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Wassenaar, M.C.; van Soest, D.P.

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M.C. Wassenaar & D.P. van Soest

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## Local Fiscal Strategies in the Netherlands: An Empirical Analysis

MATTHEUS C. WASSENAAR and  
DAAN P. VAN SOEST

*One of the most important possible sources of conflict of interest between central and local governments is difference in political preferences with respect to, for example, income redistribution. If local governments are of a different political composition than the central government, they may be inclined to reinforce or weaken the redistribution policies as pursued by the central government. We empirically test whether local governments in the Netherlands do pursue income redistribution policies over and above the central government's redistribution policy and we find that the distribution of the local tax burden over the various household types differs according to the political composition of the local council.*

The relationship between the central and local governments is a delicate one. From the central government's point of view decentralisation is a mixed blessing. On the one hand, local governments are often thought to be better equipped to tailor their policies, both in terms of taxation and spending, to the local circumstances (such as the age composition of the population in the jurisdiction, local unemployment rates, etc.).<sup>1</sup> On the other hand, however, delegating decision-making to the local level gives rise to the possibility of local representatives expressing their own political preferences, which may or may not coincide with those of the central government (Goldsmith and Newton, 1983; Newton and Karran, 1985: Ch.5).<sup>2</sup> Indeed, local governments may be of a different political composition than the coalition at the central level and hence can be inclined to reinforce or weaken policies as pursued by the central government.<sup>3</sup> Even though local authorities may appropriately represent the preferences of the majority of the inhabitants in their jurisdictions, intragenerational fairness and equity are at stake at the national level if local preferences do not coincide with the nation's preferences with respect to income (in)equality (Stewart, 1983).

The extent to which local governments are able to exercise their own political preferences has been researched extensively in the literature, focusing on either local government spending or taxation (Bailey, 1999; Clark and Ferguson, 1981; Cullis and Jones, 1998; Foster, *et al.*, 1980; Oates, 1972; Sharp, 1984; Sharpe and Newton, 1984; Tiebout, 1956). Indeed, there is substantial empirical evidence that the political composition of the local (as well as central) government is correlated with tax rate levels as is evidenced by, for example, Abrams and Dougan (1986), Allers *et al.* (2001), Ashworth and Heyndels (1997), Borge (1995), Merrifield (2000) and Reid (1998). These studies found a positive correlation between the level of tax rates and the relative strength of left-wing parties in (local) government. Government expenditures are also found to be correlated with the political composition of the coalition in power: left-wing governments are found to spend more in order to pursue political objectives such as provision of social safety (Goldsmith and Newton, 1983; Sharpe and Newton, 1984).

Acknowledging the important work that has been done on the relationship between political composition of local councils and the level of either local taxes or expenditures, we aim to contribute to the empirical literature by analysing the relationship between the council's political composition and the distribution of the tax burden over the various household types. In most countries political parties disagree as to the optimal amount of income redistribution and hence local governments may be expected to impose their own political preferences with respect to income equality by setting different local tax rates for the various types of income groups in their jurisdiction, thus either weakening or reinforcing the income distribution policy as pursued by the central government.

This article aims to empirically analyse whether local governments in the Netherlands are indeed inclined to use tax policies to affect the income distribution in their jurisdiction. We combine information on the political composition of Dutch municipality councils with information on the spread of local tax burdens over the various household types. Three types of tax are levied by Dutch municipalities, one of which is (at least indirectly) related to household wealth, although the other two are not. By keeping the two wealth-independent taxes relatively low and choosing high rates for the wealth-dependent tax, the local councils are able to affect the income distribution in their jurisdiction. Clearly not all differences in the amounts of tax paid by the various household types can be exclusively attributed to differences in political stance with respect to income and/or wealth redistribution policies. Indeed, cost considerations and the necessity to raise government income are also likely to affect both the tax level and the spread of tax burdens over households. Controlling for such considerations we test

whether the (in)equality of the distribution of local taxes over various income groups in the Netherlands is at least partly determined by the political composition of the municipality council and find that the spread in tax burdens over the various kinds of households is indeed (at least partly) determined by the local government's political composition.

