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# **Do Parties Matter for Local Revenue Policies?**

## **A comparison of Denmark and Norway**

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## **Do Parties Matter for Local Revenue Policies? A comparison of Denmark and Norway**

*Abstract.* This paper investigates the impact of party ideology on revenue politics. Theoretically, claims can be made that party ideology should matter for revenue policies. First, leftist governments are more favorable towards government intervention and a large public sector. To accomplish this, leftist governments need more revenue than bourgeois governments. Second, revenue policy is a redistributive policy area well suited for ideological positioning. However, the claim that party ideology does not matter can also be made since raising revenue is unpopular, and politicians may shy away from new initiatives. Empirically, the question is unsettled. The paper investigates the problem by looking at three revenue policy areas (income and property taxation and user charges) in two countries (Denmark and Norway). It uses data from the municipal level and thus has several hundreds of units to compare. The evidence favors the “parties-matter”-argument, particularly in the Danish case.

### **1. Introduction**

Does it matter which party controls the government apparatus? Officially, different parties pursue different policies. This is evident from official statements such as party manifestos (Budge 2001). In reality, official policy goals may also be pursued as it establishes political credibility, which is vital in parties' competition for electoral support. Building a reputation may be in the rational self-interest of party leaders. But political leaders cannot always get what they want. They are not the only actors interested in public policy. Interest organizations, the bureaucracy and the voters have substantial policy interests too. Party leaders are also often constrained by economic or institutional factors, which may leave very little room to maneuver. Political parties are thus far from omnipotent actors, but they are, as noted by Schmidt (1996), omnipresent players in politics. It seems reasonable to expect that parties may have some influence on public policy.

The present paper investigates the impact of party ideology on revenue politics. This area has been largely ignored in studies of the impact of party ideology. In the meta-analysis by Imbeau et al. (2001) only three out of the 43 included studies focus on revenue policy. In Boyne's (1996: Ch.5) survey of the impact of party ideology in local government, no studies of revenue policy are included. For some reason, political scientists have chosen to focus on the expenditure side of the

public budget, a fact often lamented by the few political scientists who venture into the area of revenue politics.<sup>1</sup>

The ensuing section outlines the theoretical argument, and provides a brief review of the empirical literature. We describe the Danish and Norwegian systems of local government, and make an empirical investigation of the impact of party ideology on local revenue policies. We find that party ideology has a considerable impact, particularly in the Danish case. Finally, we discuss country similarities and differences in the empirical results.

## **2. The impact of parties' left-right location on revenue policies**

The ideological positions of political parties are routinely ranked on a left-right scale, corresponding to parties' preferred size of public sector and redistributive policy. Despite extensive debates about this left-right scale over the past fifty years (for a review, see Blais et al. 1993: 42-43), most observers agree that the left-right policy dimension continues to be the most important in Western countries (Lijphart 1999: 78-87; Müller & Strøm 2000: 7-11). This truism is especially valid for actual party behavior. Detailed investigations of parliamentary votes show that the left-right scale is so dominant in Western parliaments that voting is almost a uni-dimensional phenomenon (Poole & Rosenthal 1991; Hix et al. 2002; Skjæveland 2003: 108-114). Consequently, if parties matter for public policy, it seems plausible to expect this influence to be related to the left-right ideological distinction. This is the basic hypothesis to be tested in this paper.

Left-right ideology can be expected to influence revenue policy in two ways. First, leftist parties are more favorable towards government intervention. In other words, the more leftist a government, the greater the size of government, the greater the need for public revenue. Consequently, we may expect revenue levels to be higher under leftist governments than under bourgeois governments. Second, revenue policy falls into the category of redistributive policies. This is exactly the type of public policy where the impact of party ideology is generally strongest (Boyne 1996: 132-135).

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<sup>1</sup> Royed & Borelli (1999: 87) speak of "the neglected revenue side". Peters (1991: xiii) states that his book is "somewhat unusual in that it is a political science book about tax policy." Steinmo (1993: 1) puts it more forcefully: "Given the hundreds of studies that examine the political struggles behind such welfare state programs as health care insurance, family policy, education, social welfare, and pensions, the paucity of studies that focus on how welfare states finance these programs is striking."

Redistribution may be pursued by relying to different degrees on revenue instruments with different distributional profiles, i.e., through the choice of tax structure. *Ceteris paribus*, leftist parties should prefer progressive to regressive revenue instruments. Consequently, we may expect leftist governments to use redistributive revenue instruments to a greater extent than bourgeois governments.

Political credibility is at the core of modern theorizing of parties (Persson and Tabellini 2000). The traditional vote-maximizing (Downsian) model assumes that policy commitments are both credible and flexible. A political party can adjust its program / promises as a response to changes in electoral preferences, and voters are assumed to believe that election promises will be carried out if the party gets majority support. In a situation with two political parties, policy positions are expected to converge towards the position of the median voter. We would not expect tax rates to increase as a result of a shift from a right-wing majority to a left-wing majority government. Research by Inman (1989) and others suggest that the ‘representative’ or median voter approach has serious shortcomings in explaining tax-policies, even in the US-style two-party system. Moreover, the median-voter theorem does not apply in multi-party systems, such as those studied here. Recent models of party competition in multi-party systems suggests that equilibrium positions will not converge towards the median of the voter distribution, but disperse across the relevant policy dimension (Adams and Merrill 1999; Merrill and Adams 2002).

