The Implications of Inequality for Fiscal Federalism (or Why the Federal Government Should Pay for Local Public Schools)

Brian Highsmith

Buffalo Law Review

ESSAY

The Implications of Inequality for Fiscal Federalism (or Why the Federal Government Should Pay for Local Public Schools)

BRIAN HIGHSMITH†

ABSTRACT

In designing public policy, a question of first principle is the degree to which government services—and the mechanisms of collecting revenue to finance those services—should be centralized within and across political systems. To inform their assessments of where redistribution should properly occur, public finance researchers have, to date, worked backwards from different assumptions about the mobility of residents within the political community. Scholars have disagreed about the viability of local governments' efforts to redistribute wealth—with traditionalists arguing that these efforts are made impossible by residential mobility, and recent reformists countering that limitations on mobility indeed allow for limited redistribution at the local level.

But these arguments have largely sidestepped questions about

---

what level of centralization is theoretically optimal for redistributive programs. And by focusing on the empirical question of residential mobility, they have ignored a variable that—I seek to demonstrate—is at least as important. In this Essay, I argue that those two deficiencies in the literature are connected. I introduce a simple model to show that economic redistribution becomes more difficult—indeed, approaches impossibility—as economic inequality increases, regardless of one's assumptions about levels of mobility (by the rich or poor). That is because economic inequality has an inherent spatial dimension: so long as citizens exhibit anything short of perfect mobility (and perfect responsiveness to redistributive policy), its rise will result in an increasing geographic concentration of fiscal resources available to governments. For this reason, higher levels of economic inequality strengthen the case for centralizing the financing of any public good or program with redistributive goals—including the great bulk of what contemporary governments aim to do.

I introduce the concept of a "fiscal unit" to refer to the geographic scope of public financing—which might be, depending on the program, a school district boundary, a county, a state, or the entire country. In order to achieve an equitable allocation of public goods, policymakers should respond to rising income inequality by shifting the site of revenue collection to occur at widely drawn "fiscal units". This can take two forms. It can be done by expanding the scope of fiscal boundaries—for example, by funding locally-administered programs at the state or federal level. Alternatively, policymakers could respond to inequality by increasing fiscal transfers from higher levels of government (wider fiscal units) to lower, geographically smaller governments.

Rather than an afterthought, the existing level of economic inequality within a political community may be the single most important question for this aspect of policy design. Where wealth is unequally distributed, the primary responsibility of assessing the revenues used to finance public goods should be assumed by levels of government representing the greatest number of people. This paper thus suggests that policymakers should respond to rising income inequality by shifting not only the burden but also the site of redistributive taxation.

I. INTRODUCTION

In recent years, American states, counties, and municipalities have undertaken aggressive efforts to shift the cost of operating their courts and criminal punishment systems onto heavily-policed communities. Facing political and economic pressures, they have constructed elaborate

systems to extract onerous payments from vulnerable families already living on the margins.[1] As a result of these efforts, people who have contact with the criminal legal system are frequently left with unaffordable debts that create acute hardship for vulnerable families and extract wealth from poor communities. This injustice has many causes, but it is perpetuated by the fiscal policy decision to fund local courts *locally*—through revenue assessed from residents who are cycled through the legal system—rather than through redistributive taxes on sources of income and wealth, including from people and corporations outside the distressed communities that are targeted by law enforcement. As one recent report concluded, "many local governments have become more reliant on [revenues from fines and fees], in part because state financial support for municipal services has eroded . . . ."[2] It is for this reason that many civil rights advocates fighting the imposition of court debt have organized around a call to fund judicial systems from general revenues collected at the state level.[3]

A similar dynamic has resulted in sharp funding disparities across local school districts. Because American public schools receive, on average, around half of their funding from local tax revenues,[4] schools in high-poverty

---

1. *See* Laura I. Appleman, *Nickel and Dimed into Incarceration: Cash-Register Justice in the Criminal System*, 57 B.C. L. Rev. 1483, 1540 (2016) ("Rising expense in the criminal justice system and shrinking public budgets have resulted in a cost transfer from state and county courts to those arrested, indicted, and convicted, imposing a heavy burden of criminal justice debt on a largely indigent population.").

2. Michael Leachman et al., *Advancing Racial Equity With State Tax Policy*, CTR. ON BUDGET & POLICY PRIORITIES 17 (Nov. 15, 2018), https://www.cbpp.org /sites/default/files/atoms/files/11-15-18sfp.pdf.

3. CRIMINAL JUSTICE POLICY PROGRAM, CONFRONTING CRIMINAL JUSTICE DEBT: A GUIDE FOR POLICY REFORM 12 (2016), http://cjpp.law.harvard.edu /assets/Confronting-Crim-Justice-Debt-Guide-to-Policy-Reform-FINAL.pdf ("To avoid creating incentives for courts and localities to fund themselves based on criminal justice debt, the judicial system should be fully funded by the state.").

4. PHYLLIS MCCLURE ET AL., CENTER FOR AMERICAN PROGRESS, ENSURING EQUAL OPPORTUNITY IN PUBLIC EDUCATION: HOW LOCAL SCHOOL DISTRICT

districts are persistently underfunded relative to their high-income neighbors—despite those districts' being tasked with educating more students in need of additional support than wealthier districts.[5] In Pennsylvania, the highest poverty school districts spend *33 percent* less educating their children than the wealthiest districts, entrenching opportunity disparities across communities within the state.[6] America is thus one of only a handful of developed countries that allows the economies of local areas to determine the quality of schools in that area.[7]

The American system of public schools, funded by local property taxes, was adopted by most states during the 19th century—a time during which, among white colonialists, "incomes were more equally distributed . . . than in any other place that can be measured."[8] As a result, "this system of using property taxes to pay for local schools did not [initially] lead to much inequality."[9] But as economic inequality increased, so did funding gaps between schools in rich and

FUNDING PRACTICES HURT DISADVANTAGED STUDENTS AND WHAT FEDERAL POLICY CAN DO ABOUT IT, 1, (2008), https://cdn.americanprogress.org/wp-content /uploads/issues/2008/06/pdf/comparability.pdf ("Nationwide, local school districts account for about 50 percent of all public school operating costs.").

5. *See, e.g.*, Alana Semuels, *Good School, Rich School; Bad School, Poor School: The Inequality At The Heart Of America's Education System*, THE ATLANTIC (Aug. 25, 2016) https://www.theatlantic.com/business/archive/2016/08 /property-taxes-and-unequal-schools/497333/.

6. Press Release, *Secretary Duncan, Urban League President Morial to Spotlight States Where Education Funding Shortchanges Low-Income, Minority Students*, https://www.ed.gov/news/media-advisories/secretary-duncan-urban-league-president-morial-spotlight-states-where-education-funding-shortchanges -low-income -minority-students.

7. *See* ORG. FOR ECON. CO-OPERATION & DEV., EDUCATION AT A GLANCE 2013: OECD INDICATORS, (2013), https://www.oecd.org/education/eag2013%20(eng)— FINAL%2020%20June%202013.pdf.

8. PETER H. LINDERT & JEFFREY G. WILLIAMSON, UNEQUAL GAINS: AMERICAN GROWTH AND INEQUALITY SINCE 1700 (2016).

9. *See* Semuels, *supra* note 5 ("In 1890, property taxes accounted for 67.9 percent of public-education revenues in the U.S. This means that as America urbanized and industrialized and experienced more regional inequality, so, too, did the schools. Areas that had poorer families or less valuable land had less money for schools." (emphasis in original)).

poor American communities.[10] The size of district boundaries mattered significantly: states that funded their school systems at the local district level experienced greater difficulty equalizing funding, compared to those that funded districts at the (higher) county level.[11] In an opinion dissenting from the Court's rejection of constitutional challenge to this system, Justice Marshall observed that the resulting scheme "arbitrarily channels educational resources in accordance with the fortuity of the amount of taxable wealth within each district."[12] As a result of this design, "countless children unjustifiably receive inferior educations that may affect their hearts and minds in a way unlikely ever to be undone."[13]

These examples illustrate the relationship between economic segregation and spatial constraints on governments' ability to provide public goods of a redistributive nature. In this Essay, I develop a simple model that illustrates the ways that economic inequality increases the stakes of the boundary drawing exercise, with respect to the possibilities for redistribution. I introduce the concept of a "fiscal unit" to refer to the geographic scope of public financing—which might be, depending on the program, a school district boundary, a county, a state, or the entire country. I show that where financial transfers across fiscal units are limited—whether by political incentives or legal structures or some other constraint—the existence of enduring economic segregation places a ceiling on the policy goal of redistribution. Thus, in order to achieve a policy of effective redistribution, a political community facing high levels of economic inequality must either (1) expand the geographic scope of the fiscal unit such that it includes both

---

10. *Id.*

11. *See id.*

12. San Antonio Indep. Sch. Dist. v. Rodriguez, 411 U.S. 1, 71 (1973) (Marshall, J., dissenting).

13. *Id.* at 71–72 (quoting Brown v. Bd. of Educ, 347 U.S. 483, 494 (1954)).

the poor and the wealthy, or (2) transfer economic resources across fiscal units.

