



Partisan influence on the local tax burden in the Netherlands*

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Abstract. This paper analyses the role of partisan politics in determining the local tax burden. Property taxes are the most important revenue source which municipalities in the Netherlands can decide upon themselves. Using a new data set on Dutch local property taxes in 1996, it is concluded that municipalities with a council dominated by left wing parties have a higher tax burden. We also find that larger coalitions have lower levels of taxation. Finally, tax exporting increases tax rates.

1. Introduction

The role of partisan politics in determining public policy is a contentious issue. Whereas some authors argue that partisan politics play little if any role, Hibbs (1987) and others pose that ideological differences are important in determining public policy. In this view left wing political parties are believed to be more in favour of an active state and income redistribution than right wing parties. In terms of taxation: it is expected that right wing government will be more favourable towards a lower tax burden than left wing governments. Some authors argue that over the last two decades, say, the latitude for partisanship at the national level has been reduced tremendously. Due to financial and economic integration, partisan preferences may have become less important in shaping national tax and spending policies. This could perhaps also explain that there is only mixed empirical evidence in support of the partisan hypothesis (see Cusack, 1997 for further discussion).

So far, only a few studies have examined the impact of partisan politics at the non-national level. Abrams and Dougan (1986) conclude that US states with a liberal governor have a relatively higher level of state spending. Ibrahim (1994) analyses the relationship between spending of counties in the UK and the “political colour” of the county’s government. He finds that Labour governments spend more than Conservative ones, but this conclusion is suspect as the author does not include control variables. Borge (1995) reports higher fee income for local Norwegian governments under socialist reign.

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Reid (1998) concludes that total expenditures of Canadian provinces with left wing governments exceed those with right wing governments. In contrast, Pommerehne (1978) does not report partisan influences on local public finance in Switzerland. Similarly, Bosch and Suarez-Pandiello (1995) find no partisan effect on local government spending in Spain in 1988.

This paper analyses to what extent partisan politics matters for the local tax burden in the Netherlands.¹ We use a new data set for property taxes, which is the most important own revenue source upon which municipalities can decide themselves. We analyse whether political differences matter in terms of the tax burden after various control variables are taken into account. It is concluded that left wing municipalities have a higher tax burden. Our data set also allows us to examine whether the type of local government matters in terms of policy outcomes. Roubini and Sachs (1989) argue that the type of government in power is very important in explaining national levels of government spending and budget deficits in OECD countries. These authors find that large coalition governments have higher deficits and spending levels, other things being equal, than one-party, majoritarian governments.² There is also some evidence that these political factors matter at the local level. Abrams and Dougan (1986) report a positive effect of competition between political parties and state spending. Borge (1995) concludes that strong political leadership (i.e., a low level of fragmentation) contributes to a significant reduction in fee income of local governments in Norway. Similar results are reported by Bosch and Suarez-Pandiello (1995) for spending of Spanish municipalities. In contrast, we find that larger coalitions have lower levels of taxation.

The remainder of the paper is structured as follows. In Section 2 the finances of municipalities in the Netherlands are outlined. Section 3 describes our model and data set, including the control variables, while Section 4 presents the results. Section 5 offers the conclusions based on these results.

2. Local public finances in the Netherlands

Municipalities in the Netherlands finance their spending through specific (41%) and general grants (26%) from central government, municipal levies (13%) and income from property and market activities (21%).³ Municipal levies consist of local taxes (48%) and user charges. The specific grants are received from different central government departments and are created to finance local government tasks imposed by central government. So this revenue is earmarked. In contrast, general grants are used to finance the so-called autonomous tasks of local government. They are channelled through the Municipality Fund that distributes the available money over the 625 mu-

municipalities according to a detailed set of criteria. These criteria have been carefully designed in order to minimize the municipalities' ability to influence their share. General grants do neither depend on the level of other local income sources, nor on local expenditures. Central government decides on the amount of money available for the Fund (Dfl 19 billion in 1996). The aim is to enable all municipalities to provide an equivalent level of public services. Still, municipalities are free to determine their preferred service levels. Local governments wanting to provide a higher level of services can finance this by increasing revenues. As user charges are not allowed to exceed (budgeted) costs, this implies a higher tax burden.⁴

Property taxes amount to 95% of local tax receipts. Municipalities are free to set tax rates and to spend revenues. There is a rate for owners and a rate for users of properties. In 1996 the combined rate varied from Dfl 5.10 to Dfl 44.30 per Dfl 5,000 of property value. The average combined tax rate was 15.63%. Like the tax rates, property tax revenues per capita show considerable variation across municipalities. The average revenue in our estimation sample amounted to Dfl 217, with a standard deviation of Dfl 60. The lowest level of taxes (per capita) is Dfl 93, whereas the highest level amounts to Dfl 527. Figure 1 shows the property tax per capita for all municipalities in the Netherlands.