The second section of the article sketches the role of municipalities in the Dutch fiscal landscape, indicating the extent to which they enjoy political autonomy. The structure of local municipality taxes in the Netherlands is discussed in more detail in section three. The fourth section presents the data, whereas the results of the regression analyses are shown in section five. Conclusions ensue in the sixth section.

#### THE ROLE OF LOCAL GOVERNMENT IN THE NETHERLANDS

The Netherlands is a unitary state with three levels of government: a central government, 12 provinces and 548 municipalities (situation in 1998). Some insight into the relative importance of these three layers of government can be obtained by comparing their shares in Dutch Gross Domestic Product (GDP): in 1998, the central government covered about 30 per cent of GDP whereas the respective shares of the provinces and municipalities were 1.5 per cent and eight per cent. Apart from the fact that municipalities account for about one-fifth of total government spending, they also play an important role in Dutch government because they enjoy a substantial amount of autonomy both with respect to both spending and taxation (Allers *et al.*, 2001).<sup>4</sup> The main governing body in municipalities is the council. The municipality council is chaired by the Mayor who is appointed by the central government, but whose executive powers are very limited. Actual political power is in the hands of the council's members who are elected directly for a period of four years on the basis of proportional representation. The main tasks of municipalities are in the realm of social security, education, public transport, environmental planning, household refuse collection and construction and maintenance of the sewerage system. However, municipalities do have the political freedom to pursue other objectives, such as income redistribution. Indeed the average municipality tax rates (as percentage of net disposable household income) do differ substantially between jurisdictions (see below and Table 2).

The central government acknowledges the municipalities' actual political power and historically has tried to reduce their influence in various ways, including centralisation of taxation. Rather than allowing local authorities to raise their own funds through levying local taxes, the central government limits the municipalities' discretion by raising taxes itself and subsequently allocating part of the tax revenues to the municipalities.

Indeed in 1998 more than 80 per cent of the local authorities' budget consisted of funds allocated to the municipalities by the government (of which more than half is earmarked for specific expenditures, thus imposing additional restrictions on municipality policy). The contribution of local taxes to the municipality budget was only about 9.5 per cent whereas charges and fees covered 8.1 per cent (Ministry of Finance, 1998a). Furthermore, the central government's concern with respect to local political power is evidenced by the fact that the central government annually monitors the level of local taxation, the distribution of the taxes over the various types of households and also the differences in tax levels between jurisdictions (Allers, 1996; Ministry of Finance, 1998b).

From this discussion it is clear that the central government is concerned with (interjurisdictional differences in) local taxation, but that it is only able to affect the local tax structure indirectly. Indeed the degree of municipality discretion with respect to local taxation is mainly determined by Dutch fiscal law, which will be discussed in the next section.

#### THE MUNICIPALITY TAX STRUCTURE IN THE NETHERLANDS

In the Dutch fiscal structure, municipalities are entitled to levy three types of tax: property tax, refuse collection rates and sewerage charges (De Kam, 1998; Ministry of Finance, 1998a; OECD, 1999). Fiscal laws in the Netherlands leave local policy-makers at least some discretion with respect to the specific rates they charge to the various types of households in their jurisdiction. Therefore, municipality councils can pursue local objectives by varying the rates for each of the three tax bases.

The property tax is levied on the imputed (market) value of the house, hence the amount of tax a household has to pay is associated with its wealth. Both owner and occupant are charged a certain percentage of the value of the property. Although the Dutch fiscal laws do not impose a specific maximum on either the property tax rate or its revenues, the tax charged to the owner cannot exceed the occupant's tax rate by more than 25 per cent. The objective of the refuse collection charge is to cover (part of) the household refuse removal costs. The Dutch fiscal laws impose a maximum with respect to this tax base: its revenues should not exceed the costs incurred for removing household waste. The refuse collection charge is independent of the value of the property, but does in some cases vary as a function of the number of household members.