Surprisingly, this relationship has not been explored in the theoretical fiscal federalism literature. As described in Part III *infra*, public finance scholars have theorized the viability of local governments' efforts to redistribute wealth to be determined by residential mobility; they have largely overlooked the importance of economic inequality and resulting geographic concentrations of wealth.[14] To inform their assessments of where redistribution might properly occur, public finance researchers have, to date, worked backward from different assumptions about the mobility of residents within the political community.[15] Over decades, something of a consensus had formed among public finance scholars that high degrees of residential mobility will undercut—indeed, make near impossible—localities' efforts to redistribute wealth. These orthodox models of decentralization argued that location-mobility limits the possibility of local redistribution because high-income people will exit—and that residential mobility thus serves as a disciplining measure for local governments. This view has been criticized in recent years, on the grounds that residents are not perfectly mobile, and thus—all else equal—local governments can engage in some amount of redistribution without risking the sort of "death spiral" predicted by previous scholars.[16]

But both of these stories underemphasize—or altogether overlook—the existing level of resource inequality within the political community. This omission has limited the literature

---

14. *See infra* Part III for a discussion of how existing theoretical accounts unduly emphasize mobility and while overlooking the importance of economic inequality.

15. *See id.*

16. See Clayton P. Gillette, *Local Redistribution, Living Wage Ordinances, and Judicial Intervention*, 101 Nw. U. L. Rev. 1057 (2007). *See also infra* Part III for a discussion of how the public finance scholarship has considered the viability of local governments' efforts to redistribute wealth.

in important ways and led to curious results. For example, although the contours of the general framework have been contested at the margins, over the years the literature has generally coalesced around what Wallace Oates identified as the "basic principle of fiscal decentralization: the presumption that the provision of public services should be located at the *lowest level* of government encompassing, in a spatial sense, the relevant benefits and costs."[17] This is precisely the opposite recommendation as what results from the framework I introduce, at least where economic inequalities are pronounced.

Indeed, this framework demonstrates that we don't have to settle the empirical debate about location-mobility to ascertain the implications of economic inequality for fiscal federalism design. I show that in the presence of economic segregation, narrowly-drawn fiscal units will decrease the share of the population that is able to access the wealth held by the "superearners" (as my model terms the wealthiest few). For instance, district lines prevent taxes assessed from wealthy homeowners in Chester County, Pennsylvania, from funding school systems educating poor students in neighboring Philadelphia (the highest-poverty large city in America).[18] I show that the case for centralizing mechanisms of revenue collection is strong, given the current distribution of economic resources across fiscal units. Additionally, I demonstrate that this recommendation is not contingent on any given level of mobility within a system.

This finding is relevant today. Over the past several decades, income gains have accrued disproportionately to a

---

17. Wallace E. Oates, *An Essay on Fiscal Federalism*, 37 J. ECON. LIT. 1120, 1122 (1999); *see also id.* at 1120 (defining fiscal federalism as concerning itself with "understand[ing] which functions and instruments are best centralized and which are best placed in the sphere of decentralized levels of government").

18. *See* THE PEW CHARITABLE TRS., PHILADELPHIA'S POOR 1 (2017), https://www.pewtrusts.org/-/media/assets/2017/11/pri_philadelphias_poor.pdf ("Poverty is one of Philadelphia's most enduring problems. At 25.7 percent, the poverty rate is the highest among the nation's 10 largest cities.").

small number of extremely high-income individuals.[19] Today, the richest 0.1 percent of Americans hold 22 percent of the country's wealth—the same share held by the bottom 90 percent of the population—a level not seen since the 1920s.[20] Indeed, few trends have received greater attention both in legal and economics literature as well as in our political discourse.[21] But these two literatures—on the proper assignment of redistribution in a federalist system and the implications of rising economic inequality—have developed separately, and not often been connected. This Essay attempts to help close that gap.

Public finance scholars have recognized that we should respond to rising income inequality by shifting the relative *burden* of taxation upward, through higher rates on superearners.[22] This article suggests that this response is insufficient, provided that policymakers do not also shift the *site* of redistributive taxation. In particular, in order to achieve an efficient and equitable allocation of public goods, policymakers should respond to rising income inequality by shifting the site of taxation to higher levels of government.

---

19. For a review of these trends, see CHAD STONE ET AL., CTR. ON BUDGET & POLICY PRIORITIES, A GUIDE TO STATISTICS ON HISTORICAL TRENDS IN INCOME INEQUALITY, (2016), https://www.cbpp.org/sites/default/files/atoms/files/11-28-11pov_1.pdf (showing that households in the middle and lower parts of the income distribution have seen their income growth slow sharply, while incomes at the very top have experienced sharp growth).

20. Emmanuel Saez & Gabriel Zucman, *Wealth Inequality in the United States Since 1913: Evidence From Capitalized Income Tax Data* 131 QUARTERLY J. ECON., 519, 520–21 (2016).

21. *See, e.g.*, Barack Obama, President of the United States, Remarks on the Economy (Dec. 4, 2013), *in* WASH. POST, https://www.washingtonpost.com/politics /running-transcript-president-obamas-december-4-remarks-on-the-economy/201 3/12/04/7cec31ba-5cff-11e3-be07-006c776266ed_story.html?utm_term=.3362a0a 77d6d (last visited May 22, 2019) (referring to economic inequality as "the defining challenge of our time").

22. *See, e.g.*, Thomas Piketty & Emmanuel Saez, *Optimal Labor Income Taxation*, *in* 5 HANDBOOK OF PUBLIC ECONOMICS 391 (Alan J. Auerbach et al., eds. 2013) (postulating that "for a given profile of social welfare weights . . . the higher the pre-tax inequality . . . the higher the optimal tax rate.").

II. A BASIC MODEL OF FISCAL FEDERALISM

By definition, one consequence of economic inequality is that an increasing share of the country's wealth is held by a small group of people, at the top of the income scale—a greater concentration of wealth *among people*. As inequality increases within a community, a greater share of its total economic resources will be held by a given share of its members. No logic is required to reach this result; it simply is one definition of inequality. Figure 1 presents a visual representation of this relationship.

FIGURE 1.   The Spatial Dimension of Economic Inequality*
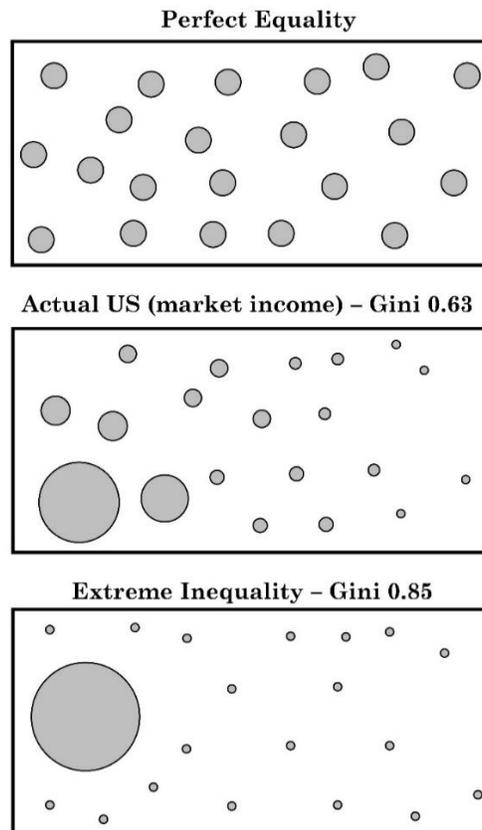
*Figure 1 is a graphical representation of outputs generated from a simple model of different distributions of wealth across an economy. As noted in the text, the size of the circles (the geometric area) corresponds to the amount of wealth held by representative households. The model and respective outputs are on file with the author.

In this Figure, as well as the others in this section, the size of the circles represents the amount of wealth held by members of the political community. I have plotted these figures such that the total wealth in the community (the summed area across all the circles) is held constant throughout all examples at 1,500 units, but wealth concentration varies across the twenty members of this community. I calculated the size of the different circles to match the levels of wealth concentration corresponding to various Gini coefficients, the most common measure of inequality.[23]

A. *Rising Inequality Results in a Higher Geographic Concentration of Wealth*

Figure 1 visually depicts what happens as wealth becomes increasingly concentrated—moving here from perfect equality, to the level of actual concentration of 2013 market incomes in the U.S.[24], to an illustrative extreme level of inequality. In the "extreme inequality" scenario, used throughout this section, a single "superearner"—one of twenty in the community, and thus the top 5 percent—holds 90 percent of total wealth for comparison, the top 10 percent of Americans held 77 percent of the country's wealth in 2012, according to estimates by Emmanuel Saez and Gabriel Zucman.[25]

The advantage of this visual representation is that it shows the spatial dimension of economic inequality. Whatever other effects inequality might have on a political community, it is clear—indeed, it is mathematically true— that one consequence of rising inequality is a *geographic*

---

23. *See generally* Robert Dorfman, *A Formula for the Gini Coefficent*, 61 REV. ECON & STAT.146 (1979).