Tax rates are set by the municipal council which is elected every four years. Mayor and aldermen form the executive board. The mayor, whose executive powers are limited, is appointed by central government. The aldermen are members of the municipal council. Their number varies according to the number of inhabitants. The aldermen are elected by the council from the parties that form a coalition. The executive board needs the support of the majority of the municipal council. In general, the parties represented in the executive board form a majority in the council, which often exceeds the minimum winning size. Local government elections were held in 1994. Since it is unlikely that the new councils and/or executive boards were able to substantially alter tax rates already in 1995, we have chosen 1996 as reference year.⁵ In that year there were 625 municipalities. Data availability reduced the number of observations to 602. This group is representative for the entire sample (see Allers, 1998, for further details and data sources).

3. The model and the data

Following Borge (1995) the following simple theoretic set-up is considered. We assume that the preferences of the median voter can be captured by the following separable utility function:



Figure 1. Property taxes per capita in the Netherlands, 1996.

$$U = U_1(S; \text{needs}, I) + U_2(C) \quad (1)$$

where S denotes per capita consumption of free local services (excluding tasks imposed by the central government, which are financed through specific grants), and C denotes other consumption (both private consumption and consumption of publicly provided goods and services, excluding S). S is supposed to depend on local needs and ideology. Local needs for governments services will depend, inter alia, on demographic, social and spatial variables. A high proportion of long-term unemployed, for instance, implies

a high demand for social and educational services. I denotes ideology, or the relative preference for public services over private consumption. The purpose of this paper is to determine whether ideology matters, that is, whether the political composition of the electorate influences the tax burden when needs are already taken into account.

Disposable income (private income net of national income tax and social insurance contributions) can be spent as follows:

$$Y_d = PT + C \quad (2)$$

where PT is per capita property tax revenue. As follows from the previous section, the budget constraint for the local government can be written as:⁶

$$pS = G + PT \quad (3)$$

where p denotes the constant unit costs of producing S and G are general grants from central government (all in per capita terms).

When p is suppressed,⁷ the optimality condition and the budget constraint yield an equation for PT (see also Borge, 1995):

$$PT = PT(\text{needs}, I, G, Y_d) \quad (4)$$

This equation is the basis for our empirical model. Below we will discuss our proxies for the non-political variables. One particular difficulty arises with the grants variable, which, in the Dutch setting, is not independent from the needs for public services.

Following Bell and Bowman (1987) we employ a linear additive model for the local tax burden. The dependent variable is the budgeted property tax revenue, as this is what the municipal council decides upon. To enable comparison between local governments we employ per capita figures. Preliminary analysis showed that the results for the non-political variables were very much influenced by inclusion of the four largest municipalities and the islands in the Waddenzee. We therefore dropped these municipalities from the sample, leaving 593 observations.⁸

Public choice theory teaches that government policies do not automatically reflect the preferences of the electorate. Policymakers may have preferences of their own. In Dutch municipalities, the executive committee consists of council members from coalition parties. The political composition of the executive committee thus differs from that of the council. To model partisan influences we follow Cussack (1997) and differentiate between the "political colour" of the council and of the executive committee (excl. the non-elected mayor). The model estimated is:

$$PT = a + bX + c_1PCCOUNCIL + c_2PCDIFEX \quad (5)$$

where X is our vector of control variables outlined below and (partly) suggested by Equation (4), PCCOUNCIL denotes the political composition of the council (reflecting the position of the electorate) and PCDIFEX denotes the difference between the political composition of the executive board (excl. the mayor) and that of the council.

The political variables are defined on a scale between zero (all seats occupied by right wing parties) and one (only left wing parties). The following (national) parties are considered to be left wing: PvdA (Social Democrats), D66 (left wing liberals), Groen Links (the Green Party) and SP (Socialist Party). All other national parties are considered right wing.⁹ Most important among these are CDA (Christian Democrats) and VVD (Conservative Liberals). Various local political parties have a clear left or right wing signature and are treated accordingly. The remaining local parties are considered to be neutral. We assume that left wing parties prefer a higher level of public services, and thus a higher tax burden, than right wing parties. In case of partisan influences c_1 will therefore be positive. If the executive board behaves entirely in accordance with the wishes of the council, c_2 will be zero. In this case, aldermen are office seekers, maximizing their chances of re-election by following the wishes of the electorate. If c_2 is positive the executive follows its own priorities. In the extreme case that the position of the electorate is not taken into account and aldermen are policy seekers $c_1 = c_2$. If $c_1 > c_2 = 0$, aldermen are partly (c_2/c_1) policy seeker and partly office seeker ($1 - c_2/c_1$).

