so small. Second, there is evidence in states particularly during periods of fiscal stress that is does in fact save money. This is not a silver bullet, but it is clearly a tool that Congress should provide to the President of the United States, particularly given the size of the outstanding debt and the economic risks associated with the debt.