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DO 'LABOUR' COUNCILS LOWER ECONOMIC FREEDOM?

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ABSTRACT

Using a panel of the UK counties, spanning the period 2010-2016, this study explores whether having a Labour or Conservative council affects a county's economic freedom. Due to data unavailability of any economic freedom index for the UK counties, the analysis employed direct measures in relevance to three sub-components of economic freedom, i.e. size of government, sound money and the freedom to trade internationally. Using a regression discontinuity approach, we find strong evidence that the political ideology of a council affects all three sub-components of economic freedom. An implication of this result is that councils appeal to specific groups of voters when making policy.

Keywords: Economic freedom; Political councils; Regression discontinuity approach; UK countries.

JEL Classification: H11; R58; C33.

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I. INTRODUCTION

Does the political ideology of an administration authority (either on a national or regional level) affect the economic freedom enjoyed by this country or region? To answer this question, we must first define economic freedom. Gwartney et al. (1996) states that *“individuals have economic freedom, when (a) property they acquire without the use of force, fraud, or theft is protected from physical invasions by others and (b) they are free to use, exchange, or give away their property as long as their actions do not violate the identical rights of others.”* Based on this definition of economic freedom, Gwartney et al. (1996) develop the Economic Freedom of the World (EFW) index for 100 countries, spanning the period 1975–1995. Since then, the index has been extended by the Fraiser Institute to cover more countries and years.

Given that the definition of economic freedom places a higher weight on limited government, a potential answer to the opening question of this paper is: yes, local administrators who favor smaller government should support policies that lead to a higher level of economic freedom. In the UK, politicians belonging to the Conservative Party (the Tories) are typically associated with a preference for a smaller government compared to those associated to the Labour Party. In the spirit of Downs (1957), the median voter theorem would suggest that ideology gives way to pragmatism and that administrators seeking to maximize the likelihood of election and re-election differ only slightly in policies and, as such, there should be insignificant differences in what is observed when comparing administrators from different parties, as it relates to the measure of economic freedom. Alternatively, county-level political competition might be viewed as a struggle between two different constituencies within the same region/county. In this environment, voters elect gubernatorial candidates who hold specific policy ideas that might impact economic freedom in different ways. A large body of research has examined whether the parties will converge towards the middle leading to very little difference if they are vote maximizers. A limited selection of this research includes Winters (1976), Garand (1988), Krehbiel (1993), Blais et al. (1993), Imbeau et al. (2001), Besley and Case (2003), Pettersson-Lidbom (2003), and Lee et al. (2004).

Researchers who have perhaps made the most use of economic freedom data are those studying economic growth. Compton et al. (2011) find that higher rates of economic growth are positively associated with economic freedom. Related work has focused on the relationship between economic freedom and income inequality with mixed results (Berggren, 1999; Scully, 2002; Carter, 2007; Compton et al., 2014). In addition, research has been done on migration and economic freedom, the black/white income gap and economic freedom, and entrepreneurship and economic freedom². More germane to our study, Bjornskov and Potrafke (2013) hypothesize that the ideology of economic freedom is favored by Republican voters. The authors examine whether policy in the areas of the size of government and labour market regulation is higher when Republicans are in control of the elected branches of a state’s government. They also find that Republican governors are more active in deregulating labour markets. In addition, Reed (2006) finds that Democratic control of the state legislature leads to higher tax burdens. However,

² For an exhaustive look at works that use the EFW Index, see Hall et al. (2015).

Reed finds that the political party of the governor has little effect on taxes. This latter result supports earlier findings by Besley and Case (1995). Thus, the influence of administrators' political affiliation on economic freedom remains unsettled.

One of the more well-known works by Caplan (2001) presents a model where the government becomes a 'leviathan' in that it grows faster and further than the desires of its citizenry. In this model, a government wants to expand its own power since this power then becomes self-reinforcing and leads to even greater power. One must keep in mind that if one political party is more conservative, there could be real limits placed on the growth of government when this party is in power, thus thwarting the 'leviathan' growth potential. Moreover, regarding this idea, Campbell et al. (2007) extend this model to include real growth rates of government with mixed results. The authors state that "*as political parity increases, the capacity of the minority to block the majority increases thereby encouraging more interparty logrolling (ibid: p. 579).*" These results seem to counter the results by Bjornskov and Potrafke (2013).