The following non-political control variables are included:

1. shortcoming of the distribution scheme of the Municipality Fund in 1996 (BIAS). In 1997 a new distribution scheme was introduced. Before, municipalities with an important regional function and a weak social structure received not enough money from the Fund to deliver an equivalent level of services. It is likely that these municipalities therefore had a higher local tax burden in 1996. Our proxy for this bias in the distribution system at the time is the difference between what the municipality actually received in 1996 from the Fund and what it would have received under the new regime. Because the precise structure of the new distribution mechanism was determined long after the 1996 budgets of the municipalities were approved, it is unlikely that the BIAS variable captures future grant revenue changes.
2. grants received from the Municipality Fund in 1996 (GRANTS). As pointed out in Section 2, receipts from the Municipality Fund depend on a number of criteria designed to equalise the municipalities' ability to provide public services at a given tax burden, while minimizing the municipalities' ability to actively influence their share by undesirable

manipulations. These criteria measure the need for municipal services, and the costs to provide some of them (e.g., municipalities with a weak soil structure receive more money because of the associated higher costs of sewer maintenance). The GRANTS variable therefore reflects both the availability of funds to finance public services, and the need for those services, as far as these are (correctly) included in the grants distribution mechanism. This explains the omission from the regression equation of variables like age structure and income distribution, which were found to be insignificant when the GRANTS variable was included in the regression. So, this variable acts not only as proxy for the variable G in Equation (4), but also for needs.

3. the number of inhabitants of the municipality (INHABITANTS). This variable also reflects needs for governments services.
4. a dummy variable to take into account that in 1997 83 municipalities were reclassified (e.g., some municipalities were merged) (CLASDUM).
5. a dummy variable to take into account that some municipalities (19 in 1996) were not autonomous in determining their tax policies as they had serious financial problems and were therefore depending upon the approval of the budget by the central government (FINDUM).¹⁰
6. average per capita available income in the municipality (INCAV), which is defined as personal income net of national tax and social insurance contributions. This variable is also suggested by Equation (4).
7. the share of housing that is subsidised by the central government (SOCHOUS) since property taxes on these houses can often partly be shifted towards central government.
8. two variables reflecting tax capacity. In a closed economy, all taxes are ultimately paid out of resident income (Bell and Bowman, 1987). However, in Dutch municipalities local property is partially owned by non-residents. Property taxes are therefore partially paid by non-residents. The ability to “export” taxes lowers the tax price and therefore might influence the local tax burden. Therefore, both the per capita value of residential (RESPRICE) and non-residential property (NRESPRICE) are included in the estimated model.¹¹ Analysis of initial regression results revealed that the square value of the latter variable is more appropriate. This may reflect that high per capita values of non-residential property indicate the presence of large firms, usually owned by non-residents, while low values correspond to a larger proportion of locally-owned, small-scale businesses.

Apart from partisan influences we have also examined whether the type of local government matters. As explained in the Introduction, one argument

is that strong political leadership may be a necessary condition to limit the growth of public spending. For example, Borge (1995) argues that the lobby of special interest groups for higher production of services financed through general taxes can be better resisted by strong political leadership. To test this view he included a Herfindahl index to measure political fragmentation and a classification variable similar to that of Roubini and Sachs (1989). Borge's results support the view that weak political leadership is more likely to accommodate pressure to increase spending. We have included a variable that measures the size of the executive board in terms of the number of political parties being represented (SIZE).¹² This variable simply measures the number of coalition partners.

