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## Government weakness and electoral cycles in local public debt: evidence from Flemish municipalities

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**Government Weakness and Electoral Cycles in  
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## ABSTRACT

### **Government Weakness and Electoral Cycles in Local Public Debt: Evidence from Flemish Municipalities**

by Benny Geys \*

Empirical research on Political Business (and Budget) Cycles is more supportive for electoral cycles in policies than in macro-economic outcomes. But even pre-electoral policy cycles receive no unanimous confirmation. In the present paper, we give credence to recent arguments that this may be due to the disregard for the political, economic and institutional context in which politicians make policy decisions. Specifically, we argue that the level of political fragmentation of the government affects both the need for and possibility to engage in opportunistic policy cycles. An analysis of local public debt data for 296 Flemish municipalities provides empirical support for this contention.

*Keywords: Political Budget Cycles, local public debt, political fragmentation, elections, municipalities*

*JEL Classification: E62, H72, H74*

## ZUSAMMENFASSUNG

### **Regierungsschwäche und Wahlzyklen in Zeiten kommunaler Verschuldung: das Beispiel flämischer Kommunen**

Ergebnisse empirischer Forschung zum Thema regierungspolitischer und Budgetzyklen unterstützen eher die These, dass es Wahlzyklen in Bezug auf politische Entscheidungen als in Bezug auf makroökonomische Effekte gibt. Dennoch gibt es auch für Politikzyklen in Vor-Wahl-Perioden keine eindeutige Bestätigung. In der vorliegenden Veröffentlichung belegen wir neuere Argumente, die zeigen, dass die Begründung hierfür in der Missachtung des politischen, ökonomischen und institutionellen Kontextes liegt, in dem Politiker politische Entscheidungen treffen. Wir belegen insbesondere, dass der Grad der politischen Zersplitterung der Regierung sowohl den Bedarf nach als auch die Möglichkeit zu opportunistischen Politikzyklen beeinflusst. Eine Analyse von Daten zur kommunalen Verschuldung von 296 flämischen Gemeinden liefert die empirische Untermauerung für diese Behauptung.

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## INTRODUCTION

Early in the legislative term, governments tend to follow relatively austere policies while the later years of the term often show considerable generosity on the part of incumbents. This ‘predictable pattern of policy’ aims to improve one’s chances of re-election (Nordhaus, 1975: 187). Alterations in macro-economic policies such as to affect economic growth, unemployment and inflation (referred to as Political *Business Cycles*) are one possibility to reach this goal. Adjustments in fiscal policies such as tax rates, expenditure patterns and so on are another (referred to as Political *Budget Cycles*).

Theoretically, Political Budget Cycles require motive and opportunity (Tufté, 1978). They are thus likely to be stronger when there is more need for them (that is, when re-election is uncertain) *and* when the incumbent has the political ability to manipulate policy. As the level of government fragmentation affects both these elements (e.g. Boix, 1997; Mueller, 2003), it follows that government fragmentation may influence the tendency of incumbents to ‘electioneer’. Nonetheless, to the best of our knowledge, only three studies take up this issue (Goodhart, 2002; Ashworth and Heyndels, 2002; Huber *et al.*, 2003). All three use country-level data and provide supportive evidence of the idea that political fragmentation affects the incentive to ‘electioneer’.

We extend previous work in two main ways. Firstly, analyse debt data from 296 Flemish municipalities (1977-2000) and thus focus on local rather than national governments. This has the advantage of allowing us to analyse opportunistic behaviour in an institutionally homogenous setting. Secondly, we explicitly test whether the number of coalition partners influences the Political Budget Cycle (rather than

restricting ourselves to an analysis of coalitions versus one-party governments as in previous work). Consideration of the number of parties in the coalition is important, as this has been shown to affect the ease of decision-making (e.g. Velasco, 2000; Ashworth *et al.*, 2005, 2006).

The remainder of the paper is structured as follows. Section 1 reviews the literature on Political Budget Cycles and shows how political fragmentation may affect these cycles. The Flemish institutional setting and data are presented in section 2. Section 3 contains the empirical analysis while section 4 concludes.

