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The political economy of the German Länder deficits: weak governments meet strong finance ministers

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Notes

- ¹ [Table A1](#) in the Appendix offers a more detailed (but still partial) review of the empirical literature related to our study.

² We consider a finance minister to be strong when he or she has the same party affiliation as the prime minister.

³ We ran our empirical models on shorter time periods, including those used in Seitz (2000) and Galli and Rossi (2002) and largely lose significance. In other words, the difference between the two groups is not statistically significant. This is true for the longer time period as well.

⁴ In our case, the difference is not statistically significant. This is true for the longer time period as well as for the shorter time period.

⁵ For the German states, we use the data at the state level. For the German states, we use the data at the state level.

⁶ In 2001, the 'Social Justice' party consisted of disaffected members of the new party, The Left.

⁷ To some extent, this is a simplification with the DIE LINKE. Note, however, that today's Berlin is not a former Western Land.

⁸ For an explanation of the variables, see Table A2 in the Appendix.

⁹ Of course, one may argue that if the election is early in the year, expenditures should raise in the pre-election year. We discuss this in detail in Subsection ‘Political opportunism’ of [Section V](#).

¹⁰ Note that we concentrate on public deficits. It may well be that there are no partisan effects in borrowing but in the structure of public spending (see, for instance, Drazen and Eslava, 2005).

¹¹ An alternative theory that explains higher deficits for coalition governments is offered by Alesina and Drazen (1991) and Alesina and Perotti (1994, pp. 22–29): consider a permanent fiscal shock. Coalition partners will then fight about the allocation of the fiscal burden to the respective constituencies. This situation is well modelled by the ‘war of attrition’. In general, delayed adjustment to the fiscal shock will obtain, allowing debt to accumulate.

¹² Note that real debt growth is simply real deficit over real debt.

¹³ Definition of all variables can be found in the Appendix in [Table A2](#).

14 Elections are not uniformly distributed over time. This is why year dummies are correlated with the variables ELECTION and PREELEC. While the ELECTION coefficient is never statistically significant, the PREELEC coefficient is. This is not surprising in a model with time fixed effects. The PREELEC variable is a time specific variable.



¹⁶ The Hausman specification test indicates that the fixed effects model is more appropriate than the random effects model. Note, however, that the Hausman test is not always reliable. As this is clearly violated, we use fixed effects.

¹⁷ He also showed, however, that the bias approaches zero as T tends to infinity. Since T is relatively large in our study ($T = 46$), the bias is likely to be moderate. Note that although T is much smaller in Seitz (2000, $T = 21$) and Galli and Rossi (2002, $T = 21$) both studies use the LSDV estimator.

¹⁸ We consider the regressors summarized in w_{it} as strictly exogenous so that variables themselves and all their lags are valid instruments. Furthermore, note that the AB estimator takes first-order autocorrelation of y_{it} into account. Thus, neither consistency nor efficiency is affected by first-order autocorrelation. But second-order correlation implies inconsistency (Arellano and Bond, 1991, pp. 281–282).

¹⁹ The estimates with BB as initial estimator have slightly higher SEs. Apart from that, results remain unchanged. The complete estimates for the BB and AH estimators are available upon request.

²⁰ Deficit data are taken from the Statistisches Bundesamt (Federal Statistical Office) (2005). Data for the GDP was provided by the Statistical Office of Baden Württemberg and the Federal Statistical Office. All nominal numbers were deflated by the consumer price index for all households obtained from the Statistisches Bundesamt (2006). Our main results do not change qualitatively when using nominal values instead. Election dates were taken from Forschungsgruppe Wahlen (Election Research Team) (2007).

²¹ Some of the variables are excluded from the model without loss of generality. For example, political party is excluded because it is only a proxy for the political stance of the candidate.

²² Note that the correlation between the variables is only slightly different from zero. Although the correlation is not significant, it remains a concern for the validity of the instruments.

²³ The effect of the election year is significant at the 1% level. This suggests that the election year has a positive effect on the dependent variable.

²⁴ Although the effect of the election year is significant, it is not significant for political party. This suggests that the election year has a positive effect on the dependent variable, but the political party does not have a significant effect.

²⁵ So suppose that the election year is 1982, would have 1981 as election year and 1980 as pre-election year. An election in February 1982

³⁰74% of coalition governments have a prime minister and a finance minister belonging to the same party.

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