
Financing divided and unified partisan governments

JAC C. HECKELMAN

Wake Forest University, P.O. Box 7505, Winston-Salem, NC 27109, USA

Received 9 July 1997

By modifying Berument's divided government-optimum financing model to include partisan interests, it is found that when the Democratic party controls both the Congress and Presidency, real monetary base grows at a higher rate than when the Republican party controls both branches. In addition, it is found that monetary base grows at the slowest rate when neither party controls both branches, supporting a gridlock version of divided government.

I. INTRODUCTION

In a recent article in this *journal* Berument (1997) attempts to test, within an optimal financing framework, the Andrabi (1997) model of noncooperative bargaining by partisan government agents. The central concern here will focus on Andrabi's implication that each political agent wants to protect its special interests by refusing to allow higher taxes on specific commodities and in doing so the government is unable to agree upon the needed tax arraignments to finance its spending. Seigniorage revenue is then increased by a passive central bank committed to covering the resulting revenue shortfall.

Berument's (1997) empirical model is based upon the revenue-smoothing model for real monetary base growth derived in Berument (1994). Controlling for the tax base, it is then expected that divided governments rely upon higher money growth than would otherwise be optimal.

However, it is argued here that by focusing exclusively on divided versus unified governments, a misspecification is introduced by failing to account for partisan objectives. In fact, Berument's (1994) model is based upon the idea that taxes and money creation enter differently into the parties' objective functions. He may have omitted the partisan influence for his recent study due to the nonsignificant

findings in the earlier study.¹ It is shown here that both influences need to be incorporated.

II. EXTENSION TO THE DIVIDED GOVERNMENT MODEL

Berument (1997) focuses on an empirical model of the form²

$$MONEY\ GROWTH = \alpha + X\beta + \gamma DIVIDED + \varepsilon \quad (1)$$

where *DIVIDED* is represented by a dummy variable for years in which a single party does not simultaneously control the executive and both houses of the legislature. It is expected that $\gamma > 0$.

Berument's regression is replicate in column (1) of Table 1.³ As does Berument, I find that the estimated coefficient on *DIVIDED* is not statistically significant at conventional levels, and in fact is the wrong sign to support his hypothesis. This result suggests the form of government is unimportant to monetary policy.

However, this may be misleading. Regression (1) is actually a restricted version of the partisan model

¹ The empirical results for the two studies are not directly comparable as the sample time period and excluded instrument set differs. In addition, the first study uses a panel of OECD nations, whereas his more recent study is exclusive to the US.

² See Berument (1997) and Table 1 for the specific explanatory variables which comprises the *X* matrix.

³ The regression results are not identical to Berument (1997) possibly due to different data sources and regression software package. I have attempted to replicate Berument's variables as close as possible using data from *CITIBASE* data bank, and the instrument list provided in the notes to Berument's Table 1. In this overidentified model, there may be more than one solution. I used *EViews* 2.0 to estimate all the regressions, and Berument used *RATS* 4.2 (personal communication).

Table 1. *Monetary base growth for divided and partisan governments*

	(1)	(2)	(3)	(4)	(5)
Constant	-0.98 -1.49	-	-0.73 -0.03	4.12 0.15	-0.80 -0.03
Time trend	0.28 2.12	0.33 2.45	0.25 1.83	0.31 2.23	0.31 2.30
Fixed exchange rate	1.88 1.20	1.59 1.02	1.97 1.21	1.54 0.97	1.72 1.11
Log (Tax/GNP)	-5.88 -0.48	-6.72 -0.56	-4.26 -0.34	-6.31 -0.53	-6.85 -0.57
Log (Mbase/GNP)	5.20 0.79	8.72 1.26	3.84 0.56	8.54 1.21	6.82 1.03
<i>DIVIDED</i>	-1.22 -1.49	4.82 0.17	-	-	-
<i>UNIFIED REPUBLICAN</i>	-	5.07 0.18	-	-	-
<i>UNIFIED DEMOCRAT</i>	-	6.41 0.23	-	-	-
<i>PARTY1</i>	-	-	-0.49 -0.82	-	-
<i>PARTY2</i>	-	-	-	0.87 1.53	-
<i>PARTY3</i>	-	-	-	-	0.78 1.81
AR(1)	0.42 2.77	0.45 3.03	0.43 2.70	0.46 3.23	0.44 2.98
$\bar{\sigma}_E$	0.0173	0.0169	0.0179	0.0170	0.0097
AIC	-7.957	-7.985	-7.89	-7.99	-8.01

Note: Estimation by instrumental variables using excluded instruments listed in Berument (1997) note to Table 1. All financial data uses real values. Coefficient estimates (except AR(1)) are multiplied times 100. *t*-ratios appear below coefficient estimates. AR(1) correction using a nonlinear least squares method. *PARTY* variables explained in text and Table 2.

$$\begin{aligned}
 \text{MONEY GROWTH} = & X\beta + \gamma \text{DIVIDED} \\
 & + \theta_R \text{UNIFIED REPUBLICAN} \\
 & + \theta_D \text{UNIFIED DEMOCRAT} + \varepsilon
 \end{aligned}
 \quad (2)$$

where *UNIFIED REPUBLICAN* and *UNIFIED DEMOCRAT* cover the cases where that party simultaneously controls both houses and the Presidency.