## **1. POLITICAL BUDGET CYCLES AND GOVERNMENT FRAGMENTATION**

### *1.1. Political Budget Cycles*

The literature on Political Budget Cycles argues that politicians ‘seek to synchronize the timing of economic benefits and government profligacy with elections’ (Petry *et al.*, 1999: 273). The reason is that high growth rates, low unemployment and/or government profligacy increase the incumbent government’s popularity and thereby its chance of re-election. This is important as holding office is assumed to be the prime concern of politicians in these models (Nordhaus, 1975; Tufte, 1978; Alesina *et al.*, 1997). That is, politicians are driven by opportunistic rather than ideological motivations.<sup>1</sup>

Early theoretical models explaining election-driven policy cycles rested on the assumption that voters are backward-looking, myopic and incapable of learning

(Alesina *et al.*, 1997). Under these assumptions, politicians can affect the voter's judgement by making popular changes in policies close to the election (Franzese, 2002). Moreover, since voters do not learn from previous experiences, they can be fooled over and over again. These assumptions are, however, not very satisfactory from a conceptual point of view. Later models therefore assume rational expectations on the part of the voter (e.g. Cukierman and Meltzer, 1986; Rogoff and Sibert, 1988; Rogoff, 1990 and Persson and Tabellini, 1990). Still, political cycles persist under the (critical) assumption that politicians have an information advantage over voters about their competence level. Competence can be defined as the ability to reduce waste in the budget process (Rogoff and Sibert, 1988; Rogoff, 1990), promote growth without inflation (Persson and Tabellini, 1990) or insulate the economy from random shocks (Cukierman and Meltzer, 1986). The information asymmetry entails that 'the incumbent government has an incentive to signal its competence by engaging in pre-electoral manipulations of policy instruments' (Alesina *et al.*, 1992: 3).

Empirically, electoral cycles in public policies are widely acknowledged by the general public. There is also a vast scientific literature on the subject. As an excellent review is available in Franzese (2002), we here only briefly run over the main findings. Firstly, policy adjustments to influence the voter's decision-making are relatively well-established. This holds strongest for direct transfers, but also for tax cuts (or delayed increases), spending increases (or delayed cuts) and public hiring (or delayed firing). Support for such cycles is somewhat more robust in developing democracies relative to developed countries (Block, 2003). Secondly, evidence for pre-electoral shifts in real outcomes (i.e. economic growth, unemployment and/or inflation) is at best ambiguous (Franzese, 2002). Hence, the evidence for electoral cycles is clearly stronger for

changes in policies than in real outcomes. Finally, it has been argued that the incentives to ‘electioneer’ are dependent upon the political, economic, institutional, structural and strategic context in which incumbents make policy. Some supportive evidence of this has been presented, but the ‘crucial variation in the contexts’ has generally been ‘underemphasized’ (Franzese, 2002: 369).

### *1.2. Influence of government fragmentation*

We contend that the level of government fragmentation may affect the extent of opportunistic political behaviour. Political fragmentation is thereby defined as the dispersion of political power. This not only refers to coalition governments, but also to cases of ‘divided government’ (i.e. when different parties control the executive and legislative branch of the government). To derive theoretical arguments why government fragmentation might influence the prevalence of electoral cycles, we start from Tufte’s (1978) description of ‘electioneering’ as a murder mystery where politicians need weapon, motive and opportunity. Two sets of weapons have generally been regarded: monetary policy and fiscal policy. While monetary policy is (at best) only available for national governments, adjustments in fiscal policy are attainable at any level of government. The motive is re-election. This implies that the more uncertain re-election is, the higher the likelihood that politicians attempt to persuade voters. Finally, opportunity has two key aspects. It requires that governments have (perfect) knowledge about the timing of elections. Fine-tuning policy decisions to one’s electoral needs can only be efficient if the incumbent knows well in advance when elections take place. It also entails that the government has the ‘political opportunity’ to change its policy. It should thus have some degree of autonomy and political power.