Furthermore, credibility requires parties to offer voters clearly distinct programs, commonly linked to the left-right dimension. A political party must maintain a stable ideological platform to build a reputation among voters – credibility would be hurt if policy promises were frequently altered. Party activists are likely to induce party leaders to refrain from short-term office-seeking behavior (Strom 1990). Credibility calls for party programs to correspond to preferences of party activists and elected representatives. To the extent they have opinions that diverge from the party platform, credibility calls for party discipline.<sup>2</sup>

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<sup>2</sup> The party trademark improves the election prospects of individual candidates. In return, political parties can demand that individual candidates respect the party program and party label, and other decisions made by the party leadership. Those who do not respect the party’s program and decisions will not be allowed to stand for reelection. Parties in Denmark and Norway cultivate their ideological reputation in a long-term perspective, and party organizations impose controls over nomination and policy coordination.

Election promises may *not* always be credible, which induces voters to keep governments responsible for their actual policies. One possible reason is the multi-party system itself, which frequently leads to situations where no single party has a majority in the elected assembly. Budget making tends to involve complex negotiations involving numerous parties, and the resulting outcome is uncertain. Citizens will not necessarily believe parties' election promises, and they may prefer to appraise actual policy results: whether taxes are increased or not. For example: Norwegian voters tend to turn against the ruling party in local government when infrastructure fees increased more than in other governments (Martinussen 2004). If voters punish left- and right-wing incumbents equally hard, we would not expect ideology to affect revenue policies. If voters punish right-wing incumbents harder than left-wing governments, retrospective voting will induce ideological differences in revenue policies.

Most of government revenue is routinely raised by established tax laws (Rose 1985: 293), and regulations are particularly important for local governments. One interpretation suggests that politicians shy away from tax initiatives out of respect for electoral reactions – the expectation that all incumbents (left- or right) are punished for tax increases on election day. The most ardent advocate of this position is Rose (1985; see also Rose & Karran 1987: Ch. 1) who argues that politicians follow a non-decision making approach to tax policy due to the political costs. If the inertia-argument is correct<sup>3</sup>, we would expect no particular partisan pattern in revenue policy at any given point of time since “whatever the bias in tax laws today, it is more a reflection of the nation's past than of its current configuration of political interests” (Rose & Karran 1987: 12). Another interpretation suggests that ideology has little bearing at the local government level due to central regulations. Local governments are simply not allowed to implement their ideological revenue policies. Others suggest that ideologies prevail even at the local level: central regulations of one tax instrument induce local governments to exploit other sources of public revenue (Shadbegian 1999; Skidmore 1999).

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<sup>3</sup> In their own analysis of taxation in postwar Britain, Rose & Karran (1987: Ch. 6) find mixed evidence. Taxation is mainly determined by “the forces of inertia”, i.e. economic growth and inflation, but party ideology has a minor, but in some instances statistically significant, effect.

We are left with contradictory theoretical expectations about the impact of left-right party ideology on revenue policy. Neither have empirical studies resolved the issue. Schmidt's (1996: 169) review of left-right partisan influence concludes, "it can safely be concluded from these studies that the hypothesis of partisan influence on public policy passes the empirical test reasonably well". Interestingly, Boyne's (1996: ch. 5) survey of the effect of left-right party ideology in local government reaches a similar conclusion. On the other hand, Imbeau et al. (2001) identify more than 600 studies containing empirical results relevant to this question. In a meta-analysis of 43 of these studies they find that the impact of party ideology is not significantly different from zero. The influence of left-right ideology is thus far from certain.

Relatively few empirical studies focus directly on the impact of party ideology on revenue policy. In table 1, we summarize the findings of these studies. About half of the studies find no effect of party ideology. The typical research design uses national data from the OECD countries. This naturally creates a small-N problem (which in some studies is mitigated by pooling data across a longer time period). Some studies avail themselves of the opportunity to focus on the subnational level and thus increase the number of cases, but they are all one-country studies. This design makes it difficult to handle country-specific effects. Furthermore, most studies focus on total revenue or a single revenue policy area (at most two). This design makes it difficult to handle policy area-specific factors.

(Table 1 about here)

In this study we want to take a fresh look. We maximize our leverage by looking at three revenue policy areas. Data about local government allows us to analyze hundreds of political units in two countries.

### **3. The institutional setting: local government in Norway and Denmark**

We explore the relationship between left-right political ideology and revenue policy in two Scandinavian countries: Norway and Denmark. Both countries have a three-tiered public sector. In order to maximize the number of cases we focus on the lowest tier, i. e. the municipal level. In

Norway there are 435 municipal units, in Denmark 273. In both countries, the municipalities are important implementing agencies of the welfare state. They provide services in the areas of childcare, primary education and old age care. Further, they are responsible for public utilities and local infrastructure. They enjoy considerable autonomy in these areas, and both countries represent cases of ‘legal localism’ (Page 1991: 13-42), i.e. systems in which local governments enjoy power over wide areas of public policy.<sup>4</sup>

Local branches of national political parties govern municipalities in both countries. The distribution of seats in the election period under investigation is shown in Table 2 where the parties are ordered on the left-right scale. This is done according to our own understanding of Norwegian and Danish politics, but the ordering corresponds to well-known expert interpretations of party locations (Castles & Mair 1984; Huber & Inglehart 1995). The table shows that the local government system in both countries contains several parties, but that three parties are dominant. In both countries the left wing is dominated by the Labour Party (Social Democrats), which holds about one third of the seats in local councils. In both countries the right wing is dominated by two large parties that together hold another third of local seats. The remainder in both countries is distributed among minor parties. Local lists - i. e. non-nationwide parties - used to be influential in both countries, but account for less than ten per cent of the seats in local councils today.<sup>5</sup>