24. CONG. BUDGET OFFICE, THE DISTRIBUTION OF HOUSEHOLD INCOME AND FEDERAL TAXES, 2013 (2016), https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51361-householdincomefedtaxes.pdf.

25. Saez & Zucman, *supra* note 20, at 520–21.

concentration of wealth.[26] This relationship was recently noted by sociologist Robert Manduca: "Because people live in places, and because people are distributed unevenly across places with respect to income or any other social characteristic, changes in the distribution of income among people will necessarily change the distribution of income across places."[27] This insight has public finance implications, for one simple reason: at least with respect to income taxes, people are indivisible—each dollar they earn is generally subject to income taxation only once per level of government, based on location at a moment in time (either of the income source or geographic domicile).[28] Although these superearners' consumption choices are not bound to a specific geographic area—and the cumulative economic effects of inequality are thus uncertain with respect to geography (though certainly biased in the direction of concentration)—it is possible to make a clear statement about the spatial dimension of economic inequality for the purpose of person-based taxation. Rising economic inequality *necessarily* results in a higher degree of geographic clustering of fiscal resources, particularly as assessed through person-based taxes.

The implications of this simple observation are particularly notable in light of recent economic trends. After all, these extremely wealthy individuals are mostly located in a handful of locations, rather than distributed across the country—and thus are outside the reach for many local jurisdictions in an inevitable geographic sense. Further,

---

26. As explained below, this is different from economic *segregation*, which follows from wealth concentration only under certain mobility assumptions.

27. Robert Manduca, *The Contribution of National Income Inequality to Regional Economic Divergence*, 97 SOC. FORCES 1, 7 (2019).

28. Although this is true as a matter of aspirational tax policy (so as to avoid taxing the same income multiple times), jurisdictions take different approaches to taxing different types of income, and the legal reality can be somewhat more complicated. *See, e.g.*, Edward A. Zelinsky, *Defining Residence for Income Tax Purposes: Domicile as Gap-Filler, Citizenship as Proxy and Gap-Filler*, 38 MICH. J. INT'L L. 271 (2017).

these superearners are perceived by policymakers to be highly mobile, and thus difficult for state and especially local governments to tax—meaning that their wealth stands outside these governments' reach in an important practical sense.[29] Their perceived potential flight risk makes it more "expensive" for local and state governments, compared to the federal government, to raise from them a given dollar in revenue.[30]

B. *Defining the Fiscal Unit*

The presence of fiscal boundaries introduces a new layer to this story. Most state expenditures involve some element of what we can describe as redistribution: instances of state spending where the group of individuals who pay for the good or service does not entirely and exhaustively overlap with the user group. Where a state endeavors to pay for a publicly provided good or service, the group of individuals from whom these revenues are collected can be thought of as constituting the "fiscal unit" for that category of spending. Fiscal units, as I use the term here, are thus defined in reference to the *financers* rather than the *users* of the good, in the cases where redistribution occurs and those two groups are distinct.

Although there are many ways for a state to limit this universe of financers, the scope of a fiscal unit can *always* be

---

29. *See, e.g.,* Charles Varner & Cristobal Young, *Millionaire Migration in California: The Impact of Top Rates*, 64 Nat'l Tax J. 255 (2011); Enrico Moretti & Daniel Wilson, *The Effect of State Taxes on the Geographical Location of Top Earners: The Case of Star Scientists*, 107 Am. Econ. Rev. 1858, (2017). *But see* Cristobal Young et al., *Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data*, 81 Am. Soc. Rev. 421 (2016), (concluding, based on a review of tax returns for all million-dollar earners nationwide over 13 years, that "Millionaire tax flight is occurring, but only at the margins of statistical and socioeconomic significance").

30. This is because residential mobility effectively increases the elasticity of reported taxable income, and thus also the economic "cost" of raising taxes. *Cf.* Jon Gruber and Emmanuel Saez, *The Elasticity of Taxable Income: Evidence and Implications*, 84 J. Pub. Econ., 1, 22 (2002).

defined in reference to some geographic boundary—typically coincident to some political community (eligible residents of a particular unit of government).[31] These political communities tend to overlap in concentric circles, where higher levels of government share a common geography with multiple smaller, subsidiary units. Theories of fiscal federalism—which typically are discussed in terms of *level* of government—can therefore also be thought of as arguments about how broad, in a *spatial* sense (and more precisely, in terms of population size), fiscal units should be defined.[32]

It is important to note here that although this analysis focuses on the spatial component of inequality, the size of these "fiscal units" is defined not in reference to landmass, but rather to the number of people occupying the space. A "small" fiscal unit may be quite large in terms of geography, if its vast space includes only few people. This highlights one key analytic advantage of using the fiscal unit as our mode of analysis: under a traditional consideration of federalism, South Dakota (population 850,000) occupies a level higher than Los Angeles (3,900,000) and equal to California (39,000,000). In this model, by contrast, the fiscal units would be arranged in reference to population size within a geographic space, rather than to the size of the landmass. Accordingly, it may be the case—supported by the theory laid out here—that the *city* of Los Angeles is better able to support redistributive functions than the *state* of South Dakota. Unlike other models of federalism, the units in this model are defined in reference to the size of governed populations—rather than to the level of government in a political sense, or to the size of the geographic landmass.

---

31. That is, a state may limit the universe of financers by, for example, assessing taxes only on a certain type of income or property—but these categories will always be defined relative to some geographic boundary.

32. Others have drawn a similar distinction between the *level* of government. *See* Zachary D. Liscow, *The Efficiency of Equity in Local Government Finance*, 92 N.Y.U. L. REV. 1828, 1837 n.34 (2017) ("These other critiques have tended to focus not on what level of government should pay for local services but rather the size of the jurisdiction that should spend the money and regulate local affairs.").

One analytic contribution of this framework is thus to shift away from *centralization* debate, which refers to the proper level of government at which functions should be provided and paid for, and towards the size of the fiscal unit. This will often map onto centralization, because states will tend to be larger than local governments (both of which will always be smaller than the federal government)—but the two measures are not the same. This has two additional benefits for the purpose of this discussion. As described further below, defining the fiscal unit this way anticipates and accounts for an important objection: if the fiscal unit is defined with respect to landmass, then geographic mobility adds a new variable that must be accounted for. This definition allows us to discuss the size of fiscal boundaries without considering mobility, since residential exit and entry will—on its own—change the size of the fiscal unit. Second, the distinction between geography and population size allows for a more productive discussion because it allows you to draw conclusions, and make policy recommendations, without getting lost in some of the ancillary federalism debates that are less relevant here.

C. *Geographic Wealth Concentration Increases the Stakes of Fiscal Boundaries*

In the absence of perfect mobility, greater economic concentration across physical spaces necessarily follows from rising income concentration. Where economic resources are unevenly distributed across geography, the spatial definition of fiscal units takes on greater significance. To the extent that financial transfers across fiscal units are limited—whether by political incentives or legal structures or some other constraint—the existence of enduring economic segregation places a ceiling on the policy goal of redistribution. In the presence of economic segregation, drawing fiscal units narrowly will decrease the share of the population that is able to access the wealth held by the superearners. And when economic inequality is rising, that

wealth will constitute a growing share of the polity's total resources. Economic inequality thus raises the stakes of "fiscal splintering" for redistributive outcomes and possibilities.

This can be seen in Figure 2, which takes two of the wealth distributions presented in Figure 1 and introduces illustrative fiscal boundaries. The two scenarios in this Figure represent the extremes of wealth distribution: where wealth is distributed equally across members of the political community, and where it is highly concentrated at the top (represented here by a single superearner).

In communities where wealth is equally distributed, it makes little difference for the purposes of redistribution how many "fiscal units" are drawn, or how you draw those lines.[33] The Figure varies the population size across the four fiscal units, but—on a per capita basis—each community has the same resources, even though total wealth in the communities changes. Here, the redistributive stakes of the boundary drawing exercise are low.[34] But in the second scenario, where there is extreme inequality, the size and boundaries of the fiscal unit matter tremendously. Ninety-three percent of wealth in the political community is held by the 30 percent of the population that resides in Unit A; absent inter-unit transfers, the 70 percent of community members (in Units B, C, and D) must fund their public goods from the remaining 7 percent of economic resources.

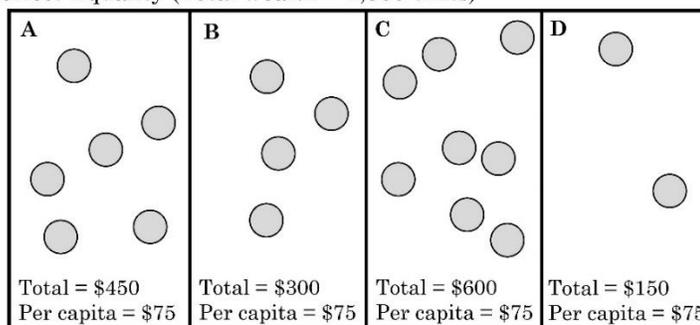The population that continues to live in the remaining,

---

33. This sets aside the reality that many redistributive public goods (especially those taking forms other than pure cash transfers) involve economies of scale or fixed costs. Schools are a classic example of this sort of mixed public good; local court systems are another. Where scale matters, then the size of the fiscal unit will have consequences even in the world where economic resources are distributed equally across community members. As Zachary Liscow has pointed out, this argument pertains more to centralized spending rather than centralized funding. *See id.* at 1830 n.3.