Given the absence of data on the EFW index for the UK counties, the objective of this paper is to use data on the direct/specific components of the EFW index, such as government expenses, sound money and freedom to internationally trade, to test the idea that the political affiliation of the county councils in the UK has an appreciable impact on those sub-components. The overall economic freedom measure from this index is comprised of the following three sub-components for which data can be found across the UK counties. i) size of government, as government spending (a higher government expenditure is considered as impinging on economic freedom). ii) sound money is proxied by inflation, since inflation erodes the value of rightfully earned wages and savings, sound money is thus essential to protect property rights. When inflation is high, it becomes difficult for individuals to plan for the future and, thus, to use economic freedom effectively. iii) freedom to trade internationally, i.e. freedom to exchange is essential to economic freedom, which is reduced when freedom to exchange does not include businesses and individuals in other nations.

In reality, there can be certain reasons why a county's voters would elect a particular individual as member of the council and these reasons can also have an influence on the types of policy changes. Thus, the relationship between the party of the council and the abovementioned dimensions of economic freedom is potentially endogenous. Therefore, the hypothesis that the traits of economic freedom, mainly less government intervention in markets, would be more commonly associated with Conservative than Labour councils, is one that must be tested with a careful empirical approach. The analysis employs a regression discontinuity design that leverages the fact that the party of the council is a deterministic function of the vote margin between the Labour candidate and the Conservative candidate. This approach allows us to compare counties which are similarly situated except for their choice of the party of the council. To foreshadow our results, they provide supportive evidence that Labour councils lead to less economic freedom. In fact, we find strong evidence that a Labour council leads to a higher size of government.

The remainder of the paper proceeds as follows. Section II discusses the methodological approach and the dataset employed in this study, while Section III presents the empirical results and discussions. Finally, Section IV concludes.

II. METHODOLOGY AND DATA

A. Methodology

A starting point for several previous studies about the relationship between a council's partisan ideology and economic freedom is a fixed-effects OLS model:

$$EFW_{it} = \beta D_{it} + X_{it}\Gamma + \alpha_i + \delta_t + \varepsilon_{it} \quad (1)$$

where EFW_{it} stands for county i 's component of economic freedom under examination in year t , D_{it} is an indicator variable, which equals 1 if county i 's council is from the Labour Party, and 0 if the council comes from the Conservative Party. The coefficient β is a consistent estimator of D , if other potentially confounding variables, both time-varying and time-invariant, are accounted for in Equation (1). Time-varying confounders that might be related to both the component of economic freedom and the party of a county's council might include the level of education in a county or the average income in that county. These and other observable variables are potentially accounted for in the vector \mathbf{X} . Additionally, the term α accounts for both observable and unobservable county fixed-effects, which could potentially influence the party of the county's council, δ accounts for year-specific factors, which influence economic freedom that could be correlated with the party of a council, and finally ε denotes the error term. However, even after accounting for observable confounding variables, this fixed-effects model is still unable to account for time-varying unobservable factors that could influence a county's level of economic freedom and the party of its council. For example, if an unobserved shock leads to a lower size of government and also increases the likelihood that a council from the Labour Party would be elected, then the estimated effect of a council from the Labour Party on this particular component of economic freedom would also be underestimated. Thus, we cannot rely on Equation (1) to provide a causal estimate of a council from the Labour Party's influence on the particular sub-component of economic freedom.

In order to overcome the endogeneity issue for unobservable shocks, we follow Lee et al. (2004) and Lee (2008) and employ a regression discontinuity approach. This approach relies on the fact that the party of the council in power is a deterministic function of the vote margin. That is:

$$D_{it} = I(v_{it} > 0) \quad (2)$$

where v_{it} is the difference between the vote share of the first and second place candidates and $v_{it} > 0$, if $D_{it} = 1$ and $v_{it} < 0$, if $D_{it} = 0$. We assume that unobservable variables that are not absorbed by the county fixed-effects vary with vote margin. In other words, once we condition on vote margin, β can be estimated without bias, which can be expressed formally with:

$$E[i_t | D_{it}, X_{it}, \alpha_i, \delta_t, v_{it}] = E[i_t | X_{it}, \alpha_i, \delta_t, v_{it}] = X_{it} \Gamma + \alpha_i + \delta_t + f(v_{it}) \quad (3)$$

where $f(v_{it})$ is a flexible function of the vote margin. A final assumption that must be made is that (v_{it}) is continuous. Requiring that the vote share function is continuous from both directions as it approaches the zero-vote margin position, allows us to approximate the level of economic freedom on either side of the Labour vote margin. We must make this approximation, because even the closest votes over our sample period have margins of hundreds of votes. We rely on both a linear and cubic control function in our estimation of Equation (3).

