

Lutz (2010): Taxation with Representation

Kaden Grace

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THE UNIVERSITY OF
TENNESSEE
KNOXVILLE

Why Do We Care?

- Policy: The manner in which grants are implemented can render them ineffective.
- Economics: Do governments behave as individuals (B&O) or not (flypaper)?

Data

- Grants by municipality and school district
- Municipal taxes
- School district finances
- Municipal population and demographics
- Municipality excluded if students < 200

Methodology and Research Design

- Estimate effect of grant per-pupil on local spending per-pupil.
- Threats: municipal economic shocks, endogenous in-migration, statistic misreporting.
- Knight (2002) political bias doesn't apply - grants are formulaic.
- Solution: instrument grant per-pupil with exogenous reform spending.



Contribution

- Plausible natural experiment that closely follows B&O's assumptions
 - Pure unconditional lump-sum grants
 - The decisive voter is fully aware of the reform
 - Budget decisions reflect the decisive voter's preferences
- Main result: \$1 of grant income reduces local funding by \$0.81.
 - Further restricting the sample to towns that purely match the theory gives an estimate of \$0.93.
- B&O's crowd-out theory is validated.

Things I Liked

- Uses natural experiment to evaluate theory under ideal circumstances.



Concerns

- Sample restriction to municipalities of < 200 students - unclear how restrictive this is

Extension

- If B&O crowding-out occurs under ideal circumstances, what causes the flypaper effect?
- Look at other situations where one assumption is clearly violated.