(Table 2 about here)

The local revenue system is dominated by three types of income sources in both countries, cf. Table 3. First, local taxes constitute about forty to fifty per cent of all local revenue in both countries, and the main tax source is the local income tax. The central government defines the income tax base, while local authorities in principle decide the local income tax rate (same rate for all income ranges, i.e., proportional income taxation). However, in both countries the central government imposes constraints on this decision. In Norway, the local income tax rate is subject to an upper and lower

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<sup>4</sup> For a general introduction to local government in Norway and Denmark, see Fevolden & Sørensen (1987), Bogason (1987), and Albæk et al. (1996).

<sup>5</sup> Local lists are mainly non-ideological and are hence coded as non-socialist in the paper’s empirical analyses. However, in Denmark, some local lists have a clear socialist profile and have been coded as such. The coding is based on the name of the local list. For example, a local list called “cross-socialist list” (“tværsocialistisk liste”) has been coded as socialist.

limit. In practice, all Norwegian local authorities use the upper limit. In Denmark, the local income tax level is negotiated annually between the local government association and the central government, the so-called 'budget cooperation' between central and local government. These negotiations normally lead to a recommendation to the individual local authorities to keep income taxation within a specified limit. Since the recommendation is not legally binding and only specifies the average local income tax rate, there is room for local variation. In addition to the income tax local authorities in both countries can also levy property taxes. In Norway, municipalities are not obliged to levy property taxes, but if they choose to do so, the rate must be kept within 0.2 and 0.7 per cent of property values. Further, property taxes may be restricted to certain areas within the municipality in Norway. In Denmark, the municipalities are obliged to levy a property tax. The rate must be kept within a range of 0.6 to 2.4 per cent of property values.

Second, local fees and user charges are quite important in both countries, although more so in Denmark. User charges are used to finance local public utilities (water supply, sewerage, garbage disposal), but are also used to partly finance welfare areas such as childcare and old age care. The central government imposes restrictions on the setting of user charges. In both countries, public utilities must generally be fully financed by user charges. In the welfare areas local authorities have greater, but far from full, autonomy. In Denmark the highest degree of local autonomy is found in the area of childcare arrangements for school children (6-9 year olds). In Norway, local autonomy is highest in the area of preschool child care (1-5 year olds) and childcare arrangements for school children (6-9 year olds). In these areas in the two countries user charges may cover from 0 to 100 per cent of the costs.

Third, grants from the central government are important in both countries, but more so in Norway where they constitute one third of all revenue.

(Table 3 about here)

### 3. Research design

In order to test the relationship between left-right party ideology and revenue policy we focus on three revenue areas. We analyze the two most important tax sources of Norwegian and Danish local authorities, i.e. income and property taxation, plus a selected example of user charges. We have selected a user charge in the two countries, which is important in three respects: Budget share, degree of local autonomy, and political saliency. The last criterion means that we look at welfare areas rather than public utilities. The first two criteria mean that in Norway we select preschool child care (1-5 year olds) where parents pay to have their children looked after in municipal kindergartens. This area has a large budget share, and local authorities are free to set the user charge as long as it does not exceed the municipal costs of running the child care facilities. In Denmark we analyze municipal childcare arrangements for school children (6-9 year olds), where parents pay to have their children taken care of after school. This is the only major area of user payment in Denmark where local authorities are free to set the user charge (as long as it does not exceed the costs of running the service).

The strength of left-right party ideology can be measured in various ways and, as demonstrated by Schmidt (1996: 157-162, cf. also Boyne 1996: 125-131), the choice of a particular indicator can make a very large difference. A first question to consider is whether party strength should be measured as proportion of seats held or simply by control of a council (i.e. control of more or less than fifty per cent of the seats). Proportion of seats may be a better measure than control if the parties give fuller expression to their ideology as their majority increases and restrain their ideological urges as their majority decreases. However, if parties exercise no restraint in using a small majority, control is a better measure. In the empirical analysis we report results from both types of measures.

A second question is which political body to focus on when measuring party ideology. At the central government level relevant bodies are the government and parliament. At the local level in Denmark and Norway there is no precise functional equivalent to these bodies, but a related distinction can be made between the mayor and the council. The mayor is responsible for day-to-day administration while the council is responsible for broader policy decisions. Once elected, the

council cannot remove the mayor from office. Therefore, both the mayor and the council may be relevant to analyze. In the empirical analysis we report results from both types of measures.

A third question concerns the classification of parties on the left-right scale. The left-right scale may be divided into any number of units (e.g. a left-center-right trichotomy). However, we follow the convention of classifying parties as either socialist or bourgeois parties. The precise classification is evident from the asterisks in Table 2. This classification is, of course, debatable, especially in the case of Denmark where the political center is held by a number of small parties. However, in practice the paper's empirical analyses are quite robust to the exact placement of the dividing line between socialist and bourgeois parties.

The paper's dependent variable – revenue policy – is measured as the rate. In the case of income and property taxation this means using local income and property tax rates. The Danish case presents no particular measurement problems since local authorities must levy income and property taxes at uniform rates within their jurisdiction. However, in Norway both income and property tax rates are more difficult to measure.