34. Of course, the fact that wealth is equally distributed on a market basis defeats the policy purpose for purely redistributive programs, but this basic dynamic holds true also where slight wealth variations are introduced.
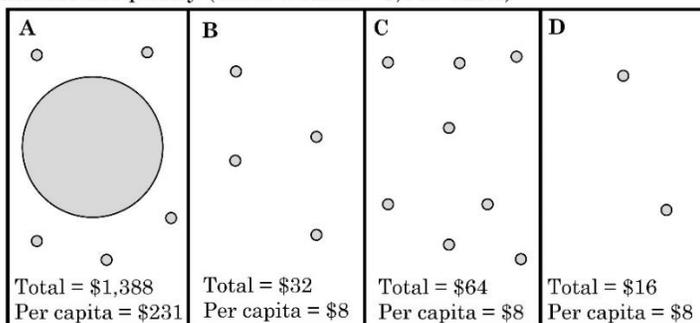
resource-poor fiscal units will be unable to access the superearners' wealth for inter-unit redistribution. If the dimensions of the polity's fiscal units do not correspondingly expand, then this sort of fiscal enclaving will thus have the effect of shrinking the share of total resources available to fund government functions serving those who does not co-occupy one of the resource-rich units. Absent inter-unit transfers, it follows that the population that lives in the "left behind" jurisdictions will be made worse-off (in an economic sense) by fiscal splintering. Indeed, in this extreme example, redistribution to these left behind community members is *impossible* without some centrally coordinated transfer of financial resources across fiscal units. As inequality rises, the world *necessarily* will look more like the second scenario.

FIGURE 2. Economic Inequality Raises the Stakes of Fiscal Boundaries*,[a]

1) Perfect Equality (Total wealth = 1,500 units)

A	B	C	D
Total = $450	Total = $300	Total = $600	Total = $150
Per capita = $75	Per capita = $75	Per capita = $75	Per capita = $75

2) Extreme Inequality (Total wealth = 1,500 units)

A	B	C	D
Total = $1,388	Total = $32	Total = $64	Total = $16
Per capita = $231	Per capita = $8	Per capita = $8	Per capita = $8

*Figure 2 is a graphical representation of outputs generated by the model utilized for Figure 1 above. The model and outputs are on file with the author.

[a]Graphical representation of wealth in a system of: 1) perfect equality wherein each of the twenty circles represents 75 units for a total of 1,500 wealth units, and 2) extreme inequality wherein each of the nineteen small circle represents 8 units and the large circle represents 1,348 units, for a total of 1,500 wealth units.

D. *Effect on different groups*

The effect of fiscal boundaries here varies across members of the community, depending on whether they co-occupy the fiscal unit with the superearner. Indeed, it is worth noting that—so long as the total amount of redistribution is held constant—fiscal splintering creates winners as well as losers. The poor families who live in the same fiscal unit as the superearners (Unit A in this model) now may enjoy the benefit of these resources without sharing with those other poor families who remain outside the unit. The effect of this is to increase their incomes, post tax and transfers, to above the level that it would be absent either redistribution or fiscal boundaries.

The departing fortunes of these two groups of poor community members—introduced by the fiscal boundaries (and based on proximity to the superearner)—highlights an additional notable relationship. This framework establishes that, where economic segregation is present, drawing subnational fiscal boundaries limits the possibilities of redistribution (absent inter-unit transfers). Figure 3 highlights an important conclusion: the presence of fiscal boundaries will tend to result in greater inequality after transfers, compared to a world where the fiscal unit is maximally large and redistribution is undertaken centrally.

Where initial fiscal resources are unequally distributed across a political community, fiscal boundaries will have the effect of limiting redistribution; over time, this will have the effect of increasing inequality compared to a world where redistribution occurs centrally. Stated differently: as long as there are some individuals who are "walled-off" from the wealth of the superearners (which will be true so long as

mobility is anywhere short of perfect, as described below), and the total level of redistribution is held constant, then narrowly-drawn fiscal units have the effect of increasing after-transfer inequality. This is illustrated in Figure 3, which shows the effect of fiscal boundaries on three different conceptual categories of community members: the superearners (described above, and shown in black); the "hangers-on" (the poor members who co-occupy Unit A with the superearner and may thus receive benefits financed by their wealth, in dark gray); and the "left-behinds" (the poor members in the remaining fiscal units, in light gray).

FIGURE 3.   Effect of Fiscal Boundaries on Different Groups
            Amid Conditions of High Inequality

1) Market Incomes[a]
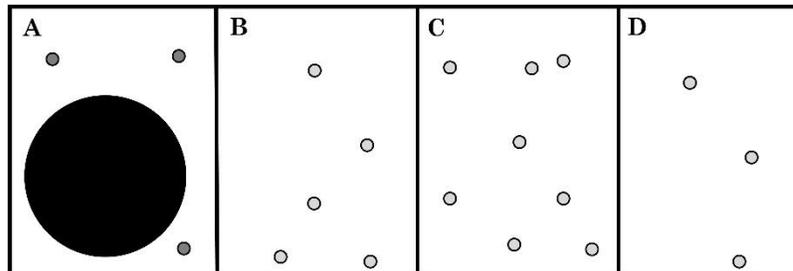
2) Post Redistribution (No Inter-unit Transfers)[b]
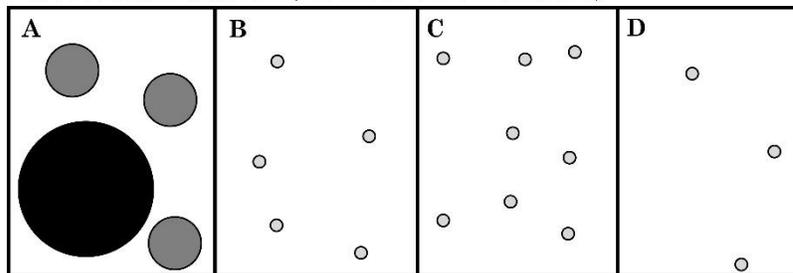
3) Post Redistribution (with Inter-unit Transfers)[c]
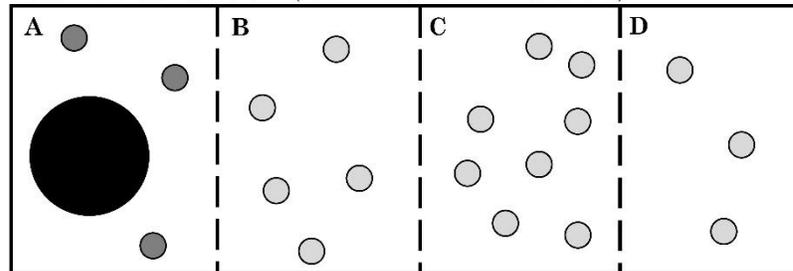
*Figure 3 is a graphical representation of outputs generated from the model utilized for Figures 1 and 2 above. The model and outputs are on file with the author.

[a]Wealth (area) of Left-Behinds: 8 (light gray); Hangers-On: 8 (gray); Superearners: 1,348 (Black). Gini coefficient: 0.85.

[b]Wealth (area) of Left-Behinds: 8 (light gray); Hangers-On: 142 (gray); Superearners: 946 (Black). Gini coefficient: 0.80.

[c]Wealth (area) of Left-Behinds: 35 (light gray); Hangers-On: 35 (gray); Superearners: 839 (Black). Gini coefficient: 0.51

To produce this Figure, I introduce a simple tax and transfer system to the extreme inequality scenario described above. Specifically, I set a flat tax—assessed on every

member in the political community, without regard to their fiscal unit—at 40 percent of economic resources. The entirety of the collected is then redistributed back to members in the form of a flat lump sum payment (akin to a universal basic income), the amount of which is calculated so as to be equal across members of the *fiscal unit*. I then recalculate wealth, inclusive of these taxes and transfers. Stated differently, the model extracts a flat-rate tax from every member in the political community, but the proceeds are collected and redistributed within the boundaries of the different fiscal units.[35]

The first scenario shows the market distribution of income, prior to tax and transfers; the next two scenarios show the effect of the redistributive tax and transfer system with and without centralized redistribution, achieved here through inter-unit transfers. Because eligibility for the transfer payments is determined centrally, the effect of the inter-unit transfers is identical to a scenario where a single fiscal unit is drawn to include the entire political community. Provided that the total amount of redistribution is held constant and the entirety of the resource is distributed without respect to unit domicile, then—at least economically—the effect is equivalent to expanding the fiscal boundary, since you are able to achieve the same redistribution.[36] Held constant in this model are total wealth, the total amount of redistribution (determined by the tax rate), and residential location (perfect absence of mobility).[37]

---

35. In this model, the government operates a purely redistributive cash transfer system, involving no economies of scale. The focus here so far has been on pure cash transfers, as they are conceptually easiest to conceive and also most straightforward to show in a model. Introducing impure or fixed cost public goods would change the numbers, but not the direction of the relationship.

