

# Do Administrative Procedures Matter? The Effect of Administrative Procedure Acts on State Government Expenditures

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## ABSTRACT

While a great deal of literature has theorized about the importance of the Administrative Procedure Act, very little evidence exists that demonstrates this degree of scholarly attention is warranted: namely, that shows that the passage of the APA of 1946 or its state-level counterparts actually affected public policy *outcomes*. In this paper, we use state-level variation to identify the effect the of passage of state-level APAs (SLAPAs) on per capita government expenditures. We find that adoption of an APA reduced per capita expenditure growth by between 1.4 and 2.4 percentage points annually. This result holds even after controlling for unobserved heterogeneity and endogeneity. Finally, we offer preliminary evidence that in addition to reducing *levels* of government expenditure (growth), adoption of APAs also reduced *volatility* in expenditure growth as well.

## 1. Introduction

For over twenty years, there has been a very large literature which has argued that the processes, procedures and structures that elected officials place on government agencies provides those officials with a degree of control over agency activities (see, e.g., McCubbins, Noll and Weingast (hereafter McNollGast) 1987, 1989; Moe 1989, 1990; Wilson 1980, 1990; Bawn 1995; Lupia and McCubbins 1994; de Figueiredo, Spiller and Urbiztondo 1999). This literature has generally taken two forms. First, there is an extensive literature which explores various mechanisms of control—oversight, budgets, appointments, and administrative procedures. This stream—largely theoretical—

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examines how each instrument can help political principals solve agency problems with bureaus, gaining either distributive or informational benefits, or both (see, e.g. McNollgast 1987, 1989; Epstein and O’Halloran 1994, 1999; Lupia and McCubbins 1994; Bawn 1995; Niskanen 1971; de Figueiredo, Spiller and Urbiztondo 1999; Gailmard 2009). A second stream—largely empirical, primarily qualitative but in some cases quantitative, explores cases in which particular instruments were employed and what the rationales for their adoption were (see, e.g., Moe, 1990; Epstein and O’Halloran 1999; Huber, Shipan and Pfahler 2001; Vanden Bergh and de Figueiredo 2003; de Figueiredo and Vanden Bergh 2004). Despite the wealth of this literature, surprisingly little, if any, of the extensive literature on bureaucracy has provided evidence that these control mechanisms—which ostensibly *should* have an impact on policy outcomes—actually do. Put another way, there is very limited empirical evidence—with, perhaps, the exception of agency’s choice of instruments (Hamilton & Schroeder 1994) —of their impact on *actual policy outcomes*.

In this paper, we attempt to rectify this situation by testing the effect of Administrative Procedure Acts (APAs) on per capita state government expenditure growth. Using expenditure growth as a means to identifying effects of APAs on policy outcomes has both advantages and disadvantages. On the one hand, by moving to the state level, we are able to exploit variation in all of our variables—and particularly in the timing of adoption of APAs—to aid causal identification (see Table 1). We are also able to use the fact that there is a panel to eliminate any confounding of effects that are identified by time or state-invariant factors. That said, looking at this measurable outcome—aggregate expenditure growth—also poses some difficulty. Such a test may have relatively low power because of the high degree of “noise” in the data— due to unobserved heterogeneity, we expect that whatever effects we identify will only be a small part of the variation in government expenditures over time. Also, it may be difficult because of the relatively inefficient approach to estimation required to identify causality properly (e.g. the necessity of using instrumental variables which may further increase noise around estimated effects). Thus, while a promising area to look for effects of APAs, our approach comes with it the potential for spurious non-results.

The above caveats aside, in this paper we proceed as follows. In the following section, we lay out theoretical arguments about the relationship between APAs and the growth of government. Our primary hypothesis is that passage of an APA may decrease the growth of government; that said, we also consider alternative mechanisms which may lead to the opposite effect. Having developed our primary theory, in Section 3 we describe our data and measurement, which will be useful for understanding all that follows.

In Section 4 we provide an initial description of our data. Perhaps most importantly, we show a preliminary investigation of our initial hypotheses—namely a state-by-state comparison of expenditure growth and the volatility of expenditure growth before and after the adoption of an APA. On average expenditures *grew* 6.3 percentage points faster after adoption of an APA and volatility declined 15.2 percentage points after adoption of an APA. This compares to an average level of growth in the entire sample of 11.4 percent and average level of volatility of 19.9 percent. In other words, these changes are dramatic but at least in the case of expenditure growth, opposite our primary hypothesis.

Having established an initial relationship between adoption of an APA and the pattern of growth of state governments in the previous section, in Section 5 we turn to issues of *causal identification*. A primary challenge to causal inference is the effect of *selection bias* on any observed relationship between the adoption of an APA at the state level and government expenditures. In particular, a major concern about such an observed correlation is that the results are spurious and the effects are actually driven by unobservable differences in the characteristics of states that adopt an APA (at a particular time) and their orientation towards government spending. In order to deal with this issue, we utilize two complementary approaches. First, because we have a panel data structure, we are able to use fixed effects to remove the effect of any time or state level-invariant unobserved selection. In other words, we can focus on the changes within a state and over time to measure the effect of an APA pre- and post-adoption. That said, perhaps of greater concern is that selection of an APA will also entail within-state time-varying effects. Indeed, this type of selection is at least *prima facie* a concern as the decision to adopt an APA occurs episodically throughout our data set. In order to deal with this issue,

it is necessary to develop a model of what drives adoption of an APA. If some of the factors driving adoption are exogenous to per capita expenditure growth, then we can model the selection explicitly and control for the timing of adoption using the exogenous factors as instruments.

In order to undertake this analysis, we draw on previous work (see de Figueiredo and Vandenberg 2004; but also, de Figueiredo 2002; Baum and Jensen 2009) which defines the *political conditions* under which we are likely to see adoption of an APA at the state level. In particular, we explore the hypothesis developed there that APAs can be viewed as mechanisms that “insulate” policies from interference from *future political coalitions*. Consistent with the earlier literature, we find that three factors best explain their adoption: they are used to constrain executives, they are used to lock in policy benefits, and finally, that these uses are primarily availed upon by Democrats. These results are interesting for two reasons. First, they stand in contrast to perhaps the two dominant explanations for the existence of APAs. One of these explanations comes from the canonical legal approach which would posit that adoption of formal rules of administrative procedure increases the basic rights of due process and representation in the rule-making and administration of public policy (see, e.g., Aranson, Gellhorn and Robinson 1982; Mashaw 1985). The second explanation is from the dominant approach taken in political science that procedural instruments are both *unbiased* with respect to their strategic usefulness (i.e. we would not expect to find distinctive partisan differences in the propensity to adopt an APA) and that adoption is primarily to solve *contemporaneous* agency problems between political principals and government agencies (see, e.g. Huber and Shipan 2001; Epstein and O’Halloran 1994, 1999; McNollgast 1987, 1989, 1999). Second, and more relevant for the current discussion, we utilize the results to create instrumental variables for the adoption of an APA at the state level. Effectively, having the theoretical model described above to explain adoption, we can then use the political variables which would affect adoption but not today’s budgets (namely, expectations about *future political control*) to control for unobservable differences between states that adopt an APA and those that do not.