In the income tax area Norwegian local authorities must, as already noted, levy the tax within centrally specified lower and upper limits, but all local authorities use the upper limit and have done so since 1979. There is thus no variation in income tax rates across local authorities. This situation is probably best understood as a rational anticipation of the central government's reaction to a reduction of the local income tax rate. Local authorities fear that the central government will interpret a local tax cut as a sign of affluence and react by cutting central grants. In other words, the absence of variation in local income tax rates is a product of central government discretion in the distribution of grants and does not reflect local ideological preferences. To measure the suppressed tax preferences of Norwegian local authorities we rely on questionnaires to councilors in 113 local authorities and analyze the share of local councilors in favor of increasing the local income tax rate.<sup>6</sup>

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<sup>6</sup> The questionnaire is from 2002/2003. The exact wording of the question on tax preferences is: "If your municipality, with respect to next year's budget, were in a position freely to set municipal tax levels, would you reduce, increase or leave unaltered the tax rate?" The individual income tax preferences are aggregated to reflect hypothetical municipal policy by taking the mean preference weighted by local party sample representativeness. In line with Borge and Sørensen's (2002) empirical study of preference-to-policy aggregation, a 'negotiated' model of preference aggregation

In the property tax area, the Norwegian situation is complicated too. While Danish local authorities must levy a property tax rate between 0.6 and 2.4 per cent of property values, Norwegian local authorities can choose whether or not to levy the property tax. In practice the share of Norwegian local authorities that levies property taxes has remained relatively stable around 50 per cent over time. If levied, the property tax rate must be kept between 0.2 to 0.7 per cent of property values in urban areas or in areas that are undergoing urbanization. But local authorities may choose to restrict taxation to certain areas within their jurisdiction, or apply it throughout. This complicated system makes it difficult to establish a single indicator of a given local authority's property tax rate. Instead, we have chosen to analyze Norwegian local property tax policy as the municipality's decision whether or not to levy the tax at all.

Finally, in the case of user charges there is no obvious "rate" to measure. However, we use the functional equivalent of measuring the ratio of the user charge to the costs of the service. This ratio varies from zero to 41 in Norway and from 1 to 108 in Denmark. These basic methodological choices are summarized in Table 4.

(Table 4 about here)

#### 4. Empirical model

In order to test the relationship between left-right party ideology and revenue policy we utilize cross-sectional data from Norwegian and Danish local authorities from the local election period 1999-2003 (Norway) and 1997-2001 (Denmark). Our general model is:

$$P_{Ak} = C_A + \beta_{1A} \cdot \text{PARTYPOL}_k + \beta_{2A} \cdot \text{CONTROLS}_k + e_{Ak}$$

( $k$  = municipality,  $A$  = income tax, property tax, user charge),

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into policy - one in which parties' numerical strength rather than political or structural position determines policy - seems a reasonable, albeit restrictive, assumption.

where  $P$  is our measure of policy outcome,  $PARTYPOL$  denotes a vector of variables describing the party ideology of the municipal council, and  $CONTROLS$  is a vector of relevant control variables.

The dependent variable – tax policy – is, as noted above, measured as the income tax rate, property tax rate and rate of user charge. Party ideology is measured as socialist share of seats in the local council, socialist control of the local council, and socialist mayor, cf. the above discussion of this question.

The control variables are the following six sets of variables that have all been demonstrated in the literature to influence local tax decisions. First, an unequal income distribution has been demonstrated to have an impact on local tax levels and tax structure (Borge & Rattsø 2004). This is measured as the ratio of median to mean income. Second, population size is included to capture structural differences across the municipalities (cf. Borge 1995; Allers et al. 2001). Third, expenditure needs and the availability of central funds to finance these needs have been demonstrated to influence local tax decisions (Allers et al. 2001; Borge & Rattsø 2004). We control for this by including a variable for exogenous income. Fourth, the tax base is likely to influence the choice of tax rate, although the direction of the relationship is theoretically indeterminate. A large base requires a lower tax rate to generate a given revenue. But a large base may also make it attractive to maintain similar, or slightly higher tax levels than comparable municipalities with smaller tax bases. Such a strategy would have a relatively large income effect and may be politically cheap since voters may be expected to focus on rates. The literature has found both types of results (Sørensen 2002; Allers et al. 2001). We use private income to control for the tax base in the analysis of income tax and user charges, and property values in the property tax analysis. Fifth, collective action problems have been demonstrated to be present in taxation (Ashworth & Heyndels 2002; Borge 1995; 2000; Allers et al, 2001; Sørensen 2003). Low general taxes may be considered a public good for political parties while increased service to specific voter groups constitute private goods to the parties. According to this reasoning, general taxes resemble common goods and may be over utilized in fragmented party systems. We include a Herfindahl index to control for this factor. Finally, the ability to export taxes has been demonstrated to have an upward effect on taxation (Allers et al. 2001; Blom-Hansen 2004). For this reason we include two specific property types in the analysis of property taxation. Please see the appendix for specification of variables.

If the “parties matter”-argument is correct, we expect an empirical pattern as outlined in Table 5. First, left-right party ideology should matter for revenue levels because leftist governments need more income. In the local Scandinavian setting this, if true, must manifest itself in the local income tax area. This is by far the most important revenue source for Norwegian and Danish local authorities. In both countries this single income source accounts for almost sixty per cent of local authorities’ own revenue (i.e. total revenue net of central government grants), cf. Table 3. So, if leftist local authorities need more income, their local income tax rates should be higher. Consequently, we expect a positive relationship between local socialism and local income tax rates (in Norway measured as preferred income tax rates).