From this murder mystery approach, two arguments can be derived relating government fragmentation to the electoral cycle. On the one hand, government fragmentation affects the political opportunity to manipulate policy. Fragmented governments are more likely to face indecisiveness and gridlock (Roubini and Sachs, 1989; Boix, 1997). Game theory holds that this indecisiveness is likely to worsen with the number of parties (de Haan and Sturm, 1997). In other words, manipulation of policy may be easier for strong, one-party governments and become more difficult the larger the number of parties. Moreover, Powell and Whitten (1993) argue that it is easier to ascribe the state of the economy (and pre-electoral fiscal ‘presents’) to a one-party majority government than to a party in a coalition. This lowers the incentive for parties in a coalition to embark on pre-electoral manoeuvres to increase their popularity.<sup>2</sup> Both arguments lead to the hypothesis that electoral cycles are less likely when the government is more fragmented.

On the other hand, legislative uncertainty is positively related to government fragmentation (see Mueller, 2003). Fragmented governments have on average a shorter tenure and, given the uncertainty involved in the coalition formation process, the political future of parties in a coalition is less clear-cut than that of one-party majorities. This higher uncertainty for parties in a coalition leads to the hypothesis that fragmented governments may indulge in more prominent pre-electoral cycles. Moreover, parties in a coalition do not fully internalise the fiscal costs of their actions (given a common pool of resources) (Weingast *et al.*, 1981; Velasco, 2000). This leads to higher expenditure levels and – to the extent that a similar reasoning holds for election-driven expenditure programs – to a steeper rise in pre-electoral expenditure under fragmented governments.

Finally, Persson and Svensson (1989), Alesina and Tabellini (1990) and Tabellini and Alesina (1990) argue that uncertainty about future government participation may create an incentive to limit the policy options of future governments by strategically increasing public debt prior to elections. Fragmented governments, being more uncertain of future legislative power (cfr. *supra*), may thus aim for higher levels of debt prior to elections in order to compromise future governments.

To the best of our knowledge, only three analyses regard the effect of political fragmentation on Political Budget Cycles. Ashworth and Heyndels (2002) explore year-to-year changes in tax structures in 18 OECD countries (1965-95). They show that fragmented and one-party minority governments witness stronger changes in their tax structure in election years compared to one-party majority governments.<sup>3</sup> Goodhart (2002) analyses monetary policy in 17 countries (1973-92). She finds that an electoral cycle in quarterly money growth exists for one-party governments, but not for coalition governments. Finally, Huber *et al.* (2003) analyse public deficits in OECD countries (1970-99). They show that an election only significantly affects budget deficits in the full sample, but not when the sample is restricted to coalition governments.<sup>4</sup>

## **2. MUNICIPAL POLICY: INSTITUTIONAL FRAMEWORK**

Flemish municipalities are governed by the local council (the legislative body) and the College of Mayor and Aldermen (the executive body). Whereas the Aldermen are selected from among the councillors, the councillors are nominated through democratic elections. These take place once every six years on the second Sunday of October. Hence, while local politicians cannot choose the date of the election to match positive

economic circumstances, they are aware of the timing of the elections and might be tempted to influence (fiscal) policies to increase their popularity.

A system of Proportional Representation (i.e. ‘highest averages Imperiali’) is used to allocate seats in these municipal elections. Such proportional systems are thought to be conducive to higher levels of political fragmentation (Duverger, 1954/1972). Table 1 reveals that this also holds for Flemish local governments (see also Geys, 2006). This table represents the number of municipalities where one to five parties (i.e. the maximum observed over the period under study) gained representation in the College of Mayor and Aldermen over the latest five municipal elections (1976 up to 2000). The average number of parties across the municipalities is also indicated for each legislative term (along with the standard deviation). However, while there are 308 Flemish municipalities, data availability forces us to preclude 12 of these from the analysis (leaving 296 municipalities – see below). For comparability, we therefore only discuss the government composition in these 296 municipalities. Note, finally, that the number of parties in the College can only vary when the composition of the government changes. Unlike at the federal level, this will – under normal circumstances – only happen following new municipal elections or once every six years.

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Table 1

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Table 1 illustrates that the average number of parties with representation in the College of Mayor and Alderman has witnessed a rise from 1.47 to 1.87 parties between the

elections of 1976 and 2000. However, there is no uniform upward trend. The elections of 1988 led to a decline in the fragmentation of Flemish municipal governments, but the following two elections (1994 and 2000) more than made up for this decline. There is also considerable variation between municipalities. For example, after the 2000 municipal elections, almost one in three municipalities has a one-party majority. Little over half of the municipalities are governed by a two-party coalition and the remaining local governments are presided by 'large coalitions' (containing three or more parties).