4. Results

Table 1 presents our estimation results, using White (1980) *t*-values.¹³ Column (1) shows the basic model. It follows that partisan politics clearly matter for the local tax burden. The coefficient of PCOUNCIL – which measures how left-wing the municipal council is – is positive and highly significant. This result is in line with the findings of Borge (1995) and Reid (1998). It also follows from the regression that the difference between composition of the council and the executive board matters too. If the executive board would not pay any attention to the wishes of the electorate, the coefficient of PCDIFEX would be the same as that of PCCOUNCIL. However, it is significantly lower¹⁴ indicating that the executive board takes the position of the electorate well into account. Still, the coefficient of PCDIFEX is significantly different from zero, which implies that aldermen's own preferences do matter. They are mostly 'office seekers' and partly 'policy seekers'.¹⁵

Column (2) of Table 1 shows the outcome if the relative strength of the four major political parties in the council are included instead of PCCOUNCIL. The results are basically in line with those of the model in column (1). The coefficients of the left-wing parties are positive, while those of the right-wing parties are negative, albeit that the coefficient of the VVD (conservative liberals) is not significantly different from zero. Column (3) of Table 1 presents the results for the composition of the executive board. Again there is support for the partisan hypothesis: municipalities with a left wing executive board face higher tax burdens. This time, the coefficient for the VVD is also significantly different from zero.

The coefficient of the variable SIZE is negative and significant. Similar results are found if the reciprocal of the Herfindahl index is used to proxy for the political coherence of the executive board (not shown). This finding

Table 1. Estimation results.

(N = 593)

Variable	(1)		(2)		(3)	
Constant	-54.60	(-1.73)	-21.78	(-0.60)	-28.67	(-0.81)
BIAS	0.15	(3.85)	0.17	(4.46)	0.16	(4.18)
GRANTS	0.11	(5.20)	0.12	(5.97)	0.12	(6.03)
INHABITANTS	0.0005	(5.09)	0.0006	(5.15)	0.0006	(4.94)
CLASDUM	-11.02	(-2.06)	-10.02	(-1.88)	-10.21	(-1.93)
FINDUM	55.56	(3.65)	55.91	(3.75)	57.39	(3.88)
INCAV	0.003	(2.11)	0.004	(2.20)	0.004	(2.67)
SOCHOUS	100.09	(3.91)	91.61	(3.37)	98.92	(3.71)
RESPRICE	0.0006	(2.81)	0.0005	(2.42)	0.0005	(2.36)
NRESPRICESQR	2.55E-8	(8.84)	2.57E-8	(7.94)	2.56E-8	(8.71)
PCCOUNCIL	90.59	(4.64)				
PCDIFEX	22.92	(2.40)	20.25	(2.09)	-57.12	(-2.73)
SIZE	-5.98	(-1.97)	-7.03	(-2.30)	-7.55	(-2.47)
CDACOUNC			-58.09	(-3.69)		
PVDACOUNC			49.67	(2.11)		
VVDCOUNC			-16.70	(-0.74)		
D66COUNC			56.69	(1.93)		
CDABOARD					-49.25	(-4.27)
PVDABOARD					49.14	(3.40)
VVDBOARD					-35.40	(-2.69)
D66BOARD					44.84	(2.30)
R ² (adj)	0.56		0.56		0.56	

White t-values in parentheses.

is in contrast to those of Borge (1995) for fee income of Norwegian local governments.¹⁶

Finally, the coefficients of the non-political control variables are all significantly different from zero and generally in line with our *a priori* expectations. The coefficient of the BIAS variable is significantly positive. One guilder under-compensation in the grants distribution system results in a 15 cents higher tax burden. This implies that under-compensated municipalities reacted primarily by curbing expenditures. The coefficient of the variable GRANTS is positive. The same result is reported by Borge (1995). Because the GRANTS variable reflects both the availability of funds to finance public services, and the need for those services – provided these are correctly included in the grants distribution mechanism – this could mean that muni-

icipalities with high spending needs are under-compensated, not only by the 1996 grants system, but – since the BIAS variable is included – by the new system as well.

For every additional 1000 inhabitants, the tax burden is 50 cents higher. This could imply negative returns to scale, as bureaucracies above a certain size are more costly to manage. An alternative interpretation is that councilors in small municipalities are more likely to be known personally by their fellow citizens, and do not relish the prospect of awkward discussions while queuing for groceries. As expected, in municipalities under central government restraint the tax burden is considerably higher (FINDUM). Average household income is positively related to the tax burden, implying that municipal services are “normal”. A higher proportion of subsidized housing is associated with a higher tax burden. This variable is used as a proxy for the proportion of households receiving rent subsidy. At least part of the property tax rate for house owners will be passed on to renters. Rent subsidy partly shifts this burden to the central government, which finances rent subsidies. This lowers the tax price for rent subsidy receivers (29% of renters; 15% of all households).