Second, left-right party ideology should matter for the choice of local revenue instruments because leftist governments use redistributive revenue instruments more than bourgeois governments do. In the local Scandinavian setting this, if true, must manifest itself in the relative use of taxes and user charges. Income and property taxes are roughly proportional taxes, while user charges are regressive. For leftist local authorities in Denmark this should make the choice of revenue instruments easy: proportional taxes can be used to finance local welfare programs while regressive user charges can be kept low. In the Danish case we thus expect a positive sign between local socialism and income and property taxes, but a negative sign between local socialism and user charges. For leftist local authorities in Norway the choice is not so simple. Since local income tax rates cannot be increased beyond the maximum rate allowed by the central government, leftist local authorities may be forced to rely on user charges for financial purposes to a greater extent than their Danish counterparts. This means that the relationship between local socialism and user charges is theoretically indeterminate in Norway. Redistribution motives point toward a negative relationship, whereas financial motives point toward a positive relationship.<sup>7</sup>

If the “taxation-by-inertia” argument is correct - i.e. politicians prefer a non-decision making approach because active tax policies are unpopular - then we would expect no statistically significant relationship between socialist strength and tax rates in the two countries.

If central regulations matter, we would observe larger ideological effects in Denmark than in Norway. In contrast to Norwegian municipalities, Danish authorities are allowed to set income tax-

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<sup>7</sup> See also Borge (1995: 365) who – contrary to our position – expects the financial motive to be larger than the redistributive motive.

rates. Property taxes are a more important revenue source in Denmark. Norwegian authorities may employ user fees as tax instruments, perhaps forcing socialist councils to set higher user charges than non-socialist councils. Danish municipalities can make an ideological trade-off between taxes and user charges, and socialist councils can collect relatively more taxes and less user fees.

(Table 5 about here)

## 5. Empirical results

The results of the empirical analyses are reported in Table 6. It presents comparable regression results for income tax-rates, property tax-rates and user charges. The estimates of party ideology are not much affected as a result of inclusion or exclusion of particular control variables. As indicated in the note under the table, alternative specifications of left-right party ideology yield slightly different results for income taxes.

(Table 6 about here)

The first part of the “parties matter”-argument suggests that income and property tax rates are higher in socialist municipalities. The coefficient measuring proportion of socialist seats in local councils is positive and strongly significant in both countries for both income- and property taxes. Note that the Herfindahl index has a negative effect on income taxes, which means that a non-fragmented party structure reduces taxes. Since right-wing local councils are somewhat more fragmented than left-wing councils (due to the large Social-Democratic party), fragmentation tends to dampen the actual revenue impact of party ideology. The second part of the “parties matter”-argument – i.e. socialist local authorities rely less on regressive revenue instruments – is investigated by comparing the sign of the coefficient measuring left-right party ideology for taxes and user fees. The coefficient should be positive in the analysis of income and property taxation and negative in the analysis of user charges. This is what we find in the Danish case: Left-right party ideology has a positive effect on income and property taxation, and a negative in relation to user charges. In Norway, local socialism has a positive effect in the income and property tax areas, but no statistically significant effect on user charges. Despite the fact that socialist authorities have an

aversion to user charges due to their regressive nature, central regulations of income taxation may lead Norwegian municipalities to apply charges as an ordinary tax.

The control variables show varying results. The ratio of median to mean income measures the extent of local income inequality. This variable appears not to matter much for the specified local revenue choices in Denmark and Norway. Borge and Rattsø (2004) find that local income disparities affect the usage of tax instruments. An unequal income distribution induces Norwegian municipalities to collect a larger share of revenue as property taxes and less by means of user charges in the infrastructure sector. Further analysis should explore whether this trade-off is related to party ideology as well.

Population size is a summary variable that captures various conditions for the production of local services such as population density and urban-rural characteristics. The precise effect of this variable is difficult to hypothesize. Table 6 shows that the effect varies from area to area. Exogenous income and expenditure needs do not generally contribute much to explaining local revenue choices. But in Denmark an upward effect of expenditure needs is found in relation to property taxation. In Norway exogenous income has a dampening effect on user charges (Borge 1995; 2000), but no certain influence on income and property taxation. The effect of the variables measuring tax base (mean private taxable income; property values) varies across areas and countries.<sup>8</sup> The importance of party fragmentation is verified in both countries in the income tax area, but not in relation to property taxation and user charges. Finally, two special types of property are included in the property tax analysis to control for the special incentives they provide. In Norway, hydroelectric power plants constitute a considerable property tax incentive, while local authorities in Denmark may use summer cottages to export property taxes since these are typically owned by non-residents. These property types are important for property taxation.

Many studies of party effects on government spending and taxes comment on the statistical significance of parameter estimates only. This can be extremely misleading as significance does not imply that estimates are sufficiently large to warrant a substantial interpretation (McCloskey and Ziliak 1996). In Table 7, we have estimated the actual revenue effect resulting from a shift in the

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<sup>8</sup> The mixed result for the other control variables across areas and countries indicate that local tax choices may be quite area- and country-specific.

socialist share from 0 to 1, measured in Danish and Norwegian Kroner (DKK and NOK) per capita. These numbers can be compared with the private taxable incomes in the two countries. Note that mean per capita taxable incomes are similar in the two countries (measured in DKK and NOK). Since the mean share of socialist representatives and standard deviations are also comparable in Denmark and Norway (cf. Appendix), it makes sense to compare a completely non-socialist council with a council populated with socialists only.