It is of interest to note here that the number of parties in the College is weakly positively related to the size of the municipality ( $r=0.22$ ). Larger municipalities are somewhat less likely to be governed by a one-party majority. Also, there is a relatively weak negative correlation between the number of parties in the College and the ideological position of the government ( $r=-0.30$ ).<sup>5</sup> This reflects the historical – though waning – supremacy of the Christian Democrats (CD&V) at the local government level. They are positioned in the ideological centre and have tended to cooperate more often with the socialist party (SP.a) on their left than with the liberal party (VLD) on their right. Finally, there is the issue of government (in)stability over time. Unfortunately, our data only allow us to observe which parties are in power in a given period. Yet, political parties at the local level in Flanders frequently split up, merge, form (temporary) cartels, disappear or simply change their name between consecutive elections. Still, this does not necessarily affect the politicians in power (such that party instability and government instability do not need to coincide). As it is often extremely difficult to determine links between parties in successive elections in the same municipality (see also Vermeir and Heyndels, 2006), an in-depth analysis of local government instability was not possible with the current data and is therefore left for future research.

### 3. EMPIRICAL ANALYSIS

#### 3.1. Empirical model

Our empirical analysis concentrates on real long-term municipal debts in 296 Flemish municipalities over the period 1977-2000 (in 2000 prices).<sup>6</sup> We use long-term debts as these indicate most closely the municipality's financial position, while short-term loans may merely reflect temporary imbalances. Moreover, we only consider loans for which the financial burden falls on the municipal government, viz. so-called 'own share' loans. These represent more than 95 per cent of the total loan volume in 2000 (Dexia, 2001). Still, two other types of loans exist. For 'government share' loans the burden of interest and amortisation is borne by a higher-level government. 'Third party' or 'pass-through' loans are arranged for and repaid by a third party (e.g. church fabrics). Both are excluded from the present analysis, however, as they imply no budgetary consequences for the municipality arranging the loan.

We estimate the following regression model (subscripts for time and municipalities dropped for convenience):

$$\begin{aligned} \partial Debt = & a + b_1 \partial Pop + b_2 \partial Inc + b_3 \partial Cost + b_4 Dexia + b_5 BBR + b_6 ICG + \\ & b_7 FRAG + b_8 ELECT + b_9 ELECT*FRAG + e \end{aligned}$$

The dependent variable is the year-on-year growth rate of real long-term municipal debts in municipality *i* at time *t* (in 2000 prices) (cfr. Jochimsen and Nuscheler, 2005).

As explanatory variables, we first of all include the growth rate of real per capita taxable income ( $\partial Inc$ ; in 2000 prices) and the growth rate of the population ( $\partial Pop$ ). These variables capture demand side effects as increases in income and/or population are likely to lead to an additional demand for public expenditures (which may be at least partly financed by debt). Secondly, we introduce the year-to-year change in the real interest rate on long-term (federal) government bonds to measure changes in the cost of borrowing. Increasing costs of borrowing can be expected to decrease debt financing by rational governments (Clingermayer and Wood, 1995). Note that this variable only changes over time but not across municipalities. It can thus only explain within municipality variation and not between municipality variation.

The 'Dexia'-variable controls for the Initial Public Offering (IPO) of Dexia Bank in 1996 (and is defined as a dummy equal to 1 in the year of the IPO and 0 otherwise). The municipalities, being prime shareholders of this financial institution, obtained large capital inflows from this event. Adhering to the 'advice' of the Flemish Regional Government to use at least 80 per cent of the IPO's benefits for debt reduction, municipal governments reduced their debts with roughly €19 million via these capital inflows (Dexia, 1998). BBR is a dummy variable equal to 1 in the period after 1982 when a Balanced Budget Rule for all Belgian municipalities was imposed by the federal government. As such rules are often argued (and found) to be effective in limiting debts and deficits (see Kirchgässner, 2003), we expect the coefficient of this variable to bear a negative sign. As a last control variable, ICG is introduced as a measure for the ideological position of the local government (see footnote 5). This assesses the effect of partisan influences on fiscal outcomes (Cusack, 1997; Bräuniger, 2005).