36. Indeed, this is Liscow's primary policy recommendation. *See* Liscow, *supra* note 32, at 1897 ("[T]his Article's most direct policy implication is that it strengthens on efficiency grounds the case for more centralized funding of the costs of providing services in poor localities.").

37. Mobility is discussed further below, but it is worth noting here that under

As shown in Figure 3, the presence of fiscal boundaries significantly limits the effectiveness of the government's redistributive policy. Where the redistribution scheme is centralized (here through inter-unit transfers to Units B, C, and D), the Gini coefficient falls from 0.85 to 0.51—a 40 percent reduction. Where redistribution occurs only within the different fiscal units, the Gini coefficient falls only 6 percent, to 0.8. Both the superearners and the hangers-on do better in this scenario. The hangers-on receive significantly higher transfers, and therefore come out much further ahead after redistribution; although in both scenarios the superearners pay more in taxes than they receive back in benefits, they also receive higher transfers and are thus better off when redistribution is localized. But the left-behinds, who make up 80 percent of the total population, are significantly worse off without the inter-unit transfers. The effect of fiscal boundaries here is to reduce the redistributive transfers to the left-behinds and increase the transfers to the hangers-on. The effect of this is to dull the impact of the redistributive program and increase total inequality, compared to a world where redistribution is carried out centrally. This is true even though there are winners and losers, even among the non-superearners.

This basic dynamic has been observed before. Forty years ago, Richard Musgrave noted that geographic inequality would tend to have this effect over time: "The fact that High Town has a higher average income than Low Town means that local provision of social goods will tend to increase inequality among the total population, including residents of both towns."[38] Political scientist George Tsebelis made a similar observation, arguing that "federalism is likely [to] increase inequalities [because] some transfer

---

the traditional models of fiscal federalism introduced above, the case for local redistribution is *strongest* where—as here, under the assumptions of this model—citizens do not move in response to varying redistributive outcomes.

38. Richard A. Musgrave, *Economics of Fiscal Federalism*, 10 NEB. J. ECON & BUS. 3, 8 (1971).

payments are restricted within states . . . [and so where] the federation includes rich and poor states, transfers from the former to the latter are reduced compared to a unitary state."[39]

Moreover, as explained below, it has been widely observed that a primary implication of our decentralized school finance structure is to codify, and perhaps reinforce, existing economic inequalities across local school districts.[40] Although this dynamic has been recognized in the context of public education, this relationship—between static economic segregation and the proper assignment of redistribution in federalist systems—has been under-theorized. In particular, while the public finance literature has extensively covered the relationship between mobility and redistributive assignment, the implications of rising inequality have received considerably less attention.[41] And although local school systems may be the most obvious example, this framework demonstrates there is no reason to believe that the basic dynamic or relationship is not present wherever state or local governments endeavor to provide redistributive public goods.

III. EXISTING ACCOUNTS OF FISCAL FEDERAL UNDULY EMPHASIZE MOBILITY WHILE IGNORING INEQUALITY

Public finance scholars have long debated the degree to which government services—and the mechanisms of collecting revenue to finance those services—should be

---

39. GEORGE TSEBELIS, VETO PLAYERS: HOW POLITICAL INSTITUTIONS WORK 89 (2002). *See also*, Jason Sorens, *Does Fiscal Federalism Promote Regional Inequality? An Empirical Analysis of the OECD, 1980–2005*, 48 REGIONAL STUD. 239, 240 (2014) ("Some public finance economists argue that [preexisting] inequalities widen over time in fiscally federal systems, as rich regions can provide more public goods at lower cost per unit of income than poorer regions.").

40. *See generally* Liscow, *supra* note 32.

41. Liscow is an important exception. *See id.* at 1837–38 (discussing the implications of rising income inequality, and in particular differences in wealth between cities and suburbs, for local school finances).

centralized within and across political systems. To inform their assessments of where redistribution properly should occur, public finance researchers have to date worked backwards from different assumptions about the mobility of residents within the political community. But these theoretical arguments, recounted in this section, have largely sidestepped questions about what level of centralization is *optimal* for redistributive programs—and have focused on empirical questions about residents' location-mobility and responsiveness to redistribution. Researchers have worked backwards from different mobility assumptions to inform their assessments of where redistribution properly should occur—largely ignoring the dynamics described in the above framework.

This Section recounts those debates, and shows that those discussions are incomplete without reference to the degree of economic concentration within the community. This omission is no small matter, because the leading principle of fiscal federal embodies the opposite recommendation of what results from the above framework that centers inequality. Even though scholars have focused on mobility, I show that the dynamic presents itself so long as citizens exhibit anything short of perfect mobility (and perfect responsiveness to redistributive policy).

A. *The Long Shadow of Charles Tiebout*

Like so many debates in the fiscal federalism literature, the dividing lines in this one can be traced back to Charles Tiebout's famous theory of location decisions and public services.[42] His model has provided normative justification for two relevant policy recommendations. First, its logic supports a policy of dividing political jurisdictions into

---

42. *See* Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956) (arguing that, under certain assumptions, people's choice of residences could function as a way of choosing among public goods, akin to the way the market allows them to choose among private goods).

numerous—and therefore, at least on average, small—local governments, to ensure this marketplace of governments from which citizen-consumers might choose is sufficiently *large*.[43] Second, Tiebout's analysis has been used to argue for entrusting these many local governments with significant authority over the provision of public goods, to ensure that the choices provided this large marketplace are sufficiently *diverse*. Together, these recommendations support a general policy of decentralized service provision—at least with respect to the class of goods and services to which Tiebout's logic can be cleanly applied.[44]

But how broad should this category of goods be defined? Wherever the state provides a good or service to the public that incurs a budgetary cost, it must raise revenue to finance the expense, either concurrently or in the future.[45] Some state-provided goods and services are financed through a user-fee model, where the individual who pays for an unsubsidized good is also its exclusive user. But the overwhelming bulk of a state's budget items involve some element of redistribution, in the broadest sense of the term: state spending where the group of individuals who pay for the good or service do not entirely and exhaustively overlap with the user group. For many public expenditures, namely

---

43. *See* David Schleicher, *The City as a Law and Economic Subject*, U. ILL. L. REV. 1507, 1508–09 (2010) ("The normative takeaway from the Tiebout model literature is clear: metropolitan regions should be divided into many local governments that are free to provide local public services in an unrestricted way, as this will ensure that mobile citizens receive their desired package of public services.").

44. *See* Liscow, *supra* note 32, at 1836 ("The model's supporters have generally argued for decentralized provision of services, and its critics have generally argued for more centralized provision."); Oates, *supra* note 17, at 1124 ("I sense a widespread impression, suggested in some of the literature, that the gains from decentralization have their source in the famous Tiebout model").

45. Laurie Reynolds, *Taxes, Fees, Assessments, Dues, and the "Get What You Pay For" Model of Local Government*, 56 FLA. L. REV. 373, 378 (2004) ("When a local government decides to provide a service, improve or construct infrastructure, or regulate private activity, the question of how to pay will generally be an important consideration.").

cash transfer programs, achieving this redistribution is the first-order goal; for other types of expenditures, including so-called "mixed" or "impure" public goods, any redistribution that occurs is incident to other policy goals. But it nevertheless does occur: incidence of the expenditure's benefits does not perfectly match the incidence of the corresponding collected revenue.

Tiebout identified mobility, and the disciplining pressures it created for cities, as the market-like mechanism by which local public goods could be efficiently provided by local governments. Although the assumptions underlying his original model are widely recognized as rarely-encountered simplifications, they are thought to most closely approximate real-world dynamics with respect to the (narrow) class of goods that can be funded and enjoyed by the same group of residents.[46] For this reason, scholars have often distinguished in their assessments between different types of public goods—in particular between purely "local" goods and those that are fundamentally redistributive in nature.[47]

B. *Assignment of Redistribution: The Orthodox View*

Depending on empirical assumptions and normative emphasis, economists have diverged somewhat on the proper assignment of purely—or at least predominately—local government functions.[48] Perhaps more precisely, they have

---

46. Indeed, one of the key contributions of Tiebout's model was to demonstrate the existence of this class of "local public goods," for which a mechanism could exist whereby decentralized provision could result in a Pareto-efficient outcome. Prior to the publication of his article, the public finance literature had generally accepted that decentralized choice could not result in an efficient provision of public goods. *See* Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387, 388 (1954).

47. *See, e.g.*, Joseph E. Stiglitz, *The Theory of Local Public Goods Twenty-Five Years After Tiebout: A Perspective* (Nat'l Bureau of Econ. Research, Working Paper No. 954, 1982) https://www.nber.org/papers/w0954.pdf.