Equation 1 compares divided governments against the excluded unified governments, which is only valid if all the unified governments are the same. Partisan theory has long noted the stylized fact that the Democratic party pursues more expansionary policies than the Republican party (Hibbs, 1987). Thus, for a given tax base (controlled for in the regression), money growth should be greater when the Democrats completely control the budget. This suggests the Equation 1 is misspecified since it assumes $\theta_R = \theta_D$.

The general representation in Equation 2 also allows a test of competing divided government models. Although the 'weak government' model of Andrabi (1997) might imply $\theta_R < \theta_D < \gamma$ once partisan policies are included, the literature

on balancing government suggests moderate voters actively seek split governments to balance the partisan interests of the parties (Fiorina, 1992). According to this view, $\theta_R < \gamma < \theta_D$. Alternatively, the gridlock version of Zupan (1991) predicts $\gamma < \theta_R < \theta_D$ as split governments are paralysed in all fiscal decisions and thus spend less money in total, thereby needing less money creation for a given tax base. Equation 2 is presented in column (2) of Table 1. Although none of the political coefficients are individually significant, the estimated coefficient for *UNIFIED REPUBLICAN* is slightly smaller than for *UNIFIED DEMOCRAT*, and the restriction of non-partisanship ($\theta_R = \theta_D$) is rejected by a Wald test, where the computed value = 2.73 is distributed as $\chi^2(1)$ with critical value of 2.71 at 10% level.

Finally, a more parsimonious representation is given in

$$\text{MONEY GROWTH} = \alpha + X\beta + \lambda_i \text{PARTY}_i + \varepsilon \quad (3)$$

where *PARTY*_{*i*} represents a linear scale to test the three split government hypotheses as shown in Table 2. For example, *PARTY1* tests Andrabi's weak government model where divided governments should rely upon the most money growth, and consequently are given the highest value. For each specification of *PARTY*_{*i*}, it is predicted $\lambda_i 0$.

The *PARTY*_{*i*} variables are included in regressions (3)–(5). Only *PARTY3* generates a statistically significant coefficient at 10% level, and is the correct sign. This representation also presents the best regression fit of all five cases, as evidenced by the smallest values for the estimated residual standard error and the Akaike Information Criteria.

III. CONCLUSION

In this note evidence has been provided that partisan objectives influence the degree of monetary base growth, and split party governments achieve a degree of growth below either of the two party objectives. This supports the partisan view of monetary policy (Hibbs, 1987; Alesina and Sachs, 1988), Presidential and Congressional influence on the FED

Table 2. *Values for PARTY_i variables based on expected effect of divided governments*

	Hypothesis		
	Weak (Andrabi, 1997) <i>PARTY1</i>	Moderation (Fiorina, 1992) <i>PARTY2</i>	Gridlock (Zupan, 1991) <i>PARTY3</i>
<i>UNIFIED REPUBLICAN</i>	1	1	2
<i>UNIFIED DEMOCRAT</i>	2	3	3
<i>DIVIDED</i>	3	2	1

(Havrilesky, 1993) and rational split-ticket voting designed to achieve gridlock (Zupan, 1991) if voters are, in Peltzman's (1992) terminology, 'fiscal conservatives'.

REFERENCES

- Alesina, A. and Sachs, J. (1988) Political parties and the business cycle in the US, 1948–1984, *Journal of Money, Credit and Banking*, **20**, 63–82.
- Andrabi, T. (1997) Seigniorage, taxation and weak government, *Journal of Money, Credit and Banking*, **29**, 106–26.
- Berument, H. (1997) Financing divided governments, *Applied Economics Letters*, **4**, 369–72.
- Berument, H. (1994) Political parties and optimum government financing: empirical evidence for industrialized economies, *Southern Economic Journal*, **61**, 510–18.
- Hibbs, D. (1987) *The American Political Economy*, Harvard University Press, Cambridge.
- Fiorina, M. (1992) *Divided Government*, Macmillan, New York.
- Havrilesky, T. (1993) *The Pressures on American Monetary Policy*, Kluwer Academic, Dordrecht.
- Peltzman, S. (1992) Voters as fiscal conservatives, *Quarterly Journal of Economics*, **107**, 327–61.
- Zupan, M. (1991) An economic explanation for the existence and nature of political ticket splitting, *Journal of Law and Economics*, **34**, 343–70.