The central interest of our analysis lies, however, in the effect of elections and political fragmentation on municipal indebtedness. FRAG is a vector of two dummy variables: the first equals 1 where only one party is represented in the College of Mayor and Aldermen and 0 otherwise and the second equals 1 where two parties are represented ('large' coalitions being the reference category). These variables test whether government fragmentation as such affects local indebtedness (and should be included to avoid biased inferences on the interaction effect with the election dummies, see below). To measure the effect of elections, we introduce a variable ELECT, which takes two different forms. Both definitions assume that voters react to observable changes in fiscal policy (and not to budget proposals). The first definition includes only years in which the election actually falls: 1982-1988-1994-2000. This will be termed '1 year' in the following and is supported by the fact that the elections always take place near the end of the year (Alesina *et al.*, 1992; Van Driessche and Heyndels, 1999). The second definition also incorporates the year before the election in the election year variable. This is termed '2 years'. The idea here is that election-induced adjustments in fiscal policy are not limited to the year of the election, but might already occur the year prior to the election. This is not unlikely given the fixed 6-year legislative term (implying perfect knowledge of election dates). Finally, to judge whether the election effect – if present – differs with respect to the number of parties in the College, we include an interaction term between FRAG and ELECT.

### *3.2. Empirical results*

Given that we have observations for 296 municipalities over 24 years (N=7104), we estimate the model using standard panel regression techniques. The findings are

brought together in table 4. Columns (1) and (2) present the results when restricting the election year variable to the year of the election ('1 year') while columns (3) and (4) give the results when the election year variable comprises also the year prior to the election ('2 years'). In each case, uneven numbered columns present the results without the interaction term and even numbered columns introduce the interaction term between government fragmentation and the election dummy. As the Hausman specification test indicated that random effects estimation dominated over fixed effects estimation (see bottom row of table 4), only the results of the random effects estimations are presented.

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Table 2  
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Let us begin by briefly discussing the findings for our control variables. Population and income growth are positively related to growth in local public debts (though the latter finding is not robust over the various specifications). This is in line with the idea that larger and wealthier populations demand more (debt-financed) public expenditures. Still, as both coefficients are well below 1, the growth rate of debt is lower than the growth rate of population and income. Surprisingly, increasing interest rates positively affect the debt growth rate. This is at odds with the idea that rational governments would decrease their borrowing when interest rates rise. However, it may derive from the so-called 'snowball effect', which states that excessive debt levels can become self-reinforcing when interest rates are high enough.<sup>7</sup> As expected, the Initial Public Offering of Dexia Bank in 1996 (DEXIA) and the introduction of the balanced budget rule (BBR) both significantly negatively affect the growth rate of local public



indebtedness. Finally, the growth rate of local public debt is higher under more right-wing governments (though this effect is only weakly significant).

Turning to the central variables of the analysis, it can be seen that the growth rate of local public debt is significantly higher in election years (whether defined as ‘1 year’ or ‘2 years’). This confirms a standard finding in the public choice literature and a characteristic of local public finances that is widely acknowledged among the general population. With respect to the effect of government fragmentation, columns (1) and (3) indicate that, taken over the entire time period, debt growth is not significantly different between one-party governments and ‘large’ coalitions (containing three or more parties), but that the two-party coalitions tend to witness a significantly higher growth rate of local public debt than these ‘large’ coalitions. Wald tests furthermore indicate that the difference between the coefficients for one- and two-party governments is not statistically significant ( $\text{Chi}^2(1) = 0.82$ ;  $p > 0.10$  for ‘1 year’ and  $\text{Chi}^2(1) = 0.83$ ;  $p > 0.10$  for ‘2 years’).