In Section 6, we turn precisely to that exercise, estimating the effect of the adoption of an APA on the growth in government expenditures. Intuitively, our approach

is a test of the hypothesis that the level of expenditures goes down after the adoption of an APA versus the counterfactual that they were the same (or went up) upon adoption of such an act. We find strong evidence that the effect on budgets is dampening, even after controlling for both the conditions for adoption of an APA and other time-invariant, state-invariant characteristics. We find that after adoption of an APA, state government expenditures grow more slowly at a rate of between 1.4 and 2.4 percentage points annually. To put this in perspective, these effects are observed during a period (1940-1981) when the average rate of expenditure growth at the state level was quite dramatic—about 11.4 percent per year, or over 80 times in nominal terms in our sample. Finally, in Section 6, we offer concluding thoughts including some preliminary evidence on the effect of the adoptions of state-level APAs on the volatility expenditure. While requiring more work, our preliminary evidence indicates that the level of volatility in expenditures also reduced dramatically once an APA was passed. This is consistent with our expectations (and our theory of adoption) that the APA acts as a particular form of constraint upon the bureaucracy. Finally, in Section 7 we conclude.

## **2. The Effect of APAs on Government Expenditures**

Our analysis focuses on two areas where one may expect to see effects of the adoptions of the APAs on state budgets: growth and volatility. In terms of the former, it is possible to posit a variety of potential effects that the passage of an APA may have on the level and growth of state budgets. First, the passage of an APA may cause budget growth to decrease for two primary reasons. On the one hand, as many theorists have pointed out, the APA at the federal and state levels were passed in order to “crack open” government agencies which were beholden to particular interest groups and/or parties (see, e.g. McNollgast 1987, 1989; Lupia and McCubbins 1994; de Figueiredo, Spiller and Urbiztondo 1999). As noted by this literature, one of the primary reasons that APAs have been passed is to create greater balance amongst interest groups—reducing the policy flexibility, and perhaps policy bias—of particular agencies. The greater balance represents a movement toward Wilson’s (1980) interest group politics. Indeed, as McNollgast (1999) discuss, the coalition to pass the federal APA was primarily

concerned with undoing some of the reform activities undertaken in the 1920's and 1930's. Wilson (1989) argues that greater interest group input into the regulatory process increases uncertainty. The regulator will be less certain about what policy to support which implies a greater probability of stalemate (e.g., maintain the status quo policy). Furthermore, the regulator will be less certain how their policy choice will be rewarded or penalized by Congress. Niskanen (1971) showed that congress is interested in the regulator's output and ultimately controls the size of the regulatory budget. These factors taken together lead to our main hypothesis that the passage of an APA should lead to tighter control over agency activities and tighter reins on outlays.

A related argument follows from a more recent complement to the early literature on APAs which rather than looking backward—focusing on equilibrating previously biased agencies—takes a prospective approach. This stream of literature, primarily pursued by de Figueiredo (2002, 2003), de Figueiredo and Vanden Bergh (2004), and building on Moe (1990, 1991), argues that the passage of the APA was motivated by groups which had temporarily gained power and wanted to lock-in durable minority rights before they again lost power to political opponents. Based on this logic, we would also see budgets drop post-adoption since future majorities are less likely to support regulatory policy that will be biased, from the future majority's perspective, away from their preferred set of policies.

While our core hypothesis is that one should observe a reduction in spending rates upon the passage of an APA, it is important to recognize alternative hypotheses; namely, there are other factors which point in the opposite direction. First, de Figueiredo and Vanden Bergh (2004) found that at the state level, Democrats were much more likely than Republicans to adopt an APA when the conditions identified above were present. Given the fiscal orientation of Democrats (see de Figueiredo 2003), one may expect that this in turn would imply that budgets would increase—even if they were minority-favoring. Second, while all of the previous arguments have focused on the indirect effect of APAs, we also may expect an increase from the APA directly: as noted elsewhere (Aranson, Gellhorn, and Robinson 1982; de Figueiredo, Spiller and Urbiztondo 1999; McNollgast 1987, 1999), the APA put much stricter and more onerous requirements on agency rule-making. Holding policy activity constant (which it may not be, we

recognize), this fact could also lead to a “red tape” effect—namely more expensive activity per unit of output, leading to higher government spending.

Against both of these possibilities—either increased or decreased expenditures—is our null hypothesis; namely, that one may observe *no effect* from the passage of an APA, at least on this dependent variable. There are a number of reasons this may be the case. First, one may argue that APAs are primarily about bias (and correcting bias), and thus are primarily about the target of spending but not the growth. If this is the case, shifting expenditures from one policy point to another may have nothing to do with the growth of government. Second, as noted earlier, the primary explanation for the APA in the legal literature is that the federal APA (and presumably, therefore, state APAs) was passed to reflect a broader set of preferences and normatively sound rule-making processes by government agencies. In this regard, one may expect that at an individual policy level, the effect of an APA on expenditure growth, could work in either direction—thus we would not expect (unless we had a strong bias in the nature of policies addressed by agencies), from this view, any effect of the passage on APAs on *aggregate* expenditures. Finally, from an empirical standpoint, one may expect that aggregate budget levels would be an extremely overdetermined and potentially very noisy place to look for effects of a specific administrative reform. Indeed, if information on a panel of regulatory spending at the state level was available, for example, we may have a better chance of observing such effects. That said, given the lack of availability of such data, we are left with more aggregated—and admittedly more noisy—measures for evaluation. Finally, as we will discuss below, looking at aggregate expenditures may pose a problem for identification as it is only possible to measure the *net* effect of the above factors—even if they are in fact all true. In this sense, results may be biased toward zero even though the effects are material.

Turning to the issue of expenditure volatility, the extant theory has clearer implications. Since APAs are sources of *constraint* on both the political principal and the agent, one may expect that, if APAs have “bite” one would observe less variation in agency behavior. This in turn would reasonably imply that expenditure volatility would decrease after the passage of an APA. Even if growth is constant, this would be an

important validation for the degree to which these instruments constrain bureaus and future political coalitions alike.

### **3. Data and Measurement**

*Data.* To analyze the predictions developed above, we use three types of data. First, following de Figueiredo and Vanden Bergh (2004), we obtained the date of enactment of generic administrative procedure acts in the states (see Table 1). We gathered current statute citations from the *Administrative Law and Regulatory Reform Bibliographic Database* created by Florida State University.<sup>1</sup> From these citations, we were able to track the legislative history for each act by referring to the statutory code for each law (See Appendix 1 for a list of citations to statutes). We also verified these classifications using law review articles that tracked developments of state-level administrative law (see, e.g. Bonfield 1986; Cooper 1965; Heady 1952; Nathanson 1948; Stason 1948).

