10.1 The distribution of government spending has changed dramatically over time in the United States.

Local state and spending have declined considerably.

Much state and local spending now supported by intergovernmental grants.

- **Intergovernmental grants**: Payments from one level of government to another.
State and Local Spending in the United States, 1902–2010
### Spending and Revenue of State and Local Governments

<table>
<thead>
<tr>
<th></th>
<th>Spending</th>
<th>Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>State $/PC</td>
<td>State $/PC</td>
</tr>
<tr>
<td><strong>Education spending</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AK</td>
<td>3,010</td>
<td></td>
</tr>
<tr>
<td>MA</td>
<td>2,643</td>
<td></td>
</tr>
<tr>
<td>TN</td>
<td>1,50</td>
<td></td>
</tr>
<tr>
<td><strong>Health care spending</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DC</td>
<td>10,349</td>
<td></td>
</tr>
<tr>
<td>LA</td>
<td>6,759</td>
<td></td>
</tr>
<tr>
<td>UT</td>
<td>5,031</td>
<td></td>
</tr>
<tr>
<td><strong>Income taxes</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NY</td>
<td>2,311</td>
<td></td>
</tr>
<tr>
<td>MT</td>
<td>854</td>
<td></td>
</tr>
<tr>
<td>Many</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td><strong>Sales taxes</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DC</td>
<td>1,847</td>
<td></td>
</tr>
<tr>
<td>Iowa</td>
<td>698</td>
<td></td>
</tr>
<tr>
<td>Many</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>
### Fiscal Federalism Abroad

<table>
<thead>
<tr>
<th>Country</th>
<th>Spending (% of all)</th>
<th>Revenue (% of all)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>0.0</td>
<td>0.8</td>
</tr>
<tr>
<td>Portugal</td>
<td>13.7</td>
<td>5.5</td>
</tr>
<tr>
<td>France</td>
<td>20.3</td>
<td>12.1</td>
</tr>
<tr>
<td>Norway</td>
<td>33.5</td>
<td>11.9</td>
</tr>
<tr>
<td>United States</td>
<td>50.0</td>
<td>35.7</td>
</tr>
<tr>
<td>Denmark</td>
<td>63.3</td>
<td>24.7</td>
</tr>
<tr>
<td>OECD Average</td>
<td>24.8</td>
<td>26.5</td>
</tr>
</tbody>
</table>

- Many countries engage in fiscal equalization.

- **Fiscal equalization**: Policies by which the national government distributes grants to subnational governments in an effort to equalize differences in wealth.
EVIDENCE: Evidence for Capitalization from California’s Proposition 13

• California’s Proposition 13 became law in 1978.
  o Set the maximum amount of any tax on property at 1% of the “full cash value.”
  o Full cash value: Value as of 1976, with annual increases of 2% at most.

• Reduced property taxes immensely in some areas, little change in others.
Each $1 of property tax reduction increased house values by about $7, about equal to the PDV of a permanent $1 tax cut.

In principle, the fall in property taxes would result in a future reduction in public goods and services, which would lower home values.

The fact that house prices rose by almost the present discounted value of the taxes suggests that Californians did not think that they would lose many valuable public goods and services when taxes fell.
Tools of Redistribution: Grants

Private goods spending (thousands)

<table>
<thead>
<tr>
<th>Private goods spending (thousands)</th>
<th>Education spending (thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,000</td>
<td>0</td>
</tr>
<tr>
<td>500</td>
<td>500</td>
</tr>
</tbody>
</table>

IC1
Chapter 10: State and Local Government Expenditures

10.3 Matching Grants

Diagram showing the relationship between private goods spending and education spending. The diagram includes indifference curves (IC1, IC2) and points A, B, X, Y, and C. The axes represent private goods spending (thousands) on the vertical axis and education spending (thousands) on the horizontal axis. The graph illustrates how matching grants affect the allocation of resources between private goods and education spending.
### Block Grant