The use of the regression discontinuity method thus allows us to compare the components of economic freedom of councils from the Labour Party who just barely won their election with councils from the Conservative Party who just barely won theirs. This is an important point, because the estimation of Equation (3) does not allow us to comment on the level of economic freedom in a county, where the council of either party won by a relatively large margin. Councils can win elections, because of past policies, because of past economic performance, or because of loyalty to the particular political party, amongst other reasons. These reasons can have implications for the types of policies the council will enact that contribute to a county's level of economic freedom. Moreover, these reasons can affect not only who wins the race for council, but by how much (that is, the win margin).

The validity of the regression discontinuity approach hinges on the requirement that once we control for vote margin and other observable time-varying confounding variables, a county's economic freedom score does not change as we cross the threshold from a Conservative council to a Labour council, except for the impact of the council's ideology. In order to assess this validity, we follow a recommendation by Lee and Lemieux (2010) and regress each of the potentially confounding variables on the Labour council variable. If these variables are continuous across the 50%-50% cutoff, then the coefficient on Labour council should be close to zero.

B. Data

The starting point for this project is the UK county-level annual data, spanning the period 2010-2016 period. These years are chosen based on data availability and primarily on the fact that counties experienced significant reforms prior to 2010. In particular, the UK local (county) governments are elected bodies that operate in territorially bounded geographical areas, employ professional career staff, and generally receive over two-thirds of their income from the UK central government. They are multi-purpose authorities delivering services in the areas of education, social care, land-use planning, waste management, public housing, leisure and culture, and welfare benefits. In the UK, prior to the consolidations that took place in 2009, there were 386 county governments of five types, 32 London boroughs, 36 metropolitan boroughs, and 46 unitary authorities, mostly in urban areas, delivering all of the services listed above. In the rural areas, by comparison, there were 34 county councils administering education and social services, as well as 238 district councils providing welfare and regulatory services.

The data used in this study are drawn from two main sources: the Department for Communities and Local Government's Revenue expenditure and socio-economic deprivation statistics, and the UK National Census Statistics and the annual mid-term population estimates published by the Office of National Statistics.

As discussed above, our economic freedom measures are based on data from explicit data that describe three out of the five components of the EFW index. These three main components are considered as the dependent variable in our estimates. More specifically, the size of the government across counties is measured as the total net service expenditure per capita of each county, supplemented within analysis of the expenditure on the major local government services within county areas: education, social care, environmental services (e.g. waste management, environmental health), transport (e.g., highway maintenance, bus services), leisure and culture (e.g., libraries, sports centres, museums), administration (i.e., central support services), land use planning, and, social housing. Data are obtained from the Office of National Statistics. Next, we obtain from the Office of National Statistics data on relative county consumer price levels of goods and services in order to calculate the role of inflation as a part of the *sound money* component of economic freedom. Finally, data on imports and exports per county are obtained from the gov.uk site on Her Majesty's (HM) Revenues & Customs in order to estimate the trade openness measure per county³

The primary political variable of interest is the political party of each county's council. First of all, the post-2009 consolidation period includes 45 counties, of which 27 come from England, 4 from Northern Ireland, 9 from Scotland and 5 from Wales. In addition, in relevance to the English counties, 6 of them are characterized as metropolitan and the remaining as non-metropolitan areas. Data come from the Ministry of Housing, Communities & Local Government, published by the HM Government. Moreover, in terms of the political background of those councils and in relevance to the two major political parties in the UK, i.e. Conservatives (Tories) and Labour, out of 45 counties, in 36 the majority of seats come from the Conservative Party and in 9 counties from the Labour Party. These data come from legislation.gov.uk, as well as from the House of Commons Library.