The second type of data measures the political factors expected to affect the adoption of APAs. This information is gathered for the time period 1930 to 1984 to coincide with the policy innovation date (1941) and the date the last two states enacted their APAs (Kansas and Kentucky).<sup>2</sup> We gathered data on two main political factors. First, we gathered data on the partisan make up of both houses of the legislature and the governor for each year. The data was obtained from the Inter-University Consortium for Political and Social Research (ICPSR) data entitled, *Partisan Divisions Among the States*.<sup>3</sup> Second, we account for variations in the supermajority veto override rules for each state by using data from *The Book of the States* (Council of State Governments 1938-1984).

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<sup>1</sup> See the following World Wide Web site: <http://www.law.fsu.edu/library/admin/admin3.html>. This web site was accessed in December 1999.

<sup>2</sup> It may occur to some readers that when evaluating expenditure growth, it would be useful to extend the panel to more recent times. While not yet completed, we plan to add these data to our existing data in the near future.

<sup>3</sup> These data have been corrected following de Figueiredo (2003) based on information from *The Book of the States*.

Finally, our third type of data is on state government finances. First, we have data that tracks the aggregate level of expenditures at the state level and were based on the data in de Figueiredo (2003) and were supplemented using a combination of sources including the ICPSR, US Government Census and US Bureau of Labor Statistics (BLS). In addition, we supplement this data with information on per capita income at the state level from the BLS.

*Measurement.* To test the hypotheses developed, we construct several measures. First, we use the dates in Table 1 to construct a dummy variable for whether an APA was passed by state  $i$  in year  $t$ .

Next we construct a series of political variables. First, we create a dummy variable that is one if there is a Democrat governor and zero if there is a Republican governor. We then construct two measures of which party, if any, controls the policymaking apparatus. Another dummy variable is one if the Democrats have political control—because the Democrats either have unified control over both houses of the legislature and the governorship *or* there is a Republican governor but the Democrats have sufficient *supermajority* control over both houses to override a veto—or zero otherwise. A similar variable is defined to indicate Republican party control.

**Table 1. Adoption Dates of State Level Administrative Procedure Acts**

<i>State</i>	<i>Year</i>	<i>State</i>	<i>Year</i>
North Dakota	1941	Oklahoma	1963
Michigan	1943	Georgia	1964
Ohio	1943	West Virginia	1964
Wisconsin	1943	Idaho	1965
Connecticut	1945	Nevada	1965
Indiana	1945	Louisiana	1966
Missouri	1945	South Dakota	1966
Nebraska	1945	Arkansas	1967
Pennsylvania	1945	Vermont	1967
Minnesota	1946	New Jersey	1968
California	1947	New Mexico	1969
Iowa	1951	Montana	1971
Arizona	1952	New Hampshire	1973
Massachusetts	1954	North Carolina	1973
Rhode Island	1956	Utah	1973
Maryland	1957	Tennessee	1974
Oregon	1957	Illinois	1975
Wyoming	1957	New York	1975
Alaska	1959	Texas	1975
Colorado	1959	Virginia	1975
Washington	1959	Mississippi	1976
Delaware	1960	South Carolina	1977
Florida	1961	Alabama	1981
Hawaii	1961	Kansas	1984
Maine	1961	Kentucky	1984

The next set of variables capture the dynamic dimension of politics by measuring expected future party weakness. We define the measure for the Democrats based on historical electoral outcomes.<sup>4</sup> We subtract the percentage of times in the previous ten

<sup>4</sup> An alternative is that elected officials are prospective, that their subjective assessment of their electoral prospects is based on a rational expectation of the future. One example of such a process would be if after a change in the partisan composition of the legislature, officials assumed that the change represented an electoral realignment. To explore this, we also constructed alternative measures of subjective assessments of electoral prospects based on prospective measures. For the Democrats, the prospective measure is calculated as

years (inclusive) that the Democrats had control of political institutions from one. A measure is also defined analogously to measure historical Republican weakness. Implicitly, these measures of historical weakness imply that elected officials base their subjective estimates of gaining political control on previous results.

In addition to these measures, we also construct a number of variables to reflect the state fiscal position. First, we construct a measure that measures the year-on-year growth in per capita government expenditures. Second, we construct a variable which measures the per capita volatility of expenditure growth—for this variable, we calculate the standard deviation of state government expenditure growth up to the year an APA was adopted and the same measure from the year after an APA was adopted to the end of our data. We also create a variable which measures the growth in per capita income on an annual basis. Finally, we construct a set of control variables to measure the effects of temporal diffusion (see, e.g. Walker 1969; de Figueiredo 2003; de Figueiredo and Vanden Bergh 2004). For temporal effects we use a set of year dummy variables to allow for period-specific effects.

#### **4. Descriptive Statistics: A First-Cut**

Before we turn to the more involved econometric analysis that follows, it is useful to examine the characteristics of the data we employ. Our sample consists of observations of 46 states over the period 1940 through 1981. We do not include Nebraska and Minnesota since their legislatures are nonpartisan.<sup>5</sup> Additionally Hawaii and Alaska entered statehood with a SLAPA in place. Finally, we have missing data on the partisan makeup of the Florida legislature through 1945 leaving a total sample of 1,926 state-year observations. Table 2 presents descriptive statistics for each of the measures we use.

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one minus the percentage of times in the following ten years that the Democrats had control over policymaking. Again, an analogous measure is constructed analogously as a prospective measure of Republican weakness.

<sup>5</sup> Minnesota's legislature became partisan in 1974; however, they adopted a SLAPA in 1946.

**Table 2. Descriptive Statistics**

<i>Variable</i>	<i>Mean</i>	<i>SD</i>
<i>SLAPA</i>	0.470	0.499
<i>Expenditure Growth</i>	0.114	0.273
<i>Democrat Governor</i>	0.585	0.492
<i>Democrat Control</i>	0.451	0.498
<i>Republican Control</i>	0.274	0.459
<i>Democrat Control with Republican Governor</i>	0.057	0.232
<i>Republican Control with Democrat Governor</i>	0.322	0.177
<i>Historical Democrat Weakness*</i>	0.547	0.447
<i>Historical Republican Weakness*</i>	0.713	0.348
<i>Historical Democrat Weakness &amp; Democrat Control</i>	0.053	0.173
<i>Historical Republican Weakness&amp;Republican Control</i>	0.087	0.200
<i>Growth in PCI (lagged one year)</i>	0.077	0.074
<i>Regional expenditure growth</i>	0.111	0.121
<i>N</i>	1,926	

\* Since these are scored in terms of *weakness* they sum to more than one.

