Overview: This post-graduate course covers some of the main topics in Fiscal Federalism, broadly defined as the research area dealing with public economics issues arising in settings where different layers of government coexist (i.e. federal, regional and local governments). The course is organized in five modules.

The first module introduces the student to the core normative analysis of fiscal federalism that attempts to allocate government spending and taxing responsibilities efficiently across layers of government assuming that governments are benevolent.

There is no market for many of the public goods and services provided by local governments around the world. In the second module, we will study empirical approaches that allow, under some circumstances, to recover demand for local public goods and services. We will also study how differences in income and preferences for local public goods shape the geography of cities.

When tax bases such as firms or capital are mobile across jurisdictions, governments can under-provide public goods and services. This will happen if, fearing to loose firms or capital, governments set tax rates that are too low. In the third module, we will study under which circumstances this phenomenon, known as tax competition, occurs. We will also study mechanisms that can mitigate the negative effects of this competition.

Grants are a salient feature of inter-governmental relations in all federations and they tend to flow from the federal to regional and local governments. In the fourth module, we will study the potential role of grants in restoring equity and efficiency within federations. In a more positive approach, we will also analyze how federal governments allocate grants based on politics, and how local and regional governments react to grants.
In the last module, we will deal with the issue of public sector debt in a decentralized setting. We will see that expectations of being bailed out by the federal government can lead to excessive public spending and debt levels.

**Course organization:** In each module, we will go through the key theoretical models in the topic. We will also review the latest empirical papers on the subject, focusing on those contributions that place more emphasis on modern identification strategies (Differences-in-Differences analyses, Regression Discontinuity Designs, Instrumental Variables approaches...). After each module, students will present papers that constitute relevant contributions to the subject.

**Grading:** A final written examination will be 50% of the final grade. The remaining 50% will be based on paper presentations (between 1 and 2).

**Prerequisites:** This course is an advanced one and requires a previous background in microeconomics, public economics and econometrics. For those that are totally unfamiliar with the economics of subcentral governments, the following reading list is recommended.

### Introductory reading list:

<table>
<thead>
<tr>
<th>Author</th>
<th>Title</th>
<th>Publisher/Edition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Topham, N. (1983)</td>
<td>&quot;Local government economics&quot;, en R. Milward et al. (eds), Public Sector Economics</td>
<td>Longman, Londres</td>
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</tbody>
</table>
Module 1  **The main pillars of the theory of fiscal federalism**

1.1 Approaches to fiscal decentralisation

1.2 Assignment of functions to the different levels of government
   
   1.2.1 Decentralisation Theorem. A critical analysis
   
   1.2.2 Local public goods

1.3 Revenue assignments to the different levels of government

1.4 From theory to practice

**Reading list:**


Module 2  The demand for local public goods and services and residential sorting

2.1  Estimating the demand for local public goods and services

2.1.1 The representative resident model
2.1.2 The discrete choice approach
2.1.3 Hedonic price models

2.2  Schools, peer effects and residential sorting

Reading list:


Brueckner, J (2011), Lectures on Urban Economics, Chapter 8


Module 3  

(Capital) tax competition

3.1 Theories of tax competition
   3.1.1 Symmetric tax competition
   3.1.2 Asymmetric tax competition
   3.1.3 Tax competition with two tax instruments
   3.1.4 Tax reaction functions

3.2 The empirics of tax competition
   3.2.1 Taxes and firm location decisions
   3.2.2 Globalization and changes in corporate taxation
   3.2.3 Estimating tax reaction functions

Reading list:

Wilson, J. (1999), "Theories of tax competition", National Tax Journal 52, 269-304
Module 4  **Transfers: Objectives, kinds and effects**

4.1. Objectives of transfers

4.2. Kinds of transfers

4.3  Equalisation transfers: theoretical grounds
    4.3.1  Equity grounds
    4.3.2  Efficiency grounds
    4.3.3  Other grounds

4.4  Formulating equalisation transfers
    4.4.1  Fiscal capacity equalisation
    4.4.2  Needs expenditure equalisation
    4.4.3  Kinds of transfers in practice

4.5  Effects of transfers

**Reading list:**


Canavire Bacazerra, G. and Zuñiga, N.G. (2010), Fiscal Transfers a Curse or Blessing? Evidence of Their Effect on Tax Effort for Municipalities in Sinaloa, Mexico, Workingpaper 10/30, Andrew Young School of Policy Studies, George State University.


Module 5  **Fiscal decentralization and public debt**

5.1  Bailout expectations and subcentral public debt
5.2  Empirical predictions
    5.2.1  The effects of bailout expectations on fiscal discipline
    5.2.2  Bailout expectations, size and public debt.

**Reading list:**


Tyrefors Hinnerich, B (2009), “Do merging local governments free ride on their counterparts when facing boundary reform?”, *Journal of Public Economics* 93, 721-728