Still, an interesting pattern arises when introducing the interaction effect in columns (2) and (4). This shows that in non-election years, both one- and two-party coalitions have significantly higher debt growth rates than ‘large’ coalitions (as the coefficients of both fragmentation variables now are statistically significantly different from 0). In election years, however, the growth rate of local public debt is *lower* for one-party governments compared to ‘large’ coalitions. This effect is obtained by adding the coefficient for the interaction effect to that of the fragmentation variable and is statistically significant in ‘2 years’ ( $\text{Chi}^2(1) = 2.72$ ;  $p < 0.10$ ), but not for ‘1 year’ ( $\text{Chi}^2(1) = 0.68$ ;  $p > 0.10$ ). Also, two-party coalitions do not differ significantly from ‘large’ coalitions in election years

(while they had a higher debt growth than such governments in non-election years, see above). Finally, one-party and two-party governments do not significantly differ from one another in non election years ( $\text{Chi}^2(1) = 0.01$ ;  $p > 0.10$  for '1 year' and  $\text{Chi}^2(1) = 0.86$ ;  $p > 0.10$  for '2 years'), but two-party governments do have significantly higher debt growth than one-party governments when elections are imminent ( $\text{Chi}^2(1) = 5.26$ ;  $p < 0.05$  for '1 year' and  $\text{Chi}^2(1) = 8.77$ ;  $p < 0.01$  for '2 years').

Taking all these results together suggests that the election-driven rise in debt growth rates is affected by the number of parties in the College of Mayor and Aldermen. This can more clearly be seen when we represent the results graphically in figure 1. In this figure, we show the average year-to-year growth rate of real local public debt on the y-axis, while the x-axis separates election from non-election years. For simplicity, we only present the results for '2 years'. It is clear that the growth rate of municipal indebtedness in election years is higher than in non-election years for all government types (indicating a significant election effect for all three levels of government fragmentation). Secondly, figure 1 illustrates that the election-year hike increases with the number of parties in the College of Mayor and Aldermen. That is, the steepness of the lines in figure 1 rises with the level of political fragmentation. Interestingly, however, the increase is clearly strongest when moving from one- to two-party governments. This suggests that the larger 'motive' to electioneer may be countered by decreasing political 'opportunities' to engage in opportunistic behaviour when the coalition becomes larger.

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Figure1

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#### 4. CONCLUSION AND DISCUSSION

The literature on Political Business (and Budget) Cycles suggests that incumbents' desire to be re-elected induces a 'predictable pattern of policy' over the legislative term (Nordhaus, 1975: 187). Though empirical evidence is stronger for electoral cycles in policies than in macro-economic outcomes, the literature to date is far from unanimous. A recent argument holds that this may be due to a disregard for the political, economic and institutional context in which politicians make policy decisions (Franzese, 2002). In the present paper, we followed this line of argument by pointing to the level of government fragmentation as an intermediary factor in opportunistic political behaviour. Specifically, we argued that the level of government fragmentation affects both the need for ('motive') and the possibility to engage in electoral policy cycles ('opportunity').

Using a dataset of local public debt in 296 Flemish municipalities (1977-2000), we find support for the intermediary role of political fragmentation on incumbents' 'electioneering'. Specifically, we show that the election-year hike in debt growth rates increases with the number of parties in the College of Mayor and Aldermen in Flemish municipalities. We argue that the greater political uncertainty faced by parties in a coalition government is an important element to explain this finding. Nonetheless, while there is a strong increase in the election-year rise in debt growth between one- and two-party governments, the additional increase is much more modest when we subsequently move to 'large' coalitions (consisting of three or more parties). This

suggests that the larger ‘motive’ may be countered by decreasing political ‘opportunities’ to engage in opportunistic behaviour when the coalition becomes larger.

It is important to note that our results are at odds with the findings of Goodhart (2002) and Huber *et al.* (2003). Using cross-country data, they show that active intervention in fiscal or monetary policy in election years is harder for more fragmented governments. One possible explanation for this difference is that the incentives and opportunities to indulge in opportunistic behaviour are different for parties in a coalition government at the local level than at the national level. Two reasons can be brought forward. The first is that national and local governments have different responsibilities. Following the subsidiarity principle (Oates, 1972), national governments are responsible for general areas of public provisions such as national security and the welfare system. Local governments mostly provide public goods with geographically restricted benefits such as parks and the local road infrastructure. This specific nature of the local governments’ responsibilities might make it easier to award specific groups in the population with clearly identifiable benefits prior to elections. Secondly, and possibly more important, the closer link between local parties and the electorate allows all parties to claim credit for their actions.<sup>8</sup> Hence, the largest party is less likely to be given complete recognition (as found by Goodhart [2002] for national governments) and all parties in the coalition have an incentive to engage in pre-electoral opportunistic behaviour. Under such circumstances, the electoral cycle is likely to become more pronounced with the number of parties in the coalition at the local government level.

