

Economics Seminar, Indian Statistical Institute, New Delhi.

SPEAKER: Gerhard Glomm, Indiana University

TITLE: Public Budget Composition, Fiscal (De)Centralization and Welfare

TIME: 3:30-5:00 P.M.

DAY & DATE: Tuesday, 16th December 2008

PLACE: Seminar Room 2

Abstract:

This paper studies the optimal degree of fiscal decentralization in a dynamic general equilibrium model of a federal economy where governments decide optimally on budget size (tax rate) and its allocation between public education and infrastructure spending. Infrastructure productivity can differ across regions. This assumption (well supported by empirical evidence) highlights regional heterogeneity in a previously unexplored dimension. We find that full centralization of tax and expenditure policies is the optimal fiscal arrangement when infrastructure spending productivity is similar across regions. When regional differences are not too large, the partial centralization regime (common tax rate but region specific budget allocations) is optimal. Only when the differences are sufficiently large does full decentralization become the optimal regime. National steady state output, on the other hand, tends to be highest under full decentralization. The paper provides a theoretical justification for the mixed results of empirical studies testing the Oates conjecture by showing that under reasonable parameter values, full centralization dominates partial decentralization, despite being inferior to complete decentralization.

<http://www.isid.ac.in/~pu/seminar.html>