(Table 7 here)

The major observation in Table 7 is that ideology has an important effect on tax revenues in Denmark. Both income and property taxes yield substantial public revenues. Greater socialist strength only yields a very small reduction in per capita revenue from user charges. Overall, we suggest that a socialist council would collect about 3,000 DKK per capita more than a non-socialist council. The actual revenue estimates are considerably smaller in Norway, less than 100 NOK per capita. Income tax rates are controlled by central government, socialist councils take in more property taxes, but it yields very little money. Neither do user charges. We have not analyzed user fees in the infrastructure sector. Based on prior regression estimates (Borge 1995; 2000; Sørensen 2003), we find that socialism generates about 670 NOK per capita in Norwegian municipalities.<sup>9</sup> Though this is of some (substantial) significance, we cannot escape the conclusion that party ideology has a considerably larger revenue impact in Denmark as compared to Norway.

The observed difference could be due to the fact that Norway has a large number of small and relatively ideologically homogenous municipalities. Additional regression analyses of the Norwegian data suggest that party ideology have comparable effects in small and large local governments (less versus more than 5000 inhabitants). Furthermore, Table 7 demonstrates a large revenue effect of lifting central tax regulations. Overall, our estimates suggest that ideological differences among elected politicians in Norwegian local government would generate revenues similar to those in Denmark.

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<sup>9</sup> Borge (2000) and Sørensen (2003) report elasticities for party share of about 0,35. An increase in socialist share from 0 to 1 produces a 42 percent increase in infrastructure fees. Each household pays about 6500 NOK in fees, about 1600 NOK per capita. The party effect is therefore about 672 NOK per capita (=1600 NOK per capita\*0,42).

More important: the Danish system of local government involves less redistribution than the Norwegian case. Danish local governments are less reliant on government grants than Norwegian authorities (table 3), which means that tax bases are relatively small in Norwegian municipalities. A given tax-rate increase yields less revenue than in Danish municipalities.

Despite so many similarities in political and institutional structures, Denmark and Norway are quite different when it comes to local democracy. There is a potential for ideological effects on revenue policies in both countries; national constraints explain why local parties have a more visible impact in the Danish case. The central government in Norway is more willing to limit local tax-bases and constrain local tax rates. Though assistance to peripheral municipalities has a role in both Denmark and Norway, the latter system includes more grants<sup>10</sup> and tax regulations that benefit the rural municipalities (Rattsø and Sørensen 1998). Equalization and regional policy plays a lesser role in Norway, while local self-rule is allowed to play itself out in Denmark.

## 6. Conclusion

In this paper two implications of the “parties matter”-argument for revenue policies have been investigated. First, if parties matter, revenue levels should be higher under leftist governments. Second, leftist governments should use redistributive revenue instruments to a greater extent than rightist governments. The paper’s empirical part has focused on local authorities in Norway and Denmark. Although alternative specifications of left-right party ideology yield slightly different results, the evidence generally supports the two implications of the “parties matter”-argument. As a result of central regulations, local parties matter considerably more in Denmark than in Norway. But given the opportunity, local parties have no hesitations about making active revenue choices. This means that the paper’s analyses are troublesome evidence for the alternative “taxation-by-inertia”-argument, which holds that the tax policy area is characterized by non-decisions.

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<sup>10</sup> Note that Dutch municipalities are especially dependent on central grants. Allers, De Hann and Sterks (2001) find that municipalities dominated by a left-wing council have higher property taxes than right-wing councils.

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**Table 1. Studies of the impact of party ideology on revenue policy**

Study	Research design	Measure of party ideology	Measure of revenue policy	Finding
Allers et al. (2001)	Regression analysis of 593 Dutch municipalities	Left-wing party control of local council and executive board	Property tax revenue per capita	Left-wing municipalities have higher property taxes
Ashworth & Heyndels (2002)	Regression analysis of 20 OECD countries	5 point scale of left-right control of government	Tax structure	No effect of party ideology
Berry & Berry (1994)	Regression analysis of 48 US states	Liberal party control of government institutions	Increase in sales tax rate and personal income tax rate	No effect of party ideology
Borge (1995)	Regression analysis of 414 Norwegian municipalities	Share of socialists in local council	Local fee income per capita	Left-wing municipalities have higher fee income
Borge (2000)	Regression analysis of a subset of Norwegian municipalities	Share of socialists in local council	Utility charges in NOK	Left-wing municipalities have higher utility charges
Borge & Rattsø (2004)	Regression analysis of 434 Norwegian municipalities	Share of socialists in local council	Tax structure (property tax vs. poll tax)	Left-wing municipalities have higher property tax shares.
Cameron (1978)	Regression analysis of 18 OECD countries	Left-wing party control of the central government	Change in general government revenue	Left-wing governments are more likely to increase revenue
Hallerberg & Basinger (1998)	Regression analysis of 19 OECD countries	10 point scale of left-right control of government	Reduction of marginal corporate and personale income tax rate	Mixed evidence
Reid (1998)	Regression analysis of 10 Canadian provinces	Left-of-center party control of government	Annual change in revenue per capita	No effect of party ideology
Rose & Karran (1987: Ch. 6)	Regression analysis of taxation in postwar Britain	Labour vs. Conservative control of government	Tax rate and revenue	Mixed evidence
Royed & Borelli (1999)	Regression analysis of 14 OECD-countries	5 point scale of right-left control of government	Annual change in central government revenue	No effect of party ideology
Schmidt (1982)	Correlation analysis of 21 OECD countries	1) Left-wing parties' time in government 2) Left-wing prime minister 3) Left-wing parties' share of cabinet seats	General government revenue as percentage of GDP	Left wing governments have higher tax burdens and faster growth in tax levels
Steinmo (1993)	Comparative historical analysis of Sweden, the UK and the USA	Close inspection party composition of government	Revenue and tax structure	No important effect of party ideology
Swank (1992)	Regression analysis of 16 OECD countries	Cabinet portfolios held by left-wing, centrist and right-wing parties	Corporate and personal income tax rate	Left-wing governments have lower corporate income tax rates and higher personal income tax rates