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Table 1: Political fragmentation in Flemish municipalities (N = 296)

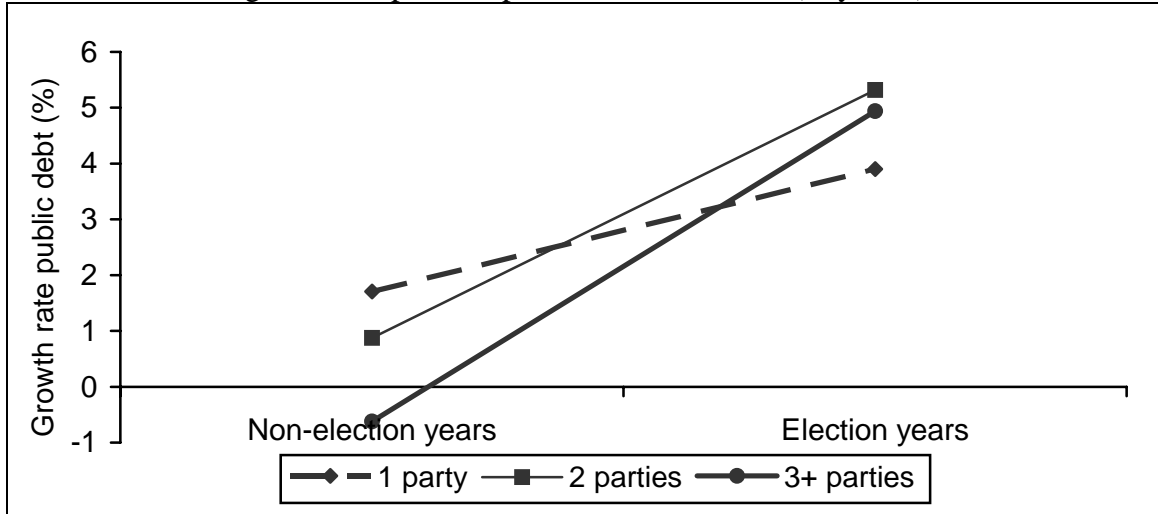
	<b>1976</b>	<b>1982</b>	<b>1988</b>	<b>1994</b>	<b>2000</b>
1 party	178	122	136	116	92
2 parties	98	125	129	144	156
3 parties	19	42	27	29	42
4 parties	1	6	3	7	6
5 parties	0	1	1	0	0
Average	1.47	1.78	1.66	1.75	1.87
Standard deviation	0.63	0.79	0.71	0.72	0.72

Table 2: Panel regression estimation results

Variable	(1) '1 year'	(2) '1 year'	(3) '2 years'	(4) '2 years'
Intercept	-0.636 (-0.39)	-0.828 (-0.50)	-1.492 (-0.91)	-2.152 (-1.30)
Population growth	0.497 *** (3.21)	0.498 *** (3.22)	0.545 *** (3.53)	0.541 *** (3.50)
Income growth	-0.003 (-0.06)	0.005 (0.10)	0.087 * (1.72)	0.089 * (1.75)
Interest rate change	0.001 ** (2.02)	0.001 ** (2.10)	0.001 * (1.89)	0.001 ** (2.03)
DEXIA	-5.016 *** (-6.09)	-4.995 *** (-6.07)	-4.452 *** (-5.39)	-4.392 *** (-5.32)
BBR	-1.353 *** (-3.32)	-1.351 *** (-3.32)	-1.205 *** (-2.97)	-1.225 *** (-3.02)
ICG	0.546 * (1.65)	0.548 * (1.65)	0.526 (1.59)	0.525 (1.59)
One party government	0.697 (1.25)	1.054 * (1.73)	0.690 (1.24)	1.808 *** (2.69)
Two party coalition	1.026 * (1.89)	1.056 * (1.78)	1.020 * (1.88)	1.404 ** (2.12)
Election dummy	3.124 *** (7.09)	4.195 *** (3.26)	3.278 *** (9.29)	5.323 *** (5.25)
One party * Election	-	-2.145 (-1.49)	-	-3.353 *** (-2.97)
Two parties * Election	-	-0.186 (-0.13)	-	-1.152 (-1.01)
Wald (full model)	136.40 ***	141.70 ***	172.84 ***	186.80 ***
Hausman	1.61	1.58	1.05	1.06

Note: N = 7104 (296\*24); t-statistics between brackets; \* significant at 10%, \*\* at 5% and \*\*\* at 1% (two-tailed tests); Wald (full model) tests the joint significance of all variables in the model while Hausman assesses the use of random versus fixed effects.