A number of variables measuring county-level characteristics that could be related to the party of the council are also used to assess the validity of the regression discontinuity design. County personal income per capita (which provides statistics on self-employment, employment, pension and investment income) is obtained from HM Revenues & Customs. County personal income is converted into constant 2010 pounds using the annual consumer price index, available from the Office of National Statistics. The percent of the population living in a census-designated metropolitan area is also retrieved from various editions of the Office of National Statistics. Finally, the percent of the population with a bachelor's degree is extracted from the gov.uk. Summary statistics are provided in Table 1.

³ Measured as the percent of the sum of imports and exports to GDP).

Table 1.
Descriptive Statistics

The table provides summary statistics for seven variables. SD denotes standard deviation, minimum statistics (Min.) and maximum (Max.) statistics together with their mean are noted.

Variable	Mean	SD	Min.	Max.
Labour Council	0.126	0.501	0.000	0.219
Personal Income (2010 £, thousands)	29.56	6.48	15.29	44.78
Percent with Bachelor's Degree	0.157	0.046	0.068	0.317
Percent in Metro Area	0.257	0.191	0.168	0.273
Inflation (%)	1.27	0.16	1.15	1.38
Net Service Expenditure Per Capita	9,367.5	1.079	9,35	9,385
Trade Openness (as % of GDP)	0.65	1.02	0.54	0.78

The table provides summary statistics for seven variables. SD denotes standard deviation, minimum statistics (Min.) and maximum (Max.) statistics together with their mean are noted.

III. EMPIRICAL ANALYSIS

A. Baseline Results

Table 2 provides the results from Equation (3) using the entire sample of counties and a linear vote margin control function. Recall that an important assumption made in Section II was that observable and unobservable time-varying confounding variables vary continuously with the vote margin. Given this assumption, the inclusion of the control variables in the vector X_{it} in Equation (3) is not necessary. However, as pointed out by Fredricksson et al. (2013), if these control variables are not endogenous to the council's party affiliation, their inclusion can potentially make the estimate of the effect the council's party more precise.

The findings document that with respect to the component of the government size (net service expenditure per capita-Column 1) there is statistical (at 1%) evidence that a Labour council can implement policies that lead to higher size of government. Moreover, the size of the estimated coefficient indicates that a Labour council leads to a size of government that is higher by approximately 0.47, which economically is a substantial effect. In particular, the standard deviation of the size of government is 1.08, implying the average effect of a Labour council on this sub-component of economic freedom is 43.4% of the standard deviation. With respect to the other two sub-components of economic freedom, the results indicate that a Labour council contributes 35.6% to higher inflation and 35.4% to weaker trade openness.

The control variables included in this regression specification also display statistically significant relationships across the three specifications of economic freedom. In particular, personal income per capita is positively correlated with all three sub-components of economic freedom, while the higher the percentage of

people with a college degree, the higher the government size and trade openness are, and the lower inflation is. Finally, there is an indirect association between the percentage of population living in metropolitan counties and the size of government, and a positive association between this part of the population and both inflation and trade openness.

Table 2.
The Effect of a Labour Council on Economic Freedom (Linear Version)

The table reports the linear estimates of a Labour council on economic freedom. Figures in brackets denote *p*-values. Finally, *: $p \leq 0.10$; **: $p \leq 0.05$; ***: $p \leq 0.01$.

Variables	Net Service Expenditure Per Capita	Inflation	Trade Openness
	(1)	(2)	(3)
Labour Council	0.468*** [0.00]	0.057*** [0.00]	-0.361*** [0.00]
Personal Income Per Capita(-1)	1.094*** [0.00]	1.659*** [0.00]	2.344*** [0.00]
Percent with College Degree(-1)	0.318** [0.03]	-0.094* [0.06]	1.028*** [0.00]
Percent of Population in Metro Areas(-1)	-0.084** [0.05]	0.127** [0.04]	0.562*** [0.00]
Adjusted R ²	0.73	0.68	0.82
No. Observations	1,128	1,128	1,128

Table 3 repeats the previous analysis, but this time it employs a non-linear (cubic) vote margin control function. The new findings provide strong statistical support to those reported in Table 2.

Table 3.
The Effect of a Labour Council on Economic Freedom (Non-Linear-Cubic Version)

The table reports the non-linear estimates of a Labour council on economic freedom. Figures in brackets denote *p*-values. Finally, *: $p \leq 0.10$; **: $p \leq 0.05$; ***: $p \leq 0.01$.