**Diagram Description:**
- **Private goods spending (thousands):** The Y-axis represents private goods spending in thousands of dollars, ranging from $0$ to $1,375$.
- **Education spending (thousands):** The X-axis represents education spending in thousands of dollars, ranging from $0$ to $2,000$.
- **Points and Lines:**
  - **Point A:** Initial equilibrium point before any change.
  - **IC$_1$ and IC$_3$:** Indifference curves indicating combinations of private goods and education spending.
  - **Income effect and Substitution effect:** Arrows indicating changes in consumption due to changes in income and relative prices.
  - **Points X, Y, and Z:** Representing changes in consumption due to different policy changes or shocks.

**Key Concepts:***
- **Income effect:** Change in consumption resulting from a change in income while prices remain constant.
- **Substitution effect:** Change in consumption resulting from a change in relative prices while income remains constant.

**Example:**
- **IC$_1$:** Represents a lower level of education spending with a higher level of private goods spending compared to IC$_3$.
- **Income effect:** Moving from A to Y, the household consumes more private goods and less education spending due to an increase in income.
- **Substitution effect:** Moving from Y to Z, the household consumes less education spending and more private goods spending due to a relative price change in favor of private goods.
Conditional Block Grant
If residents perceived that property taxes were “too high” in California, why did they wait until 1978 to lower them?

- Proposition 13 actually a response to school finance equalization in California.
- Taxes no longer financed local school spending; just taxes, rather than prices. Tax price became infinite.
- Voters were happy to limit property taxes once those taxes no longer brought them any benefit.
after the election, districts where the measure just passed spend about $1,000 more per pupil, essentially all of it in the capital account.31

Panel A of Table IV presents estimates of the intent-to-treat effect of bond passage on district spending and on state and federal transfers (all in per-pupil terms) over the six years following the election, using equation (7).32 Bond passage has no significant effect on any of the fiscal variables in the first year. We see large increases in capital expenditures in years 2, 3, and 4. These increases fade by the fifth year following the election. There is no indication of any effect on current spending in any year, and confidence intervals rule out effects amounting to more than about

31. It is possible that districts use bond revenues for operating expenses but report these expenditures in their capital accounts. The CCD data are not used for financial oversight, so districts have no obvious incentive to misreport.

32. We make one modification to equation (7): We constrain the r = 0 coefficients to zero. It is not plausible that bond passage can have effects on that year’s district budget, which will typically have been set well before the election. In any case, results are insensitive to removing this constraint.
uniformly significant after year 0. The estimates indicate that the TOT effect of bond approval in year $t$ is to increase average prices by 2.8%–3.0% that year, 3.6%–4.1% in year $t + 1$, 4.2%–8.6% in years $t + 2$ through $t + 5$, and 6.7%–10.1% in $t + 6$. Figure VI plots the coefficients and confidence intervals from the two dynamic specifications, showing estimates out to year 15. The recursive estimator shows growing effects through almost the entire period, whereas the one-step estimator yields a flatter profile. Confidence intervals are wide, particularly for the recursive estimator in later periods, and a zero effect is typically at or near the lower bound of these intervals.\footnote{We have also estimated models that constrain the TOT to be constant over time. With our one-step estimator, we obtain a point estimate of 4.9% and a standard error of 1.7%.

As discussed in Section IV, the TOT estimators assume that house prices are unaffected by the likelihood of a future bond

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure_v.png}
\caption{Log Housing Prices by Vote Share, One Year before and Three Years after Election}
\end{figure}
Local Public Spending

Private spending $C$

Median voter preference

Median voter outcome

Education spending $G$

$y$

$C$

$O$

$G$

$y$
Matching grant

Private spending $C$

Education spending $G$

$G$ increase to $G'$ through substitution and income effect

$C'$

$C$

$O$

$G$

$G'$

$y$

$2y$ Education spending $G$
Education spending $G$ increases to $G'$ through income effect.
Conditional Block grant

Same effect as block grant