Figure 1: Graphical representation of results ('2 years')



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- <sup>1</sup> Hibbs (1977) has argued that politicians are driven by ideological policy objectives. Frey and Schneider (1978a, b) point to the possibility that ideological motives are central early in the legislative term while opportunistic motivations tend to take the upper-hand when elections are imminent.
- <sup>2</sup> Goodhart (2002) shows that only the largest party in the coalition benefits from improved economic performance while smaller coalition partners may lose support. Hence, these small coalition partners have little incentive to manipulate policy prior to elections.
- <sup>3</sup> They interpret this as evidence that active intervention to offset ‘automatic’ changes in the tax system is harder for more fragmented governments. This result, however, is also compatible with the idea that fragmented governments may counter their political uncertainty by more extensive changes in the tax system prior to elections.
- <sup>4</sup> Related to this work, there is a growing body of literature looking at the intermediary effect of political fragmentation on various politico-economic phenomena. Alesina *et al.* (1997), for example, find that partisan effects on government policy and economic outcomes are clearer in two-party/bloc systems than in multi-party/bloc systems. Tovmo and Falch (2002: 153) show that the flypaper effect (i.e. the finding that grants have a larger effect on government expenditures than income) ‘may be a result of weak political leadership’. Lane (2003: 2661) finds that countries with ‘dispersed political power are the most likely to run procyclical fiscal policies’. Finally, Kontopoulos and Perotti (1999) and Ashworth and Heyndels (2005) uncover that political fragmentation affects the asymmetry in the reactions of governments to budgetary ‘good’ and ‘bad’ times.
- <sup>5</sup> The government’s ideological position (ICG) is defined as the weighted average position of the coalition parties on a scale from 0 (extreme Left) to 10 (extreme Right): i.e.  $\sum_{i=1}^n (p_i \cdot Complexion_i)$ , where  $n$  is the number of parties in the College of Mayor and Aldermen,  $p_i$  is the seat share of party  $i$  in the College and  $Complexion_i$  refers to the ideological position of this party on a classic Left-Right scale (from 0 to 10). The data concerning a party’s ideological position were obtained from Deschouwer (1996). They are based on a self-placement survey and were obtained by asking presidents and spokesmen of the parties in the municipalities to locate their party on an ideological scale between 0 (Left) and 10 (Right). The figures range from 2.6 (Agalev) to 6.1 (VLD).

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- <sup>6</sup> The data were extracted from appendix 14 of the municipal budgets (for 1977-94) and obtained from Dexia Bank (for 1995-2000). We had to remove 10 municipalities due to incomplete data-series. Moreover, Antwerp and Ghent were removed as they obtained sizeable reorganisation loans from the federal ‘hulpfonds tot financieel herstel van de gemeenten’ during the mid-1980s. This leaves us 296 Flemish municipalities.
- <sup>7</sup> Formally, it can be shown that debt will necessarily increase when the interest rate is higher than the nominal growth rate of taxable income *unless* a sufficiently large primary surplus (that is, surplus of revenue over non-interest expenditures) is created (Moesen and Van Rompuy, 1997). As this snowball effect mainly arises in times of extreme budgetary stress, we re-estimated our model for the period 1984-2000. While local public indebtedness in Flanders had become problematic by the late 1970s, the situation was drastically improved by 1984 (Moesen and Van Damme, 1994). While leaving the other coefficients largely unaffected, this change in the time period does give a significant *negative* coefficient for the interest rate variable (results available upon request).
- <sup>8</sup> Note that this closer link could make it harder for incumbents at the local level to ‘mislead’ the electorate or decrease the need for signalling ones competence. This would imply that electoral cycles may be weaker at the local than at the federal level.