48. *See, e.g.*, Wallace E. Oates, *Toward a Second-Generation Theory of Fiscal Federalism*, 12 INT'L TAX & PUB. FIN. 349, 352 (2005) ("Decentralized levels of government found their primary role in the provision of efficient levels of "local"

tended to divide on the question of how broadly or narrowly these categories should properly be defined—particularly considering that, as noted, almost all government functions provide *some* spillover benefits that are "uncaptured" by the financing population, and thus some element of redistribution.[49]

With respect to redistributive goods, something of a consensus has emerged in the public finance literature: these functions ought to be assigned to the central level of government.[50] In this literature, redistribution has been

public goods—that is, public goods whose consumption was limited primarily to their own constituencies."); Laura Levaggi & Rosella Levaggi, *Devolution And Grant-In-Aid Design For The Provision Of Impure Public Goods*, 5 SPRINGERPLUS 1, 1 (2016) ("Traditional fiscal federalism theory postulates that devolution for the provision of local public goods increases welfare. However, most of the services offered at local level are local impure public goods whose characteristics may prevent devolution from being efficient."). *But see, e.g.*, Barry R. Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 J.L. ECON. & ORG. 1, 6 (1995) (arguing that service decentralization, as a general policy, limits intrusive tendencies of the public sector and supports the effective operation of private markets).

49. *See, e.g.*, Gerald E. Frug, *City Services*, 73 N.Y.U. L. Rev. 23, 25–26 (1998) ("[Cities] provide services—like police, fire, sanitation, and education—that not only can be allocated to some people at the expense of others but often are. As a result, the theory of public goods, when applied to local governments, largely consists of arguments about whether, and to what extent, it is efficient for cities to supply these kinds of 'mixed' or 'impure' public goods."); Levaggi & Levaggi, *supra* note 48, at 2 ("The traditional literature on fiscal federalism . . . argue[s] that the allocation of functions between Central and local Governments should follow efficiency principles. Production should be assigned to the tier which is better informed on local preferences, while Central Government . . . may use grants for equity and efficiency reasons."); John R. Brooks, *Fiscal Federalism as Risk-Sharing: The Insurance Role of Redistributive Taxation* 68 TAX L. REV. 89, 110 (2014) ("Another key result of classic fiscal federalism theory is that local public goods defined spatially . . . can be most efficiently provided by the government whose political lines lie most close to the spatial dimension for the local public good, all else equal."); Oates, *supra* note 17, at 1121 ("Decentralized levels of government have their *raison d'etre* in the provision of goods and services whose consumption is limited to their own jurisdictions.").

50. *See* Brooks, *supra* note 49, at 110 ("The standard view in the literature is that redistribution . . . should be exclusively allocated to the most central level of government—at the federal level, in the United States—with subnational governments focusing more on allocation of public goods and raising revenue from flatter and more stable taxes, such as a real property tax."). *See also* Richard A.

defined broadly—generally assuming some transfer across income groups, but frequently emphasizing the spatial components of the task.[51] As John Brooks has described, this theoretical consensus attaches to both the expenditure and revenue side: "[R]edistribution, and the closely related progressive income tax, should be assigned exclusively to the most central level of government in a federal system, leaving subnational governments to focus on allocation of public goods, funded with taxes tied closely to benefits."[52]

Indeed, this is frequently presented not as a policy recommendation but rather as a sort of natural rule, based on the implications of the same disciplining forces of mobility and citizen-as-consumer behavior that Tiebout identified.[53] The idea is that the mobility of economic units constrains local governments in their attempts to redistribute income in a way that does not similarly limit higher levels of government.[54] Should a local government attempt to provide

---

Musgrave, *Economics of Fiscal Federalism*, 10 NEB. J. ECON. & BUS. 3, 10 (1971) ("Adjustments in the distribution of income should be the responsibility of central policy, since it is only here that such measures can be conducted effectively and without causing severe efficiency losses."); Micheael Keen & David E. Wildasin, *Pareto Efficiency in International Taxation* 15 (Ctr. For Econ. Studies & Ifo Inst., Working Paper No. 371, 2000) (arguing that under certain assumptions, it will be Pareto-improving for the national authority to subsidize local redistribution). *But see* David E. Wildasin, *Locational Efficiency in a Federal System*, 10 REGIONAL SCI. & URB. ECON. 453, 461 (1980) ("[T]he demonstration that local tax systems are not ideally efficient is not a demonstration of the need for central government intervention—for example, in the form of inter-jurisdictional equalizing grants, as suggested by numerous writers. For such intervention is liable to introduce its own distortions and costs, and these must be weighted against the defects of the existing system.").

51. *See* Musgrave, *supra* note 50, at 4 ("The spatial incidence of social goods differs. They may thus be arranged depending on whether their benefit incidence is local, statewide, regional, or national.").

52. Brooks, *supra* note 49, at 89.

53. *See* Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 417 (1956).

54. *See* Gillette, *supra* note 16, at 1059 ("Redistributive exactions, the theory goes, should be the exclusive domain of more centralized jurisdictions—state and federal governments—from which taxpayers cannot easily exit without simultaneously giving up jobs, friends, or lifestyle.").

any significant support of low-income households, it is theorized, this choice is likely to result in both 1) an influx of poor residents seeking to avail themselves of the generous benefits, risking the transformation of redistributive localities into "welfare magnets,"[55] and 2) an exodus of those with higher incomes, who must then bear the corresponding tax burden.[56]

In an early and influential formulation of this view, James Buchanan described each resident of a metropolitan area as representing some net value to his or her community.[57] The existence of local redistribution, he argued, drives a wedge between residents' contributions and their "costs": those that would pay more taxes than they would use in services would have a positive net value, while those with lower incomes and higher service needs would have a net cost to their community.[58]

Buchanan predicted municipalities that did not make focused efforts to retain profitable residents—and make

---

55. *See id.*, at 1057, 1059 (describing and providing examples of this literature).

56. *See, e.g.*, Brooks, *supra* note 49, at 111 ("States with significant redistributive policies may become unattractive to higher-earning individuals and correspondingly more attractive to lower-earning individuals. If taxpayers are highly mobile within a nation, this could be costly to such a state, since the state would prefer the reverse—to be attractive to high-earning individuals, rather than low-earning individuals.") Charles C. Brown & Wallace E. Oates, *Assistance To The Poor In A Federal System,* 32 J. PUB. ECON. 307, 317 (1987) (arguing that local redistribution will tend to attract poor from other jurisdictions and thus increase the local price of redistribution).

57. James M. Buchanan, *Principles of Urban Fiscal Strategy*, 11 PUB. CHOICE 1, 13 (1971). *See also* Gillette, *supra* note 16, at 1070 ("[T]he underlying theory is that local residents and firms can too easily escape redistributive burdens by emigrating to localities that impose only benefit taxes. Emigrants are likely to be the relatively wealthy, who bear a disproportionate share of the redistributive burden and thus have incentives to find alternative residence. As they exit, the redistributive burden falls increasingly on those who remain, heightening incentives for them to emigrate as well. Simultaneously, the promise of redistribution attracts more beneficiaries from outside the locality, creating greater demand for the benefits of redistribution.").

58. Buchanan, *supra* note 57, at 4–5, 12.

themselves unattractive to net service consumers—could easily fall into something of a death spiral.[59] They would have to raise tax rates to pay for their service shortfalls, thereby driving away the mobile net taxpayers; this exodus would aggravate the fiscal shortfall and force further tax hikes, in turn driving away still more higher-income residents.[60] As Michelle Wilde Anderson has documented, there are many examples of this dynamic playing out much as predicted in recent decades.[61] Where core cities or older suburbs continued to have disproportionate low-income populations, the gap between service costs and available revenues has often to a vicious cycle of ever-greater service cuts followed by further out-migrations and revenue deterioration requiring further service cuts.

Even those who have not gone so far prescriptively have generally argued that mobility of individuals with higher income makes significant redistribution at the local level difficult—or even impossible—to achieve, at least as a practical matter.[62] The strong version of this argument is summarized by Clayton Gillette:

> The basis of that orthodoxy, derived from standard theories of fiscal federalism and urban economics, is straightforward: *Local governments cannot successfully or efficiently redistribute wealth.* That conclusion is predicated on a simple and compelling premise. Residents and firms that bear the burden of local redistribution can too easily exit to neighboring jurisdictions that impose only benefit-based taxes of the sort that underwrite goods and services for taxpayers themselves. Mobile residents who escape redistributive taxes impose a greater redistributive burden on those who remain, inducing them to follow suit in a continuing downward spiral.[63]

An early form of this absolute conclusion is provided by

---

59. *See id.* at 1, 12, 14.

60. *See id.* at 4–5.

61. *See* Michelle Wilde Anderson, *The New Minimal Cities*, 123 Yale L.J. 1118, 1145–48 (2014).

62. Dennis C. Mueller, Public Choice III 189–204 (2003).

63. Gillette, *supra* note 16, at 1058 (emphasis added).

Musgrave, who argued—based on the implications of residential mobility—that "[p]olicies to adjust the distribution of income among individuals must be conducted on a nationwide basis."[64] Richard Briffault has argued that local financial control may have the effect of reinforcing the consequences of initial inequalities across regions by creating a "centrifugal force," due to the sort of competitive pressures described by Buchanan.[65]

The development of this orthodoxy can be observed in the debate within the economics literature. In an early contribution, Mark Pauly argued that the assignment of redistribution to the local level allows polities to vary levels of redistribution across regions, and thus—where political preferences for redistribution vary across geographies—can promote efficiency.[66] His work called for redistribution to be carried out at the local level wherever local governments are better able to express these diverse preferences for redistribution, which could occur under his model. This result can be thought of as one application of the general principle Oates identified, which Gillette also uses to support his argument for local redistribution.[67] But economists

---

64. Musgrave, *supra* note 50 at 7. *See also id.* ("Progressive income taxation at the upper as well as transfers at the lower end of the scale—if substantial in scope—must be uniform within the entire area over which there is a high degree of capital and labor mobility, which means they have to be a function of the national government.").