Perhaps more instructive, Tables 3 and 4 show the average expenditure growth and the volatility of expenditure growth before and after adoption of an APA by a particular state. The data are ordered by state by year of adoption of an APA.

The results provide important initial evidence concerning the primary hypotheses articulated above. Pooling across states, we find that, on average, before adoption of an APA, state government expenditures grew at a rate of 5.8%, whereas after adoption of an APA, state government expenditures grew on average by 12.1%. This provides initial evidence that we may *reject* the hypothesis that APAs reduced the size of government. On the other hand, the volatility of expenditures appears to comport with our hypotheses—in this case, volatility declined on average by 15.2 percentage points after adoption of an APA, from an average in the pre-adoption cross-section of 27.2 percent to an average after adoption of just 12.0 percent, despite the fact, as noted earlier, that the

average was increasing during this period. While we leave further examination of the latter result to future work, in what follows we take a closer look at the former result.

**Table 3. Before And After Adoption: Levels of Expenditure Growth**

<i>State</i>	<i>Before Adoption</i>	<i>After Adoption</i>	<i>Years w/o SLAPA</i>	<i>State</i>	<i>Before Adoption</i>	<i>After Adoption</i>	<i>Years w/o SLAPA</i>
North Dakota	-7.6%	10.6%	11	Oklahoma	5.5%	10.6%	33
Michigan	2.8%	10.4%	13	Georgia	7.3%	11.4%	34
Ohio	8.2%	9.7%	13	West Virginia	7.8%	11.9%	34
Wisconsin	0.6%	10.4%	13	Idaho	6.2%	12.4%	35
Connecticut	7.3%	10.9%	15	Nevada	10.4%	12.3%	35
Indiana	2.4%	10.2%	15	Louisiana	7.9%	10.8%	36
Missouri	-2.1%	10.3%	15	South Dakota	6.4%	10.4%	36
Nebraska	-1.4%	10.7%	15	Arkansas	4.7%	11.4%	37
Pennsylvania	1.3%	10.2%	15	Vermont	4.9%	11.0%	37
Minnesota	-0.2%	11.8%	16	New Jersey	5.0%	23.5%	38
California	6.2%	38.5%	17	New Mexico	8.3%	12.3%	39
Iowa	6.6%	8.1%	21	Montana	6.4%	11.0%	41
Arizona	6.1%	13.6%	22	New Hampshire	7.5%	12.9%	43
Massachusetts	6.4%	10.3%	24	North Carolina	5.8%	12.4%	43
Rhode Island	4.0%	11.4%	26	Utah	7.7%	13.5%	43
Maryland	5.4%	11.8%	27	Tennessee	5.9%	11.5%	44
Oregon	5.0%	11.1%	27	Illinois	8.6%	10.0%	45
Wyoming	5.6%	11.6%	27	New York	7.4%	7.5%	45
Alaska	nm	20.4%	nm	Texas	7.2%	14.2%	45
Colorado	8.5%	10.7%	29	Virginia	8.4%	11.4%	45
Washington	7.8%	10.9%	29	Mississippi	9.2%	11.2%	46
Delaware	6.4%	9.9%	30	South Carolina	12.7%	9.4%	47
Florida	9.2%	12.3%	31	Alabama	7.9%	9.7%	51
Hawaii	nm	12.2%	nm	Kansas	7.1%	na	54
Maine	3.5%	11.0%	31	Kentucky	8.5%	na	54

**Table 4. Before And After Adoption: Expenditure Growth Volatility**

<i>State</i>	<i>Before Adoption</i>	<i>After Adoption</i>	<i>Years w/o SLAPA</i>	<i>State</i>	<i>Before Adoption</i>	<i>After Adoption</i>	<i>Years w/o SLAPA</i>
North Dakota	33.8%	11.3%	11	Oklahoma	23.3%	5.5%	33
Michigan	38.5%	11.3%	13	Georgia	23.0%	6.7%	34
Ohio	53.6%	12.8%	13	West Virginia	38.7%	5.9%	34
Wisconsin	32.6%	7.2%	13	Idaho	24.1%	6.5%	35
Connecticut	11.2%	12.0%	15	Nevada	34.1%	7.3%	35
Indiana	35.1%	8.2%	15	Louisiana	28.5%	6.4%	36
Missouri	30.8%	7.4%	15	South Dakota	30.1%	5.9%	36
Nebraska	34.2%	7.8%	15	Arkansas	22.5%	6.5%	37
Pennsylvania	33.3%	12.5%	15	Vermont	21.4%	7.2%	37
Minnesota	30.8%	11.5%	16	New Jersey	19.7%	58.0%	38
California	33.2%	170.8%	17	New Mexico	24.4%	5.7%	39
Iowa	32.4%	8.4%	21	Montana	22.3%	6.3%	41
Arizona	29.1%	18.6%	22	New Hampshire	21.9%	5.3%	43
Massachusetts	27.5%	8.0%	24	North Carolina	20.0%	6.0%	43
Rhode Island	25.2%	6.9%	26	Utah	22.0%	4.7%	43
Maryland	23.5%	7.8%	27	Tennessee	19.6%	4.9%	44
Oregon	24.0%	5.5%	27	Illinois	23.3%	5.8%	45
Wyoming	28.8%	10.0%	27	New York	19.3%	5.5%	45
Alaska	nm	14.7%	nm	Texas	19.4%	5.0%	45
Colorado	33.2%	5.3%	29	Virginia	21.9%	3.9%	45
Washington	26.9%	8.0%	29	Mississippi	28.0%	3.9%	46
Delaware	26.0%	10.4%	30	South Carolina	52.3%	5.3%	47
Florida	26.0%	8.8%	31	Alabama	18.0%	nm	51
Hawaii	nm	14.7%	nm	Kansas	19.1%	nm	52
Maine	21.7%	9.2%	31	Kentucky	19.8%	nm	52