The revenues obtained through sewerage charges are also capped by the total costs of maintaining the sewerage system. As in the case of property tax, the charges are split between the owner of the house and the occupant. As in the case of the household refuse collection charge, the sewerage

charge may depend on the number of household members, but it is independent of the value of the household's property. In most municipalities, either the owner or the occupant is charged for the property being connected to the sewerage system, but not both.

Municipalities are autonomous in determining which of the three taxes they impose and are to a certain extent free to set the tax levels. Although the central government is the main actor pursuing income-redistribution policies in the Netherlands (through the implementation of income and wealth taxes), Dutch municipalities are able to strengthen or weaken income redistribution through the relative distribution of the property tax rates and the relative value of the sewerage and refuse collection charges as compared to the property tax rates. For example, if a local council aims to achieve a more egalitarian income distribution than the one that results from the central government's tax policies, it would choose relatively low levels of the refuse collection rate and sewerage charges (possibly zero) and make the household property tax rate relatively high. Alternatively, setting the wealth-independent taxes at their maximum level and choosing a low rate for the property tax can increase the skewedness of the local income distribution.

#### DESCRIPTION OF THE DATA

To analyse the relationship between the political composition of the city council and the distribution of the local tax burdens over the various household types, we used information from two data sources: the local tax burden survey as undertaken by the Netherlands' Ministry of Finance (1998b) and the Central Bureau of Statistics' (1994) voters survey. The latter data set contains information on the voters' perceptions of the relative weight that the various political parties assign to income equality as a policy objective. This survey was conducted at the time of the 1994 parliamentary elections. Political parties were ranked from one to seven, from those for whom income redistribution is not an important issue to those that propose to actively pursue an income redistribution policy (see Table 1). These survey data have been used to construct a political composition index that reflects the weight each of the 548 Dutch municipalities' local councils attach to inequality of wealth or income. This political composition index is calculated as the weighted average value of party representation in local councils on 1 January 1998.

The other data set used in this analysis is the local tax burden poll, a questionnaire that was sent to all municipalities in the Netherlands in order to collect information on the tariffs and tax base for each of the three local taxes for the year 1998 (Ministry of Finance, 1998b). Of the 548 Dutch municipalities, 485 returned the questionnaire, hence the survey suffered

TABLE 1  
PERCEIVED IMPORTANCE OF INCOME REDISTRIBUTION ISSUES IN POLITICAL  
PARTIES' OBJECTIVES<sup>a</sup>

Party	Value
Small left-wing parties	6.5
GroenLinks (Green Party)	5.9
PvdA (Social Democrats)	5.3
D66 (Liberal Democrats)	4.6
CDA (Christian Democrats)	4.3
VVD (Conservative Party)	3.2
AOV/Unie 55+ (Senior Citizens' Party)	5.0
SGP/GPV/RPF (Religious Right)	4.7
Left-wing local parties <sup>b</sup>	5.5
Local parties <sup>b</sup>	4.5
Right-wing local parties <sup>b</sup>	3.5
Average value	4.5

*Notes:* a. Values in this table show the opinion of each political party on the statement about income policy on a scale from one to seven. The value of '1' means the party wants to increase the differences in income level. The value of '7' means that the party would like to decrease these differences.

b. As a result of the scope of the National Survey of Voting Behaviour (which was aimed at analysing national elections), no score is available for a few local parties in this survey. For these parties, we determined values based on the average stance of the nation-wide parties. For local parties without a clear left- or right-wing signature, we used the nation's average value of 4.5. Local left-wing parties were assigned the national average value plus one (i.e., 5.5), whereas local right-wing parties were assigned the national average score minus one (thus, their value was set at 3.5).

from a non-response of slightly more than ten per cent. Municipalities are not homogenous in terms of the composition of their housing stock or in terms of characteristics of their residents. To ensure comparability between municipalities, we define eight types of households, based on household size, the imputed (market) value of the property and the occupant's legal status. A distinction is made between single and multiple person households. The imputed property value is also a dichotomous variable, indicating whether the property's market value is close to either 150,000 or to 280,000 Dutch guilders.<sup>5</sup> The occupant's status is either tenant or owner, hence the house is either rented or owner-occupied.