Variables	Net Service Expenditure Per Capita	Inflation	Trade Openness
	(1)	(2)	(3)
Labour Council	0.496*** [0.00]	0.069*** [0.00]	-0.388*** [0.00]
Personal Income Per Capita(-1)	1.138*** [0.00]	1.594*** [0.00]	2.137*** [0.00]
Percent with College Degree(-1)	0.279** [0.04]	-0.073* [0.08]	0.874*** [0.00]
Percent of Population in Metro Areas(-1)	-0.089** [0.05]	0.146** [0.03]	0.528*** [0.00]
Adjusted R ²	0.75	0.66	0.83
No. Observations	1,128	1,128	1,128

B. Validity of the Regression Discontinuity Design

Even though the evidence shows no causal impact of a council's party on the economic freedom witnessed by a county, it is important to show that the regression discontinuity approach used in this paper is valid. This approach can only be used if the researcher is confident that time-varying county-level characteristics, which could potentially be correlated with the party of the council, are not systematically different under a Labour council that is barely elected compared to a Conservative council that is also barely elected. If any of these county-level characteristics are different on either side of the vote margin cut-off, then it would be imprudent to state that the council's partisan affiliation is the cause of any differences between economic freedom.

A common way to test the validity of the regression discontinuity design is to regress potentially confounding variables on the Labour council variable. This method, proposed by Lee and Lemieux (2010), examines whether these variables are discontinuous at the vote margin cut-off. It is important to note that this validity test can only examine whether the observable variables, are discontinuous at the vote margin cut-off. We have no way of testing whether unobservable county-level characteristics are discontinuous at the cut-off. Tables 4 and 5 (the linear and non-linear versions, respectively) give us confidence that the other variables that are plausibly related to whether a county has a Labour council are similar as the vote margin moves from Labour to Conservative.

Table 4.
Validity of the Regression Discontinuity Design (Linear Version)

The table presents the results of testing the validity of the regression discontinuity design in its linear version by regressing potentially confounding variables on the Labour council variable. Figures in brackets denote *p*-values.

Variables	Personal Income Per Capita	Percent with College Degree	Percent of Population in Metro Areas
	(1)	(2)	(3)
Democratic Council	-0.00048	-0.00036	-0.00018
	[0.28]	[0.39]	[0.55]
Adjusted R ²	0.28	0.22	0.14
No. of Observations	1,128	1,128	1,128

Table 5.
Validity of the Regression Discontinuity Design (Non-Linear Version)

The table presents the results of testing the validity of the regression discontinuity design in its non-linear version by regressing potentially confounding variables on the Labour council variable. Figures in brackets denote *p*-values.

Variables	Personal Income Per Capita	Percent with College Degree	Percent of Population in Metro Areas
	(1)	(2)	(3)
Democratic Council	-0.00048	-0.00036	-0.00018
	[0.28]	[0.39]	[0.55]
Adjusted R ²	0.28	0.22	0.14
No. of Observations	1,128	1,128	1,128

IV. CONCLUSION

The definition of economic freedom emphasized the importance of limited government with respect to the government size, sound money (inflation) and trade openness sub-components of economic freedom. Previous research for the case of the US had found evidence that Democratic governors enact higher income taxes and that Republican governors are associated with less labor market regulation. However, researchers had also found evidence that the party of the governor had little effect on important policy outcomes which contribute to economic freedom.

Given this motivating definition and the unsettled nature of the previous research, we hypothesized that Labour councils in the UK would enact policies that would lead to lower economic freedom compared to Conservative councils. The analysis tested this hypothesis using county-level data in the UK, spanning the period 2000–2016 and employed a regression discontinuity approach in order to overcome potentially endogenous relationships between the party of the council and other factors that could affect the choice of council and the types of economic policies that are implemented.

The results provided strong statistical (and economic) support to the hypothesis. Over the time period studied, we found strong evidence that a Labour council led to lower economic freedom compared to a Conservative council. The conclusion one could draw from these results is that the partisan ideology could affect economic freedom through certain sub-channels, such as government size, sound money and the freedom to internationally trade. In other words, partisan ideology can have substantial effects on a county's voter.

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