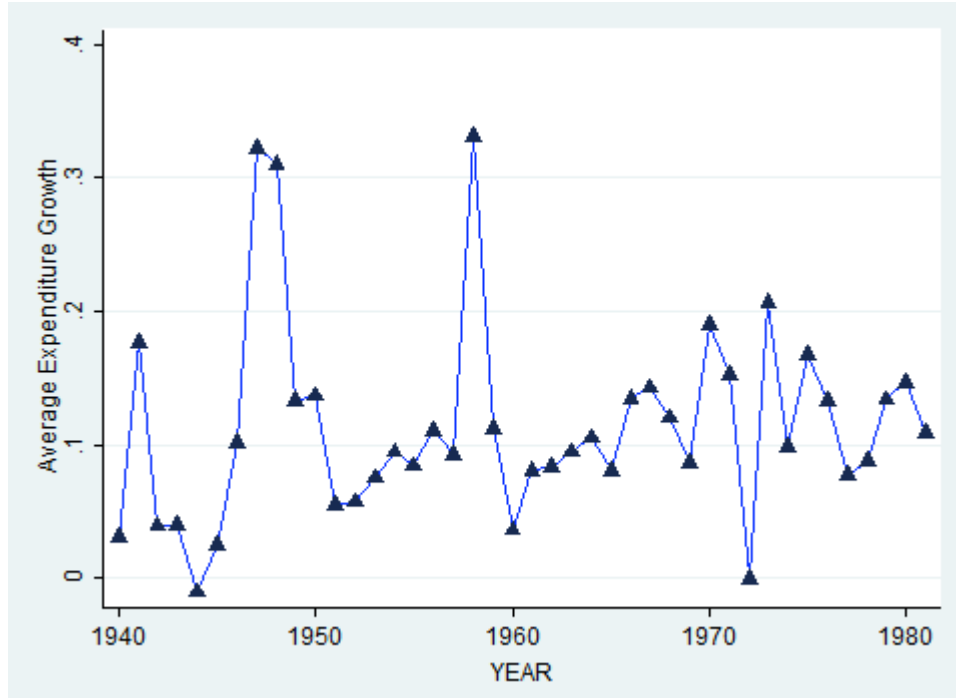
## 5. Identification Strategy

Why did expenditure growth increase following adoption of an APA? While the initial evidence appears to contradict our hypothesis that APAs were budget-reducing, there are a number of caveats to this result. Foremost among these is that the relationship between APAs and expenditure growth, when measured unconditionally in the cross-section of states, is spurious. In other words, an open question is whether the results above are driven by some common factor not observed in the data so far.

*Fixed Effects.* One particular problem that may confound the above analysis is that there are omitted factors which are correlated with both adoption of an APA and expenditure growth. A prime example is a secular increase in the size of government.

Hypothetically, imagine that the size of government is increasing at an accelerating rate during the period. In this case, because APAs are adopted progressively in the period, on average, the size of government will be higher after adoption than before adoption, but purely from the fact that government is growing at an accelerating rate.

FIGURE 1: ANNUAL AVERAGE STATE-LEVEL EXPENDITURE GROWTH

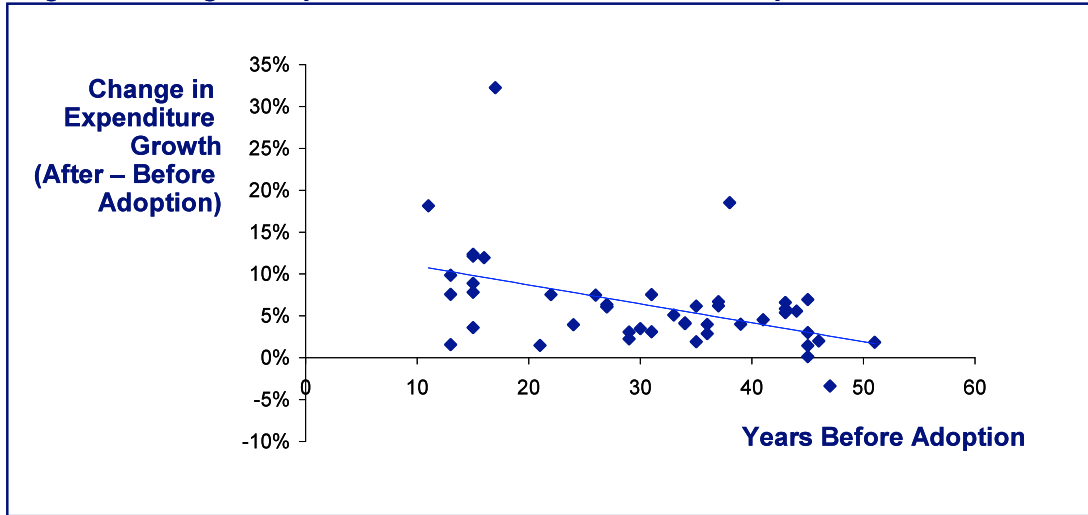


In fact, the first part of the above claim—that expenditure growth is increasing over time in our sample period, is in fact true. In Figure 1 we show the average state expenditure growth, across the full sample, by year. What can immediately be seen is that, although there are some exceptions, government expenditure growth is increasing, on average, over the horizon. As another way of looking at this, Figure 2 plots the difference in expenditure growth before and after adoption of an APA, as a function of the time it was adopted. As can be seen, the later one adopts, the lower the difference—indicating the effect of the time trend on the differences that were observed in the data in Table 3.

How can we deal with this issue? Here we benefit from two facts: first that we have a panel data structure; second, that the adoption at the state level is occurring asynchronously. Together, this suggests that we can use fixed effects to tease out state-

and time-invariant factors which may be unobservable causal factors driving the growth in state expenditures.

**Figure 2. Change in Expenditure Growth Versus Time of Adoption**



**Note:** Excludes states without data before or after (ie Alaska, Hawai'i, Kansas and Kentucky)

*Drivers of APA Adoption.*<sup>6</sup> As noted earlier, in order to effectively estimate the causal effect of adoption of an APA on expenditures requires one to address the possibility that adoption of APAs may be non-random. This in turn raises the possibility of additional selection bias in measuring the effects of an APA.

In order to address this problem, the first question is whether the reasons APAs are adopted are time-varying. If not, a standard panel regression—controlling for time and case invariant effects, would be sufficient. In fact, the extant literature demonstrates precisely that adoption of APAs was driven by time-varying factors.

In particular, following de Figueiredo and Vanden Bergh (2004; see also Baum and Jensen 2009; Moe 1990), we argue that adoption of APAs encapsulates a tradeoff for public officials concerned with both current political circumstances and expected future ones. In this context, an APA can be understood as a mechanism to insulate the current political majority against future changes in policy when control over public authority

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<sup>6</sup> This sub-section extensively and liberally draws from de Figueiredo and Vanden Bergh (2004).

changes. For this result to hold, de Figueiredo (2002; see also Vanden Bergh 2000) identifies three conditions that define such an insulating mechanism. First, it must be costly to those in power. If the mechanism is costless, then there will be no variation in adoption; it will be a dominant strategy for groups to adopt these measures. Second, the mechanism must increase benefits to future political minorities. This condition provides an incentive for the group to pay the costs when in power in exchange for gaining benefits when out of power. Finally, the mechanism must be (politically) durable; in other words, adoption itself must change the political landscape to make repeal less likely than adoption itself. Otherwise, even if weak groups institute such mechanisms when they gain a temporary moment of control, their action will be reversed when they lose power. In fact, APAs exhibit each of these three characteristics.