On the basis of these characteristics, summarised in the first four columns of Table 2, we can determine the municipality tax burden for each of the eight types of household. The average annual amounts (in Dutch guilders) levied for property taxation, refuse collection and sewerage charges are presented in columns five to seven. As this table illustrates, independent of the value of the house, property taxes are more than twice as high for owner-occupants than for tenants. Furthermore, property taxes do not depend of the number of household members. Comparing the amounts



TABLE 2  
CHARACTERISTICS OF THE EIGHT HOUSEHOLD TYPES

(i) Household type number	(ii) Household size	(iii) Property value	(iv) Legal status occupant	(v) Property tax bill	(vi) Refuse collection charge	(vii) Sewerage charge	(viii) Sum of all municipality taxes	(ix) Municipality taxes as a percentage of net disposable income
1	Single	150,000	Rented	213 (74)	329 (88)	77 (95)	620 (148)	2.8% (0.7%)
2	Single	150,000	Owner- occupied	477 (165)	329 (88)	162 (87)	973 (191)	4.5% (0.9%)
3	Family	150,000	Rented	213 (74)	401 (91)	91 (105)	705 (152)	2.5% (0.5%)
4	Family	150,000	Owner- occupied	477 (65)	401 (91)	176 (91)	1,059 (179)	3.7% (0.6%)
5	Single	280,000	Rented	397 (138)	329 (88)	77 (94)	805 (179)	1.4% (0.3%)
6	Single	280,000	Owner- occupied	890 (308)	329 (88)	161 (87)	1,381 (34)	2.3% (0.5%)
7	Family	280,000	Rented	397 (138)	401 (91)	91 (105)	890 (176)	1.4% (0.3%)
8	Family	280,000	Owner- occupied	890 (308)	401 (91)	176 (91)	1,467 (298)	2.3% (0.5%)

*Note:* Monetary values in 1998 Dutch guilders; standard deviations are shown in parenthesis.

*Source:* Ministry of Finance, 1998b.

of money to be collected for property taxes and refuse collection, tenants' property taxes are either lower or approximately equal to the amounts raised by the refuse collection charges, whereas the former exceed the latter in case of owner-occupied houses. The reason for this is that the property tax does discriminate between tenants and owner-occupiers whereas refuse collection rates only depend on household size. The sewerage charges are also independent of the value of the house, but are determined by household size and the legal status of the occupant. In general, the sewerage charges are substantially lower than the other two taxes.

Adding up the amounts of taxes paid by the various household types for each of the three tax bases discussed above, we calculate the ratio of the tax burdens paid by the occupants of cheaper properties to those paid by the occupants of the more expensive houses in each of the 485 municipalities in the data set. These ratios will serve as dependent variables in the regression equations presented in the fifth section. In the eighth column of Table 2, the average differences in terms of the total tax burden are presented along with their standard deviations. The total amount of taxes paid is found to vary substantially depending on the type of household considered and the value of the house. In general, the average owner-occupants are found to pay between 1.50 and 1.71 times as much tax as tenants, depending on whether we consider single households in relatively cheap or more expensive houses. The total average tax burden for expensive houses (imputed value of 280,000 Dutch guilders) exceeds the total tax burden of cheaper houses (with a value of 150,000 guilders) by a factor of between 1.26 (for families in rented houses) and 1.42 (for single owner-occupied households). The differences in tax bills are much smaller when comparing single versus multiple person households. The tax bill for families exceeds that of one-person households by a factor ranging from 1.06 (for expensive owner-occupied houses) to 1.14 (for cheaper rented houses).

From the standard deviations presented in parenthesis in Table 2 it is clear that the actual tax burdens (i.e., the three specific as well as the total tax burdens) vary considerably across municipalities. This conclusion is reinforced when looking at relative tax rates as opposed to absolute tax burdens. In the ninth column of Table 2 the municipality tax rates are presented as a percentage of net disposable household income and the standard deviations indicate that these also differ substantially between the various household types.