**Table 2. The local party system in Norway and Denmark.**

Left-right orientation	Norway			Denmark		
	Name of party	Seats in local councils 1999-2003		Name of party	Seats in local councils 1997-2001	
		N	Per cent		N	Per cent
Socialist  Bourgeois	Red Electoral Alliance*	68	1	Unitary List*	14	0
	Communist Party*	3	0	Socialist People's Party*	233	5
	Socialist Left Party*	673	5	Social Democrats*	1,648	35
	Labour Party*	3,804	31	Radical Liberals	88	2
	Centre Party	1,798	15	Centre Democrats	4	0
	Liberal Party	522	4	Christian People's Party	30	1
	Christian Democratic Party	1,200	10	Conservatives	480	10
	Conservative Party	2,086	17	Agrarian Liberals	1,557	33
	Progress Party	989	8	Danish People's Party	119	3
				Progress Party	44	1
	Local Lists	1,098	9	Local lists	468	10
Total		12,241	100		4,685	100

\* Classified as socialist in the paper's empirical analyses.

**Table 3. The local revenue system in Norway and Denmark (2001).**

	Norway		Denmark	
	Per cent	Per cent of GDP	Per cent	Per cent of GDP
Taxes	40	5	54	10
- of which local income tax	38	5	46	8
- of which local property tax	1	0	3	0
Fees and user charges	16	2	24	4
Central government grants	34	4	20	4
Other	10	1	2	0
Total	100	13	100	18

Source: Statistics Norway; Statistics Denmark

**Table 4. Basic methodological choices.**

Revenue areas to be investigated	Measure of left-right party ideology	Measure of revenue policy
<ul style="list-style-type: none"> <li>• Local income taxation</li> <li>• Local property taxation</li> <li>• Local user charges in the areas of preschool child care (Norway) and child care arrangements for school children (Denmark)</li> </ul>	<ul style="list-style-type: none"> <li>• Proportion of socialist seats in local council</li> <li>• Socialist control of local council (dummy)</li> <li>• Socialist mayor (dummy)</li> </ul>	<ul style="list-style-type: none"> <li>• Local income tax rate (Denmark: actual rate; Norway: hypothetical tax rate)</li> <li>• Local property taxation (Denmark: property tax rate; Norway: probability of levying property taxes)</li> <li>• User charge as percentage of costs of running the user financed service</li> </ul>

**Table 5. Empirical expectations of the “parties matter”-argument.**

	Effect of socialist strength:	
	Norway	Denmark
Income tax:		
- actual tax rate	- Invariant, not analyzed	- Positive
- preferred tax rate	- Positive	- No data, not analyzed
Property tax rate	Positive	Positive
User charge (rate)	?	Negative
Total revenue effect	Positive, very small	Positive, substantial

**Table 6. Analysis of local revenue policy**

	A1 - Norway	A2 – Denmark	B1-Norway	B2 - Denmark	C1-Norway	C2 - Denmark
Dependent variable:	Income tax preference (share of councillors favoring tax increase)	Income tax rate	Probability of levying property tax	Property tax rate	User charge as percentage of service cost (municipal pre-school child care arrangements)	User charge as percentage of service cost (municipal child care arrangements for school children)
Proportion of socialist seats in local council	0.636*** (5.34)	1.374*** (3.34)	2.518*** (6.83)	18.669*** (7.32)	3.387 (1.21)	-15.415*** (-3.10)
Ratio of median to mean taxable income	-0.044 (0.13)	3.983 (1.49)	0.275 (0.02)	-3.179 (-0.19)	13.163*** (3.55)	-40.671 (-1.26)
Population size (log)	-0.004 (-0.25)	-0.123* (-1.46)	0.463** (6.36)	-1.038** (-2.03)	-0.381 (-0.73)	1.779* (1.75)
Exogenous income and expenditure need	0.177 (0.93)	0.0002** (2.42)	-0.525 (0.17)	0.001** (2.47)	-18.193*** (-5.07)	0.0004 (0.38)
Mean private taxable income (log)	0.092 (0.75)	-2.727*** (-4.07)	1.062 (0.63)	-10.052** (-2.09)	14.459*** (4.29)	-8.120 (-0.98)
Party fragmentation	-0.739*** (-3.35)	-1.555** (-2.12)	1.137 (0.46)	-6.269 (-1.37)	-5.765 (-1.05)	5.301 (0.61)
Property values	-	-	-1.904*** (10.00)	0.00005*** (4.61)	-	-
Hydroelectric power plants	-	-	2.5620*** (82.69)	-	-	-
Summer cottages (log)	-	-	-	0.689*** (4.38)	-	-
Adjusted R <sup>2</sup> /gamma/log likelihood	0.258	0.279	0.639	-718	0.221	0.036
N	113	273	433	273	275	249
Estimation method	OLS	OLS	Logistic	Tobit	OLS	OLS

\*\*\*p<0.01; \*\*p<0.05; \*p<0.1 (Wald chi<sup>2</sup>/T-values in parenthesis)

Alternative specification of left-right party ideology (results available upon request from the authors):

*Income taxation (A1, A2)*

- socialist control: positive and significant in Norway; positive but insignificant in Denmark.
- socialist mayor: positive, but insignificant in both Norway and Denmark.