Passing an APA imposes costs on the enacting coalition. On the one hand, the enacting coalition incurs fixed costs (e.g., time and political capital) to pass an act. More importantly, an administrative procedure act also constrains the action of an existing legislature. In constraining a majority, then, APAs also transfer gains to the minority. A legislature or executive would therefore only be willing to bear these costs if they felt they were going to be in the minority in the future (Spiller 1992; Spiller and Tiller 1997).

Most importantly, the incentive to bear these costs depends on procedures being durable. As evidenced by the fact that no act has been repealed after its adoption, APAs are durable. In other words, the political conditions for repeal *ex post* are not the same as those for adoption *ex ante*. The most important reason for this durability is that APAs enable the organization of previously unrepresented, perhaps even unorganized, groups. Because an APA reduces the fixed costs of organizing, it is easier for previously excluded groups to participate. This means that the groups that benefit from an APA have a greater incentive and capability to fight against repeal than they did for adoption, making repeal more difficult than adoption. In other words, the passage of the APA changes the competitive political structure that makes repeal less likely than adoption.<sup>7</sup>

As a final step we condition our analysis on *partisan control*. This is based on the implications of two different streams of literature: the dominant view in the legal

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<sup>7</sup> As discussed further below, the durability of APAs affects the appropriate empirical methodology employed to test our hypotheses.

literature, and the more traditional rational choice literature. The partisan view holds that political liberals advance their interests by creating administrative procedures that must be followed by all agencies. There are two reasons why the adoption of an APA might be in the interest of political liberals. First, according to the legal literature (see, e.g., Aranson, Gellhorn and Robinson 1982; Mashaw 1985), adoption of formal rules of administrative procedure increases the basic rights of due process and representation in the rule-making and administration of public policy. To the extent that Democrats were purely ideologically motivated, and embraced an agenda to pursue civil and legal rights in the post-War period, Democrats were more likely to pass APAs.

In addition to ideological reasons, Democrats motivated by constituent interests might also adopt APAs. In the latter part of the nineteenth century and the first half of the twentieth century, many scholars observed that there were asymmetries in the interest group environment of government agencies (see, e.g. Bernstein 1955; Stigler 1971; Peltzman 1976; Rothenberg 1994). One of the main effects of the adoption of the specific elements of both the state and federal APAs—through rules of standing, requirements for public hearings, and subsidies to groups for developing standards—was to enfranchise groups previously excluded from the administrative policy-making process.<sup>8</sup> By making it easier for groups typically represented by Democrats—consumers and environmentalists, for example—to participate in a process that had largely been dominated by the regular constituency of Republicans—an APA increases the likelihood that constituent interests of Democrats would obtain favorable policy outcomes.

Despite this view, others theorize that administrative procedures create benefits for both Republican and Democrat minorities. This literature does not suggest that administrative procedures only benefit liberal interest groups. Instead, it argues that

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<sup>8</sup> As de Figueiredo, Spiller and Urbiztondo (1999: 285) point out, “One of the central properties of administrative procedures is to enable participation in the regulatory process of interest groups that previously were, for technical or incentive reasons, unable to participate...[They] aid the participation of a number of previously excluded groups.” Indeed, an examination of specific state APAs reveals that these procedures, in general, rarely *excluded* any groups, and instead simply facilitate the participation of previously disenfranchised groups. Section 3 of the Massachusetts code on administrative procedure, for example, ensures that “prior to the adoption, amendment, or repeal of any regulation...the agency shall give notice and afford interested persons and opportunity to present data, views, or arguments...” (*General Laws of Massachusetts*, Chapter 30A §3). Similarly, the South Carolina code provides that before promulgating any rule, an agency must notify all parties and provide appropriate information to them regarding the impact of the rule (*South Carolina Code of Laws*, Title 1, Chapter 23 §1-23-110 and §1-23-111).

administrative procedures can benefit both parties. If, as Epstein and O’Halloran (1996) and Huber and Shipan (2001) both posit, there are no partisan biases in the use of procedures, then both parties will be equally likely to adopt such procedures when there is divided government.

In summary, the foregoing discussion suggests a number of possible explanatory variables for adoption of an APA. Broadly speaking, the literature is divided on two dimensions: the legal literature suggests *partisan* biases in the adoption of an APA while the law and economics literature is distinctively *non-partisan*; and while the majority of the literature suggests *static* explanations (in other words, explanations which do not depend on the configuration of *future* political control), another line of literature emphasizes *dynamic* considerations. Based on the four cells of the above set of arguments, we evaluate these as possible explanatory variables which can be utilized to model adoption of an APA.

A final issue in estimating the causes of adoption is that expenditure growth itself may lead states to adopt an APA. This means that when we estimate an adoption equation, there is potential bias introduced through simultaneous causation. To deal with this issue, we use regional expenditure levels excluding the state of interest and per capita income growth—an observable measure of growth in state GDP, as instruments for government expenditures.

Notably, these instruments are each worth further discussion. In the case of the former, we argue that near-state expenditures while not directly affecting in-state expenditures should be correlated with them (beyond, for example, national level effects). There are a number of reasons this may be the case. First, state-level diffusion patterns typically occur with some degree of regional autocorrelation (see, e.g. Walker 1969). Second, even if we move away from “viral” or sociological explanations for geographic diffusion, it is commonly observed that exogenous characteristics may cluster geographically (see, e.g. de Figueiredo 2003). Finally, and perhaps most importantly, given that labor mobility is correlated with distance, we are likely to see the responsiveness of state budgets to other states to be correlated with distance as well (see, e.g., Tiebout 1956). At the same time, it is unlikely that other state expenditure growth is likely to directly—independent of the way it affects in-state budgets—increase the

likelihood of adoption of an APA. Similarly, it also is sensible that expenditures will be correlated with a state's income level—if a state obtains a shock to its growth, it will likely be reflected in state expenditure levels, either through the direct effect of taxation revenues or indirectly through political willingness to spend. Thus, both of these factors are likely to drive government expenditures (and should be included in that equation) even if not adoption.

Before explicitly estimating a selection equation, it is useful to examine the data to provide an intuition for the nature of adoption. To that end, Table 5 describes the frequency of different political regime types and the frequency of adoption of an APA by each of those regimes. In each column is a different type of political control. The rows represent either a Democrat or Republican governor. There are two quantities in each cell. In the upper left corner is the proportion of times in our data set that there was a combination of control of the legislature and governorship that the cell represents.<sup>9</sup> In the bottom right corner is the frequency of adopting an APA given that the combination is in place. This is analogous to an estimate for the hazard rate as function of the political environment.

