Activity: Local Public Goods
Econ 308

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1 Gruber 10.10: Assessing Tiebout

Suppose that appetite for education is uncorrelated across generations: children with a thirst for learning can be born into families that don't share that bent, just as readily as a child born into a highly educated family may have no interest in school. Consider the public good of education from the perspective of students who will use their local education system as a way to invest in their future human capital. What potential implications will a mismatch in parent and student appetite for education have for the efficiency of a Tiebout equilibrium in the funding of schools through local property taxes?

In eq'm, there will be a match among parents who care about education & are among parents who don't, but 50% of the students will be misallocated.

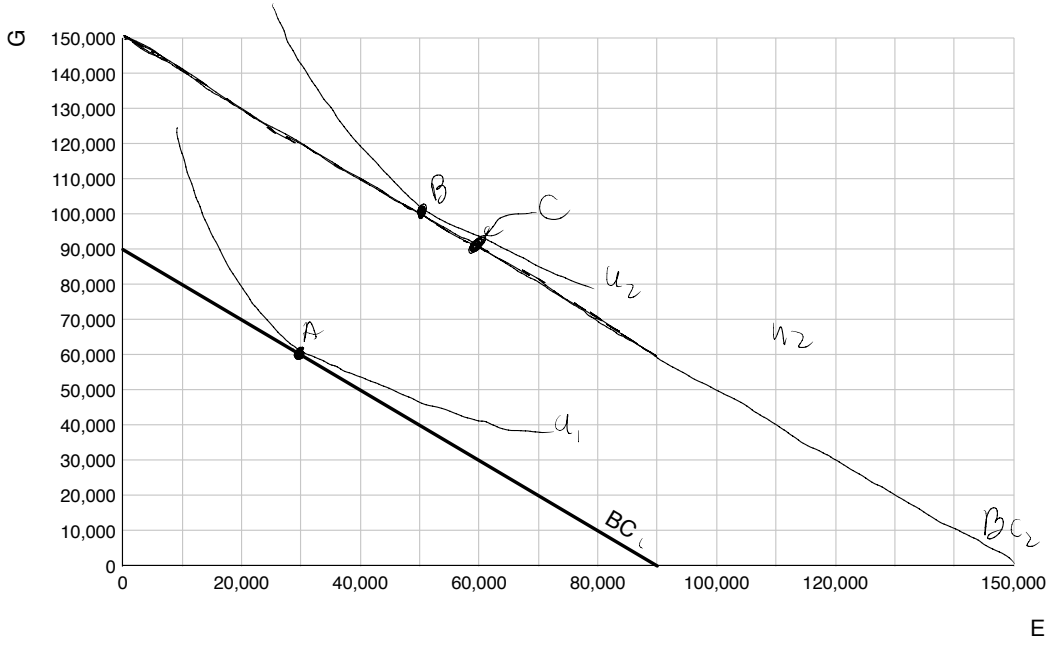
Property taxes will thus be allocated inefficiently for the purposes of education.

2 Block Grants

The city government of Grantsburg must choose how to allocate the city budget of \$90,000 between units of educational quality (E) and all other public goods (G). The city's preferences (i.e., those of the median voter) over E and G are given by:

$$U(E, G) = \ln(E) + 2 \cdot \ln(G)$$

For simplicity, let the unit prices of E and G both equal \$1 so that we can interpret E and G as levels of spending. The city's budget constraint, BC, is depicted below.



a. Determine Grantsburg's choice of E and G. Label this choice as point A in the figure.

$\frac{2E}{G} = 1$ $\quad G = 2E$ $\quad E + 2E = 90K$ $\quad E = 30K$ $\quad G = 60K$

b. If the city is given a \$60,000 unconditional block grant from the state, what is Grantsburg's new choice of E and G? Draw the new budget constraint BC' and label the new choice as point B in the figure.

$E = 50K$, $G = 100K$

c. Finally, suppose that the \$60,000 block grant is conditional — it must be spent on education. Label Grantsburg's choice with this policy as point C in the figure.

$B = C$