65. Specifically, he predicts efforts by the affluent to physically segregate themselves from the less affluent, to deploy local land use powers to heighten the barriers to local economic integration, and to incorporate separately so as to protect their local wealth and immunize local taxpayers from regional fiscal needs and demands. *See* Richard Briffault, *The Role of Local Control in School Finance Reform*, 24 CONN. L. REV. 773, 805–06 (1992).

66. *See* Mark V. Pauly, *Income Redistribution as a Local Public Good*, 2 J. PUB. ECON. 35, 36–37 (1973).

67. *See* Oates, *supra* note 17, at 1122 ("The efficient level of output of a 'local' public good . . . is likely to vary across jurisdictions as a result of both differences in preferences and cost differentials. To maximize overall social welfare thus requires that local outputs vary accordingly."); Gillette, *supra* note 16, at 1065 ("If . . . preferences for redistribution are heterogeneous, local programs would allow a larger number of individuals to satisfy their preferences for a specific level

2019]

IMPLICATIONS OF INEQUALITY

Burbidge and Meyers later argued that, once certain of Pauly's assumptions are relaxed, diverse preferences for redistribution may lead to unequal residence-based taxation and thus actually undermine economic efficiency—that "the price of local expression of diverse preferences for redistribution may be inefficiency."[68]

A number of scholars have identified practical or political considerations—for example, the implications of legal structures that exist at the state and local level, including balanced budget requirements and constitutional tax and expenditure limitations—that function as additional constraints on local governments' ability to redistribute effectively.[69] Still others have rejected Tiebout's analytic framework on normative grounds, arguing that local governments should advance democratic values by accommodating citizens' need "to participate actively in the basic societal decisions that affect one's life."[70]

C. *Assignment of Redistribution: Recent Reconsiderations*

But the shadow of Tiebout remains long in this literature, both descriptively and for its normative implications. Against this backdrop, several legal scholars have pointed out that—despite theoretical arguments predicting that redistribution can take place only centrally—

---

of redistribution.").

68. John B. Burbidge & Gordon M. Myers, *Redistribution Within and Across the Regions of a Federation*, 27 CANADIAN J. ECON. 620, 629 (1994). Their model focuses in particular on the labor mobility assumption. (Pauly's model, like Tiebot's, had made the simplifying assumption that individuals do not work.)

69. Brooks, *supra* note 49, at 105–07 (discussing the implications of state fiscal institutions including balanced budget requirements, tax and expenditure limitations, and rainy-day funds); *See* David A. Super, *Rethinking Fiscal Federalism*, 118 HARV. L. REV. 2544 (2005) (highlighting various structural biases in state constitutional structures and arguing, among other things, that states should revise their fiscal constitutions to take account of recessions).

70. Gerald E. Frug, *The City As a Legal Concept*, 93 HARV. L. REV. 1059, 1068 (1980). *See also* Richard Briffault, *Our Localism: Part II-Localism and Legal Theory*, 90 COLUM. L. REV. 346, 399–435 (1990).

local governments are, in practice, able to achieve a significant amount of redistribution.[71]

Because these arguments stand out within the local government literature as important exceptions from the consensus that municipalities are unable to effectively achieve redistribution, it is worth noting here what leads these authors to their unorthodox conclusions. As described above, much of the case that has been made for centralization hinges on the presumed or asserted impossibility of local redistribution. That is, the theoretical arguments have not generally been made in reference to any particular benefit of centralization on its own terms—but rather as something of a default, given the combination of 1) an observed political desire to achieve redistribution, and 2) the constraints placed on local governments by mobile residents.

Gillette pushes back against the orthodoxy he summarizes by identifying several reasons why redistribution has, for some time, been "a staple of local government."[72] The asserted effect of each reason he discusses is to dull, in some way, the market-like forces of citizen mobility that Buchanan and others had identified.[73] For example, he discusses the ways that agglomeration economies—economic returns available by virtue of geographic proximity to others—might constrain the location decisions of both firms and residents, such that their responsiveness to imposed tax extractions might fall somewhere short of perfect.[74] He notes that members of a

---

71. *See supra* notes 49–52 and accompanying text for a discussion on presumed or asserted impossibility in local redistribution.

72. Gillette, *supra* note 16, at 1060 (noting that, according to 2001 Census figures, about seven percent of all municipal direct expenditures went towards unreimbursed direct expenditures for public welfare and health care).

73. *See generally id.*

74. *Id.* at 1057 ("The market for residence . . . will be distorted by the same agglomeration economies that induce firms to remain within a particular jurisdiction, notwithstanding that it would prefer that all those within its network migrate to some alternative jurisdiction. Exit will only occur if the costs related to exploitation exceed the significant costs related to emigration.").

community might plausibly support some level of "benign" redistribution to others in their community, even in excess of their own returns.[75]

Discussing the political dynamics of redistributive policy, Gillette has also argued that local redistribution "typically entails the transfer of relatively small amounts from a large number of individuals to a smaller group of beneficiaries, each of whom receives a significant benefit."[76] But as economic inequality rises, the nature of redistribution—where it occurs at all—will tend to shift. To the extent that wealth is concentrated among a few superearners, the model Gillette describes, where the many transfer to the poorer few, will no longer be available; resources for redistribution will either come from the few superearners or they will not be available.[77]

Another recent account, from John Brooks, makes a similar argument, applied to tax policy.[78] He discusses recent empirical work showing that an individual's mobility response to local redistributive tax and spending policies is often relatively muted, and varies across demographics and other factors.[79] From this result, he proposes separating the insurance function of income taxation—the function of smoothing receipts across the business cycle, which should be retained by the central authority—from its redistributive function, which he argues can safely be untaken by state governments without risking taxpayer flight.[80]

---

75. *Id.*

76. *Id.* at 1065.

77. *Id.*

78. Brooks, *supra* note 49.

79. *Id.* at 90–91.

80. *Id.* at 142 ("The relevant costs, at least within the range of plausible current policies, are not from tax migration and crippling state tax competition as a result of redistributive policies, but rather from poor risk management— suboptimal insurance against income shocks, both for states and their residents.").

Notably, both of these authors ground their arguments in the existence of mobility constraints—the various reasons why residential mobility is something short of perfect—which supports their findings that local redistribution *can* be achieved. As generally theorized, the relationship is inverse: as mobility increases (approaching perfect responsiveness), the amount of redistribution that can be achieved at the local level declines. Evidence that location decisions are highly sensitive to benefit spillover undermines, in this model, the case for local redistribution; evidence that location decisions are determined by other factors makes local redistribution more attractive.

As such, many of the arguments "against" centralized redistribution have adopted the limited formulation that redistribution *can* happen at the local level, rather than making a positive case that this the *preferable* design.[81] Support for this proposition, where it can be found, tends to come not from the academic literature but from political actors who take a dim view of redistribution as a policy goal. For example, columnist David Brooks recently wrote that "[c]onservatives tend to like their [income] redistribution done at the local level"[82] and many Republican policy proposals—like converting entitlement programs into state-level block grants—implicitly adopt this recommendation, even where it is not argued in these terms.[83]

---

81. *See* Brooks, *supra* note 49, at 112 ("It may be that some limited state role in redistribution—perhaps close to what states are currently doing—is appropriate, and may even be optimal."). *But see* Gillette, *supra* note 16, at 1121 ("The conventional wisdom that local redistributive programs will encourage exit to localities that impose only benefit-based taxes . . . ignores the spatial benefits of redistribution that may make local programs efficient and effective.").

82. David Brooks, *The G.O.P. Rejects Conservatism*, N.Y. TIMES (June 27, 2017), https://www.nytimes.com/2017/06/27/opinion/the-gop-rejects-conservatis m.html?ref=opinion&_r=0.

83. Center on Budget and Policy Priorities, *The Proglem with Block-granting Entitlement Programs*, CBPP.org, https://www.cbpp.org/the-problems-with-block-granting-entitlement-programs (last visited May 22, 2019).

D. *School Finance Equity*

Throughout this theoretical literature, mobility is the key variable that determines the availability of local redistribution: as location decisions become more elastic with respect to benefit spillover, the attractiveness of centralizing redistribution increases. But in the applied literature, other inputs have received greater attention. In particular, scholarship on education in the United States has devoted significant attention to the implications of resource inequality across geographies.[84] Indeed, perhaps the central conclusion of the scholarship on school funding inequality is that economic segregation leads to less redistribution and the need for higher rates of taxation in poor towns.

