

Lecture on “Empirical Fiscal Federalism”

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Federal and unitary countries alike share multi-level public finance structures where sub-central government units – states/regions at the intermediate level, and districts/municipalities at the lowest level – have an independent role in taxation and public service provision, and the past decades have seen a trend towards greater fiscal decentralization around the globe (the “silent revolution”). Subnational governments account for around one-quarter of total government spending, with the bulk of subnational spending being on education, social protection, public transportation, housing and community amenities, and raise own revenues from various income, consumption, and property taxes. Empirical research on fiscal federalism issues has been growing in recent years due to the increasing availability of data on sub-central budgets and the concomitant development of sharp econometric methods relying on clear strategies for identification of key causal effects. This lecture reviews the recent empirical work in this area, focusing on horizontal fiscal externalities – that is, externalities that arise among same-tier authorities and give rise to tax, expenditure or yardstick competition – and on the main issues that arise concerning the specification, estimation, and interpretation of spatial fiscal reaction functions.