*Property taxation (B1, B2)*

- socialist control: positive and significant in both Norway and Denmark.
- socialist mayor: positive and significant in both Norway and Denmark.

*User charges (C1, C2)*

- socialist control: Negative and significant in Denmark; positive, but insignificant in Norway.
- socialist mayor: Negative and significant in Denmark; positive, but insignificant in Norway.

**Table 7. The revenue impact of local party ideology in Denmark and Norway**

Estimated municipal revenue increase per capita as a result of the socialist share of seats in the local council shifting from 0 to 1.

(Based on regression estimates in table 6. Norway: NOK, Denmark: DKK)

	<b>Denmark</b>	<b>Norway</b>
Income tax effect	1,418	0
Property tax effect	1,730	12
User charges effect	-157	-
Effect on total revenue	2,991	12
<b>Total revenue effect as percent of mean taxable income*)</b>	<b>1,9</b>	<b>0,01</b>
Potential income tax effect for Norway		1,322
Effect on total revenue, including hypothetical effect		1,417
Total revenue effect as percent of mean taxable income*)		0,9

\*) See Appendix for mean per capita private taxable income

## Appendix: Descriptive statistics of variables used in regression analyses

Variable	Mean value	Std. deviation	Max. value	Min. value	N	Comments and sources
Proportion of socialist seats:						
- Norway	0.36	0.14	0.85	0.00	434	Norwegian Social Science Data Services
- Denmark	0.41	0.13	0.82	0.06	273	Statistics Denmark
Socialist control:						
- Norway	0.17	0.38	1.00	0.00	435	Norwegian Social Science Data Services
- Denmark	0.23	0.42	1.00	0.00	273	Statistics Denmark
Socialist mayor:						
- Norway	0.38	0.49	1.00	0.00	435	Norwegian Social Science Data Services
- Denmark	0.39	0.49	1.00	0.00	273	Statistics Denmark
Share of representatives in favor of increase in income tax rate:						
- Norway	0.31	0.14	0.6	0.00	113	Questionnaire surveys to local politicians conducted by the Norwegian School of Management in the fall of 2002. Responses aggregated to shares by weighting for local party representativeness
Income tax :						
- Norway: Hypothetical tax rate (tax preference)	12.82	0.42	14.53	11.75	113	Questionnaire surveys to local politicians conducted by the Norwegian School of Management in the fall of 2002.
- Denmark: Actual tax rate in %	20.9	0.9	23.2	15.5	273	Statistics Denmark
Property tax:						
- Norway: Levies property taxes	0.50	0.50	1.00	0.00	434	Dummy. Based on non-zero income from property tax figure. Statistics Norway.
- Denmark: Tax rate in per thousand	13.1	5.2	6.0	24.0	273	Statistics Denmark
User charge:						
- Norway	26.7	6.1	40.6	0.0	275	User charge for municipal pre-school child care arrangements. Measured as percentage of costs.
- Denmark	39.6	9.2	107.8	1.2	249	User charge for municipal child care arrangements for school children. Measured as percentage of costs.
Ratio of median to mean taxable income:						
- Norway	0.85	0.04	1.00	0.59	434	Statistics Norway
- Denmark	0.91	0.03	0.96	0.74	273	Statistics Denmark
Population size:						
- Norway	10,445	29,981	512,589	233	433	Statistics Norway
- Denmark	17,432	25,186	286,668	2,266	273	Statistics Denmark
Exogenous income and expenditure need:						
- Norway	23,284	315	38,648	19,998	435	Exogenous income adjusted for expenditure need
- Denmark	27,641	652	30,586	26,126	273	Local expenditure need + (distance to national average x equalization level) in DKK per capita. Danish Ministry of Interior.
Mean private taxable income:						
- Norway	154,271	21,608	271,000	111,700	434	Statistics Norway
- Denmark	158,465	20,432	267,439	128,729	273	Statistics Denmark
Party fragmentation:						
- Norway	0.27	0.09	1.00	0.14	434	Herfindahl index ( $\sum p_i^2$ , where $p_i$ is party i's share of council representatives). Norwegian Social Science Data Services.
- Denmark	0.32	0.07	0.58	0.16	273	Herfindahl index ( $\sum p_i^2$ , where $p_i$ is party i's share of council representatives). Statistics Denmark.
Property values:						
- Norway: Mean appraised residence value (NOK)	58,573	15,895	131,399	22,565	434	Statistics Norway
- Denmark: Land values (DKK per capita)	92,667	38,532	319,273	44,179	273	Danish Ministry of Interior.

Specific property types (controls in property tax analysis):									
- Norway: Hydroelectric power production	0.35	0.48	1.00	0.00	434	Measures membership in hydroelectric power municipalities' national organization (LVK). Membership list.			
- Denmark: Summer cottages	0.08	0.17	1.14	0.00	273	Measured per capita. Statistics Denmark.			

All data are from 2001 unless otherwise indicated.