Three results stand out from the analysis. First, the probability that Democrats adopt an APA is higher than the probability that Republicans adopt them. Second, when there is a Democrat supermajority facing a Republican governor, the likelihood of adoption increases dramatically, from 4.1% to 19.1%. This provides initial evidence in favor of the argument of Epstein and O'Halloran (1999) and Huber and Shipan (2002), that when there is divergence in the preferences of the legislature and governor, the likelihood of adoption increases dramatically. Finally, when there is a simple Democrat majority and a Democrat governor the frequency of adoption is 14.3%. In this case, a unified government passes an APA. While it is not possible to infer conclusively from this descriptive analysis, one potential explanation is that weaker Democrat majorities have a higher chance of losing power, and therefore take advantage of unified control to lock in benefits in the event they lose power. Of course, in order to test this hypothesis it

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<sup>9</sup> Note that we only include observations up to the point when a SLAPA was adopted (inclusive).

is necessary to examine the data in a more sophisticated manner, a task to which we now turn.

**Table 5. Partisan Distribution of Offices and Adoption of SLAPA**

	<i>Legislature</i>					<i>Total</i>
	<i>Democratic</i>		<i>Republican</i>		<i>Divided</i>	
	<i>Democratic Maj ority</i>	<i>Super- Maj ority</i>	<i>Republican Maj ority</i>	<i>Super- Maj ority</i>		
<b><i>GOVERNOR</i></b>						
<i>Democrat</i>	2.0	43.2	5.4	3.1	7.3	61.0
<i>Republican</i>	14.3	1.5	5.2	6.1	6.4	3.7
<b><i>Total</i></b>	<b>2.5</b>	<b>4.4</b>	<b>14.1</b>	<b>13.0</b>	<b>5.0</b>	<b>39.0</b>
<i>Democrat</i>	3.7	19.1	4.7	4.3	1.9	4.8
<b><i>Total</i></b>	<b>4.5</b>	<b>47.6</b>	<b>19.5</b>	<b>16.1</b>	<b>12.3</b>	<b>100.0</b>
<i>Democrat</i>	8.3	3.2	4.8	4.7	4.6	4.1

**Notes:** Cells are: % of “states” in sample, % of times in that state in which SLAPA is adopted

In order to model adoption of APAs more explicitly, we next estimate instrumental variable panel regressions with the explanatory variables based on the constellation of hypothesized relationships extracted from the literature above. Table 6 provides the results under two specifications: without and with year fixed effects.

The results of this analysis are very similar to the results seen in de Figueiredo and Vanden Bergh (2004)—the likelihood of adoption increases when Democratic supermajorities experience divided government and when Democratic governments (executive and legislative) are fearful of losing control over public authority in the future. The results provide confirmation of implications of two streams of the literature. On the one hand, the results reveal the *dynamic* nature to the calculus behind passage of an APA. Namely, coalitions pass an APA when they are in power but are insecure about retaining control in the future. Thus, they are passed when these coalitions are in power in order to *lock-in* benefits for periods they are out of power. Even if this costs the enacting coalition

when they do gain control of public authority, they are willing to make that sacrifice in exchange for the (more frequent) periods when they do not hold sway.

Second, the distinctively *partisan* flavor of adoption provides support for the legal literature’s view that APAs are not symmetrically available to advance the causes of both major parties. Indeed, this result also draws on intuitions in a subset of the rational choice literature (see, e.g. Lupia and McCubbins 1994; de Figueiredo, Spiller and Urbiztondo 1999): because both the national and state-level APAs did not *exclude* groups from participating, but instead *enabled* additional participation by previously underrepresented groups, they primarily benefited the party whose supporting interest groups faced stiffer hurdles for acting collectively. In particular, the evidence indicates that while other effects—such as evening of informational rents—might benefit all political principals, because of their *balancing* effect on interest group competition, it is those groups who are most likely to be shut out of the political process, either because of their high barriers to overcoming collective action or limited access, who are most likely to benefit from their enactment.

**Table 6. Drivers of APA Adoption**

<b>Dependent Variable: Pr (SLAPA=1)</b>	<i>Panel IV</i> <i>1<sup>st</sup> Stage</i>	<i>Panel IV</i> <i>1<sup>st</sup> stage</i>
<i>CONSTANT</i>	0.0202	0.4638
<i>Democrat Governor</i>	0.0431	0.0410
<i>Democrat Control</i>	-0.0749	-0.0678
<i>Republican Control</i>	0.0320	3.85E-02
<i>Democrat Control with Republican Governor</i>	0.1788***	0.1713***
<i>Republican Control with Democrat Governor</i>	-0.1009**	-0.0952*
<i>Historical Democrat Weakness</i>	-0.0400	-0.0352
<i>Historical Republican Weakness</i>	-0.0593	-0.0493
<i>Historical Democratic Weakness &amp; Democrat Control</i>	0.2538***	0.2070**
<i>Historical Republican Weakness&amp;Republican Control</i>	0.0187	0.0069
<i>Growth in PCI (lagged)</i>	4.05E-05***	-7.91E-08
<i>Regional Expenditure Growth</i>	-0.0210	-0.0338
<i>State Fixed Effects</i>	Yes	Yes
<i>Year Dummies</i>	No	Yes
F-statistic	10.46	3.55

n 1065 1065

**Note:** \*\*\* $p < 0.01$  \*\* $p < 0.05$  \* $p < 0.10$   
(two-tailed)

**6. Estimating the Causal Effect of APA Adoption on Public Expenditures**

While the above results provide important qualifications to the existing literature, perhaps more importantly for the current exercise, the results show that adoption of APAs is driven by *time-varying* factors; in this case, time-varying political environments. This in turn means that we cannot use fixed effects to control for endogeneity in the analysis of expenditure levels, and we are compelled to use instruments. That said, the instruments are straightforward, coming directly from the theory and analysis of the adoption decision. Namely, the above results suggest that we need to use measures of prospective political opportunity (as measured by the degree of “unusualness” of the current coalition) to instrument for APA adoption. Armed with these instruments we can then identify the causal effect of APAs on state government expenditure growth. In other words, by using this set up, we can identify the effect of the adoption of an APA primarily using cross-state variation in adoption times, combined with an analysis of the within-state effect of a adopting an APA.

Given our earlier analysis, we specify an equation in Table 7 to analyze the drivers of state government expenditures. Notably, here we use a number of controls as previously discussed: per capita income growth to proxy for state GDP growth; the current configuration of the legislature and governor; and state and time (year) fixed effects. Unlike the results in Table 3, these results (by using per capita income and time fixed effects), presumably control for spurious results from the overall growth of government during our sample period.

The results in Table 7 are instructive about the effect that passage of an APA may have on the level of state government expenditure growth. Namely, once we appropriately control for other factors which may be correlated with expenditure growth, we find strong negative and statistically significant effects of adoption of an APA on the rate of government expenditure growth. In other words, in the properly identified equation, using both time and state fixed effects and instruments for adoption of an APA, adoption of an APA significantly reduced expenditure growth rates. This indicates that

the counterfactual, in the absence of adoption of the APA, would have been even higher rate of growth of government at the state level. Looking at the magnitude of our estimates, the results show that adoption of an APA reduces state government expenditure growth between 1.4 percentage points and 2.4 percentage points. These point estimates are in contrast to an average expenditure growth rate over the entire sample of 11.4 percent; in other words, the passage of an APA decelerates the rate of state government expenditure growth by between 12 and 21 percent, a relatively large reduction.