Our aim is to test whether local councils pursue redistributive income policies over and above those implemented by the central government. However, in order to determine the impact of the local councils' political composition on the ratios of the total tax burdens we need to control for other factors that may cause the amounts of taxes levied to differ between

the various types of households in a municipality. The main mechanism to consider is that Dutch local tax structure is such that revenue-raising arguments result in larger differences in tax burdens. If higher tax revenues are called for, the caps imposed on the refuse collection rate and the sewerage charges imply that the property tax rates should be increased (Sterks and Allers, 1998). This, in turn, increases the differences in tax burdens among households that differ in terms of wealth.

Therefore, to isolate the difference in tax burdens arising from purely redistributive motifs as compared to those resulting from tax-raising policies, we control for the latter. Apart from political preferences for higher per capita tax burdens (also captured by the political composition variable), three additional reasons for revenue-raising policies are identified.

First, previous research shows that the level of per-capita tax burden is positively correlated with the number of inhabitants in a municipality due to diseconomies of scale (for evidence using Dutch data, see Allers *et al.*, 2001; Ladd, 1994, finds similar results using data for US counties). Therefore, we include the number of inhabitants in a municipality as an explanatory variable.

Second, in case of financial mismanagement the central government can force municipalities to improve their financial situation. In return for receiving a grant to cover (part of) its expenses, the municipality should meet special requirements with respect to the various tax rates it levies. The sewerage charges and the refuse collection rates should be such that all expenses on waste removal are covered and the property taxes should be at least 40 per cent higher than the national average. The spread in household tax burdens in municipalities that are subject to this arrangement can be expected to be higher than the national average because the requirements on the property taxes are more strict than those on the sewerage charges and the refuse collection rates. This financial restructuring instrument is known as Article 12 of the Financial Relationship Act and a dummy variable is constructed that has the value of '1' for the municipalities that had an Article 12-arrangement in the period 1991–98.<sup>6</sup>

The third relevant factor is the quality of the stock of houses in the municipality under consideration. Controlling for municipality size, a relatively low average value of the property in a jurisdiction that the local council needs to impose a higher property tax rate for the same level of tax receipts.

#### REGRESSION RESULTS

Combining the information on the household-specific tax burden, the municipality political composition index and the municipality-specific

controls, we are able to analyse whether local councils actively pursue redistribution policies, according to their political composition. Local governments aiming to pursue an income redistribution policy over and above that of the central government will try to make the household tax bill an increasing function of household wealth, for which the household's property value can be expected to be a reasonable indicator. The dependent variable in the regression analysis is the ratio of the tax burdens of households living in a house with a value of 150,000 Dutch guilders to the burden of households occupying houses worth 280,000 guilders. We investigate this relationship between the tax burden ratio and the political composition index for each of four types of households: single persons in rented houses, single persons in owner-occupied houses, families in rented houses and families in owner-occupied houses.<sup>7</sup> The results of these regression analyses are presented in Table 3.

TABLE 3  
DETERMINANTS OF THE TAX BURDEN RATIO FOR HOUSEHOLDS OCCUPYING A  
LOWER OR HIGHER VALUE PROPERTY

	Single person household, tenant	Single person household, owner	Multiple person household, tenant	Multiple person household, owner
<i>Average tax burden:</i>				
Property value, Dfl. 150,000	620	973	705	1,059
Property value, Dfl. 280,000	805	1,381	890	1,467
Average ratio	0.770	0.704	0.792	0.722
<i>Estimation results:</i>				
Constant	1.032 (16.600)	0.885 (16.286)	0.985 (17.187)	0.868 (16.207)
Political composition of local council	-0.063 (-4.889)	-0.048 (-4.212)	-0.050 (-4.228)	-0.043 (-3.825)
Inhabitants (in 10,000)	-0.001 (-2.973)	-0.001 (-1.571)	-0.001 (-4.009)	-0.001 (-2.577)
Article 12	-0.037 (-4.140)	-0.032 (-4.170)	-0.037 (-4.501)	-0.034 (-4.413)
Average property value (in Dfl. 100,000)	0.028 (6.061)	0.029 (7.169)	0.035 (8.253)	0.037 (9.472)
R <sup>2</sup> (adj.)	0.283	0.280	0.349	0.357
F-value	49.629	48.443	66.664	68.016
Number of observations	485	485	485	485

Note: T-values in parentheses.