The value of non-residential property is an important determinant of the tax burden, reflecting tax exporting. This is in line with the results reported by Bell and Bowman (1987) and Ladd (1975). The fact that the value of residential property also exerts some influence points to the possibility of tax illusion, since private income is included in the model. When per capita property value is high, a heavy tax burden is masked by the relatively low tax rate needed to generate it. So voters who generally focus on nominal tax rates when comparing tax burdens across municipalities have a wrong view of the burden. Earlier evidence for tax illusion at the local level is reported by Heyndels and Smolders (1994) and Pommerehne and Schneider (1978) for Belgian and Swiss municipalities, respectively. An alternative interpretation is that the value of residential property reflects household wealth, which may influence the demand for municipal services.

5. Concluding comments

In this paper we have analysed the role of partisan politics in determining the local tax burden in the Netherlands. Property taxes are the most important revenue source which municipalities in the Netherlands can decide upon themselves. Using a new data set on Dutch local property taxes in 1996, it is concluded that municipalities with a council dominated by left wing parties have a higher tax burden. In contrast to previous studies on the local tax burden in the Netherlands, this conclusion is based on a model in which a

whole range of non-political control variables is included. We also find that larger coalitions have lower levels of taxation. Finally, municipalities where non-residents pay a larger share of the tax bill have higher tax levels.

Notes

1. Previous attempts to explain local tax burdens in the Netherlands (all in Dutch) have serious shortcomings due to lack of control variables and sample size. See Allers (1998) for further details.
2. However, subsequent research reports less support for this so-called weak government hypothesis (see, e.g., Edin and Ohlsson, 1991; De Haan and Sturm, 1997). Still, Alesina and Perotti (1995) conclude that coalition governments are less successful in adjusting public finances than one-party governments.
3. The figures refer to 1996. Source: Ministry of Finance (1996) and CBS (1998). Income from market activities is for a large part offset by the costs associated with these activities, and thus cannot be spent freely.
4. Borge (1995) argues that user fees of Norwegian municipalities are fiscally motivated. In the Netherlands the receipts from user charges consist primarily of fees for garbage collection and sewerage. These are not typically areas for politically motivated increases in spending.
5. In 1997, among other institutional changes, a new redistribution system for the Municipality Fund was introduced. Therefore we decided against taking this year as reference year and against a panel data model for 1996 and 1997.
6. National law allows municipalities to borrow only to finance investments, and to bridge small short-term fluctuations in current expenditures. In practice, deficit financing of local service production can therefore safely be ruled out.
7. In a small country like the Netherlands, prices of most inputs are virtually constant across municipalities. Local government wages, for instance, are harmonised nationally.
8. The four major cities and the five island municipalities differ substantially from the other municipalities because of higher cost levels and higher grants. The results for all 602 observations are available on request.
9. We have also estimated the model with separate variables for the most important political parties to check whether our conclusions are sensitive to this grouping on a left-right scale. As will be explained, they were not.
10. These are so-called article 12 municipalities.
11. Both variables are potentially endogenous. High property tax rates are likely to be at least partially capitalised in property values and may discourage settlement and investment (Ladd and Bradbury, 1988; Yinger, Bloom, Börsch, Supan, and Ladd, 1988; Rosen and Fullerton, 1997). However, property values are not updated annually. In 1996, 97% of the municipalities use property values dating back to before the local elections in 1994. The probability that these are related to 1996 tax rates is limited.
12. De Haan, Sturm, and Beekhuis (1999) find that in contrast to the Roubini-Sachs index the number of political parties in government is a proper indicator for government strength in explaining public debt growth.
13. We have also estimated the model including an additional dummy variable which takes into account that various municipalities do not have user charges for sewerage and thus finance sewer maintenance from tax revenues. As this variable is likely to be endogenous,

we prefer the reported model. The basic conclusions are not sensitive to the inclusion of this dummy variable (not shown; results available upon request).

14. A one-sided t-test confirms $c_1 - c_2 > 0$ ($t = 3,08$).
15. In fact, the coefficients of PCCOUNCIL and PCDIFEX suggest that aldermen are one part policy seeker ($c_2/c_1 = 23/91 = 0,25$) and three parts office seekers ($1-23/91$).
16. There is one objection that can be raised against our variable for the size of the coalition: it implies that an increase from 1 to 2 parties will have the same impact as an increase from 4 to 5 parties. Therefore, we have created separate dummies for all possible sizes of the coalition. The results suggest that the negative impact of our variable SIZE is clearly caused by large coalitions (not shown).

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