Finally, the results in Table 7 provide an indication why our preliminary results (in Table 3) provided a different picture. Namely, it is clear that both correlated factors and the endogeneity of adoption—based on time-varying characteristics of states—are affecting the raw comparison in Table 3. Once we introduce both an instrument for adoption (political expectations) and political and economic controls, the direction of the effect flips to negative. Further, when we add in time dummies the effect becomes even more significantly and sizably negative, indicating that much of the effect we saw in Table 3 was due to the accelerating size of government in the period under study.

**Table 7. Drivers of Government Expenditure Growth**

<i>Dependent Variable: Expenditure Growth</i>	<i>Panel IV 2nd Stage</i>	<i>Panel IV 2nd Stage</i>
<i>CONSTANT</i>	-0.005	0.409
<i>Adopt SLAPA</i>	-1.4261***	-2.387***
<i>Democrat Governor</i>	0.050	0.044
<i>Republican Control</i>	0.039	0.043
<i>Democratic Control and Republican Governor</i>	0.2475***	0.3715**
<i>Regional Expenditure Growth</i>	0.0001***	0.000
<i>State Fixed Effects</i>	Yes	Yes
<i>Year Dummies</i>	No	Yes
F-statistic	2.26	0.85
n	1926	1926

**Note:** \*\*\* $p < 0.01$  \*\* $p < 0.05$  \* $p < 0.10$  (two-tailed)

## **7. Conclusion**

Passage of the federal Administrative Procedure Act of 1946 and the similar state-level Administrative Procedure Acts (APAs) was one of the most significant developments in administrative law in the post-War period (McCubbins, Noll, and Weingast 1999; Bonfield 1986; Davis 1978; Nathanson 1948; Stason 1948). These acts created a set of superordinate requirements—including rules of notice, standing, information gathering, and judicial review—which every agency must follow in making policy decisions.

That said, most students of public policy are ultimately interested in policy outcomes. Indeed, scholars of the economics of regulation, law and economics and political science, have argued that the process followed in developing administrative law and policy can be determinative to the policy outcomes emanating from these processes. Despite these claims, however, little empirical evidence exists which actually demonstrates these effects. Further, this problem is accentuated by the fact that in order to evaluate the effects of such institutional features, it is necessary first to answer why the institutions are adopted in the first place.

In this paper we attempt to rectify this problem by analyzing the effects the passage of state-level APAs had on the level and pattern of growth of government from 1930 to 1984. Drawing on earlier work on adoption of APAs, we control for selection through both instrumental variables related to future expectations and fixed effects. Once appropriately controlling for selection on observables and unobservables, we find that passage of an APA substantially reduces the rate of growth of government. Furthermore, while not conclusive, we also find preliminary indications that the level of volatility in government expenditure is also reduced substantially by their passage.

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**Appendix 1. Citations to Laws creating an APA**

<b>State</b>	<b>Statutory Citation</b>
Alabama	Acts 1981, No. 81-855, p. 1534 ss. 1 to ss. 27
Alaska	SLA 1959, ch. 143
Arizona	Laws 1952, Ch. 97 ss. 1-11
Arkansas	Acts 1967, No. 434, ss. 1 to ss. 15
California	Stats. 1947, c. 1175, 1425; Cal. Gov. Code ss. 11370-3, 11421-7, 11440, 11445
Colorado	Laws 1959 H.B. 212 ss. 1-8
Connecticut	Public Acts No. 67, 1945
Delaware	60 Del. Laws, C. 585, ss. 1
Florida	Laws 1961, c. 61-280, ss.1 to ss. 6; Laws 1961, c. 61-292
Georgia	Acts 1964, pp. 338-356
Hawaii	L. 1961, c. 103, ss. 1 to ss. 20
Idaho	1965, Ch. 274 ss. 1 to ss. 14
Illinois	P.A. 79-1083, Art. I, ss. 1 to ss. 21 (1975)
Indiana	Acts 1945, c. 120
Iowa	Acts 1951 (54 G.A.) ch. 51 ss 1 to ss 11
Kansas	L. 1984, Ch. 313 ss. 1 - ss. 36; Ch. 338 ss1 to ss 27
Kentucky	Enact. Acts 1984 Ch. 417 ss. 1 to ss. 35
Louisiana	Acts 1966, No. 382 ss. 1 to ss. 17
Maine	Laws 1961, c. 394 ss. 1
Maryland	An. Code 1957, art. 40, ss. 40A; art. 41, ss. 244 to ss. 256; art. 76A, ss. 8 to ss. 15
Massachusetts	St. 1954, c. 681, ss. 1
Michigan	P.A. 1943, No. 88
Minnesota	Minn. Stat. Ann. ss. 15.041-9 (1946)
Mississippi	Law, 1976, ch. 487, ss. 1 to ss. 10
Missouri	L. 1945 p. 1504, ss. 1 to ss. 14
Montana	Enacted Sec. 1 to Sec. 24, ch. 2, Extra Laws 1971
Nebraska	Laws 1945 c. 255, ss. 1 to ss. 6, p. 795
Nevada	1965, p. 962 - 965
New Hampshire	1973, 507:1-4
New Jersey	L. 1968 c. 410 ss. 1 to ss. 17
New Mexico	Laws 1969, ch. 252
New York	Laws 1975, c. 167, ss. 1
North Carolina	1973, c. 1331, ss. 1
North Dakota	S. Laws 1941, ch. 240 ss1 to ss22
Ohio	1943 Ohio Gen. Code Ann ss 154-61 to ss. 154-73
Oklahoma	Laws 1963, c. 371, ss1 to ss. 27
Oregon	1957, c. 717, ss. 1 to ss. 14
Pennsylvania	1945 Pamphlet Laws 1388, no. 442
Rhode Island	G.L. 1956, ss. 42-35-1 to ss. 42-35-18
South Carolina	1977 Act no 176, Art. I and Art. II
South Dakota	SL 1966, ch. 159
Tennessee	Acts 1974, ch. 725, ss1 to ss18
Texas	Act 1975, 64th Leg., p. 136, ch. 61; Vernon's Ann. Civ. St. art. 6252-13a
Utah	Laws 1973, ch. 172
Vermont	1967, No. 360 (Adj. Sess.), ss. 1 - ss. 18
Virginia	1975, c. 503
Washington	Laws 1959, ch. 234, ss. 1 to ss. 20
West Virginia	1964, C. 1
Wisconsin	St. 1943 ss. 227
Wyoming	W.S. 1957, ss. 9-276