For each of the four household types, the relationship between the ratio of the tax burdens and the political composition of the local council is found to be negative and significant: the more left-wing the local council's coalition (that is, the higher the value of the index), the lower the ratio of the total tax burdens of the relatively poor households to that of the more affluent households. Left-wing councils achieve their objectives by keeping the refuse collection and sewerage charges relatively low and by setting a relatively high level of property taxes. Therefore, the revenues from refuse collection taxes and sewerage charges in these municipalities only cover part of the actual service costs.

In general, the other explanatory variables have a significant relationship with the tax burden ratio and the signs are as expected in all four regression equations. The more inhabitants in the jurisdiction, the lower the tax burden of households living in the relatively cheap houses compared to those in the more expensive ones. We also find that municipalities subject to government supervision as a result of (past) financial mismanagement (Article 12) generally impose higher property taxes, thus resulting in a larger spread in tax burdens. Finally, the higher the average value of the stock of houses in a jurisdiction, the lower the tax rate of the property taxes and hence the smaller the difference between the tax burdens.

## CONCLUSIONS

In both the theoretical and empirical literature, the relationship between the central and local governments has been researched extensively, emphasising the sources of possible conflict of interest. Income redistribution is one of those important political issues for which party preferences differ widely. As local governments may be of a different political composition than the central government's coalition, local authorities may be inclined to reinforce or weaken the redistribution policies pursued by the central government. Indeed, given the proportional representation in municipality councils, such differences may appropriately reflect the preferences of the majority of the jurisdictions' inhabitants, but may be in conflict with the nation's preferences (as represented by the central government) with respect to equity and fairness.

This article contributes to the literature by empirically analysing the impact of political factors on the distribution of local tax burdens over various types of households in the Netherlands. The results show that in municipalities with a left-wing local council, the differences in tax burden between occupants of lower- and higher-valued houses are larger than in municipalities with a right-wing local council. Thus, we find that local governments in the Netherlands thwart the redistribution policy of the central government, at least to some extent.

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## NOTES

1. Examples are discussed in various papers in Young (1983). However, Newton (1982) argues that the democratic merits of small units of local government are generally exaggerated as compared to the democratic qualities of larger units. This implies that local governments may not necessarily be the only institution capable of meeting local needs.
2. However, note that the local politicians' room for manoeuvre is limited by the extent to which agents (households or firms) are inclined to migrate out of their jurisdiction when dissatisfied with the policies pursued. See, for example, Sharp (1984) and Tiebout (1956). For an overview, see Sharpe and Newton (1984: Ch.3).
3. For an international comparison of the role of local governments in various countries, see Norton (1994).
4. Obviously, provinces also play a role in the Dutch political landscape. As the meso level is beyond the scope of this article, we refer to Toonen (1993) for an excellent overview of the role of provinces in the Netherlands.
5. The property values of 150,000 and 280,000 Dutch guilders are the same as used in Dutch income policy to analyse the effects of (redistributive) policy measures and (exogenous) economic developments on the income of different types of households.
6. According to the Financial Relationship Act, only municipalities that had an Article 12-grant in 1998 were obliged to comply with the requirements of the Article 12-Act in 1998. However, history has shown that former so-called Article 12-municipalities are not able to lower the tax rates directly after their Article 12-period has expired.
7. In addition to these four regressions, we can also determine the impact of the political composition index on the ratio of total tax bills of single to multiple person households and the ratio of total tax bills of tenants to those of owner-occupiers. However, as these analyses more accurately measure differences in political preferences with respect to family values and house ownership, we do not pursue them.

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