Education is a classic example of the class of "impure" public good described above, including elements of redistribution as well as benefit to the financer. In the United States, as noted above, primary schools are largely financed by locally assessed property taxes—though with significant redistributive inter-district transfers from the higher levels of government, especially through the federal government's Title I program. Over the past several decades, courts have made municipal boundaries crucial determinants of the availability of education, even as they have rejected challenges to the exclusion of low-income people from many affluent communities.[85] In that same

---

84. *See* Liscow, *supra* note 32, at 1837–38 (reviewing this literature and noting that, in the local education context, "the dominant critique [of the Tiebout model] has been the stark inequalities associated with decentralized funding"). *See also* Reynolds, *supra* note 45, at 375 ("[T]he current legal system has made it possible for affluent suburbs to capture wealth and impose costs on other parts of metropolitan areas, most importantly through the exercise of zoning powers, taxation powers, and school funding systems.").

85. *See* Milliken v. Bradley, 418 U.S. 717, 752–53 (1974) (refusing to allow federal court to order cross-district school desegregation remedy despite finding of intentional discrimination by the state that chartered those suburbs); *see also* San Antonio Indep. Schl. Dist. v. Rodriguez, 411 U.S. 1 55–59 (1973) (rejecting equal protection challenge to vast disparities in school financing based on local property values).

period, scholars and advocates have observed that decentralized systems of education finance will tend to limit the quality of education received in poor school districts, despite the residents' bearing a significantly greater tax burden than their wealthier neighbors. On this basis, many legal scholars have argued that the equal provision of educational opportunity requires some form of fiscal centralization.[86]

Some of this literature has discussed the sort of competitive pressures deriving from residential mobility that Tiebout and Buchanan identified.[87] But scholars also have recognized that the existence of economic segregation across geographies raises the stakes of the centralization debate even on a static basis. As Richard Briffault has observed, "local financial control contributes to inequality in the provision of local education . . . [by] dividing states into districts of radically different taxable wealth, making the quality of local services dependent upon the amount of local wealth."[88] Notably, the local government literature has in this context highlighted *constraints* on mobility—in

---

86. Liscow, *supra* note 32, at 1839 ("[C]entralization advocates argue that, with a decentralized finance system, it is not the differences in tastes but rather the differences in income that drive differences in spending between jurisdictions, with severe consequences for inequality.").

87. *See, e.g.*, WILLIAM A. FISCHEL, THE HOMEVOTER HYPOTHESIS 229–232 (2001); Richard Briffault, *The Role of Local Control in School Finance Reform*, 24 CONN. L. REV. 773, 805 (1992) ("In contemporary metropolitan areas, local financial responsibility encourages residents dissatisfied with the quality of education in their community to take the Tiebout solution and 'exit' to communities with the resources and programs to provide the desired educational services, rather than loyally remain in their old communities . . . ."); Isaac Bayoh et al., *Determinants of Residential Location Choice: How Important Are Local Public Goods in Attracting Homeowners to Central City Locations*, 46 J. REGIONAL SCI. 97, 99 (2006).

88. Briffault, *supra* note 87, at 805–06 ("Local financial responsibility . . . both reflects and contributes to interlocal wealth disparities by creating fiscal incentives for the economic and political fragmentation of metropolitan areas, [and] reducing the taxable resources of less affluent communities . . . ."); Liscow, *supra* note 32, at 1830–31 ("When funding is decentralized, and local communities pay for their own services, the wealth of the community becomes a key determinant in how much a community can pay for services like schools.").

particular, successful efforts of affluent communities to exclude low-income families with children—as justification for greater centralization of this particular mixed public good. This is remarkable, considering that the theoretical case for redistributive centralization is frequently justified in reference to the competitive pressures created by high degrees of residential mobility. This inconsistency within the leading accounts of fiscal federalism might naturally suggest that models of fiscal federalism omit an important variable— or at the very least overemphasize residential mobility—but this tension has not previously been recognized.

IV. THE CENTRAL DYNAMICS OF THE MODEL ARE NOT SENSITIVE TO DIFFERENT RESIDENTIAL MOBILITY ASSUMPTIONS

Does mobility matter at all, then? Particularly given its central role in previous models, it should be acknowledged that all of the scenarios described in Part II assume away mobility; the models are static, and the residents of this political community do not respond to these changes in the way that the literature predicts they will. In particular, this analysis implicitly assumes the existence of some constraints on the ability of poor people (the left-behinds) to simply move to the resource-rich jurisdiction (Unit A). This is an important limitation, because—as discussed above—in a world without any constraints on their mobility, poor people will naturally tend to move to the wealthier jurisdictions. To the extent that this is true, it will provide a countervailing pull on this theoretical relationship between inequality and geographic segregation, and thus also between fiscal splintering and redistribution. (Of course, as just described, the fiscal federalism literature suggests that the case for decentralizing redistribution becomes stronger as mobility declines—but it should be noted here that this simplifying assumption limits the model.) What are the consequences of this simplification?

The most obvious objection concerns the left-behinds. I

noted in the previous section that this group clearly loses from fiscal splintering. The effect of economic inequality means that a greater share of total resources will be located outside of these left-behind districts. This is mathematically true whether or not these individuals are concentrated geographically, provided that fiscal units are drawn such that some number of individuals is excluded from the resource-rich jurisdictions.[89] To the extent that the superearners will seek to live near other similarly-wealthy individuals, the effects will be magnified. If these superearners are additionally able to exclude individuals who have fewer financial resources—if they are able to enforce their enclaving through political or practical means—then the relationship will be stronger still.

But it may be argued that the number of these "left-behind" residents will in practice likely be small, considering that over time the poor are likely to migrate towards the rich—such that the same geographic community will grow larger as a fiscal unit, because it will include both poor and rich. If the total amount of redistribution is held constant across time, then this fiscal splintering also creates winners: poor families who share a fiscal unit with the superearners now may enjoy the benefit of these resources without sharing with those other poor families who remain outside the unit.

Because people are mobile to some degree, we cannot know with certainty how large the share of the population that will remain in these categories is—that is an empirical question that lies beyond the scope of this Essay. But there are reasons to believe that constraints on mobility do exist, and those constraints will limit the ability of the left-behinds to simply move to the superearners' fiscal unit. As long as *some number* are left behind—and thus "walled off" from the

---

89. In the absence of perfect mobility, rising inequality leads to greater economic segregation. This is true because even if every poor person were to follow the superearners, the community would still have a geographic concentration of wealth, and it would now also have a geographic concentration of poverty. This simply describes a geographic concentration of people.

superearners' wealth—we can state with certainty that fiscal splintering will tend to increase inequality post-redistribution, as compared to a centralized regime. Although the *strength* of this relationship (between economic segregation and redistributive outcomes) will be affected by a number of factors, this Essay shows that the *direction* of this relationship does not require qualification.

It is true that, at the margin, poor people will tend to migrate to cash-rich communities: this is a central conclusion of the federalism literature, and there is some empirical support for the proposition. Studies estimating migration effects of welfare programs characterized by inter-state benefit variation policies have ranged from finding no tax migration effect at all to a comparatively high degree of responsiveness.[90] But even the studies finding the highest degree of responsiveness—a result that, it should again be noted, federalism scholars typically would consider evidence for *centralizing* redistribution[91]—show that mobility is short of perfect.

This is, in part, because poor families, like everyone else, are attached to their communities for reasons separate from the tax and transfer system. But beyond those factors, wealthy communities have a variety of legal and practical

---

90. *See* Kathleen M. Day & Stanley L. Winer, *Policy-Induced Internal Migration: An Empirical Investigation of the Canadian Case*, 13 INT'L TAX & PUB. FIN. 535, 535–36 (2006) (finding, in over twenty years of Canadian tax data, little migration based on interstate policy differences in the generosity of unemployment insurance); Robert Kaestner, Neeraj Kaushal & Gregg Van Ryzin, *Migration Consequences of Welfare Reform*, 53 J. URB. ECON. 357, 358–59 (2003); Phillip B. Levine & David J. Zimmerman, *An Empirical Analysis of the Welfare Magnet Debate Using the NLSY*, 12 J. POPULATION ECON. 391, 407 (1999). Others have demonstrated empirically that local governments can use income taxes to redistribute wealth without significant migration effects. *See* Timothy J. Goodspeed, *A Re-Examination of the Use of Ability to Pay Taxes by Local Governments*, 38 J. PUB. ECON. 319, 340 (1989).

91. *See, e.g.*, Brooks, *supra* note 49, at 112 ("If it is difficult for taxpayers to move, and if there are factors that outweigh taxation (such as jobs, family, culture, and the like), then states actually may have some room for redistribution with little repercussion.").

tools that can be used to exclude.[92] Even if the effect of these measures is imperfect, they do have a real effect on residential mobility; indeed, this is a central finding in the thread of literature responding to Tiebout.[93] David Schleicher has shown that rates of inter-state mobility are low particularly among disadvantaged groups, despite a growing connection between moving and economic opportunity.[94] To the extent that people are unable to move, for whatever reason, then some number will be unable to escape their cash-poor communities for the greener pastures of the wealthy fiscal units.

But even if no constraints on mobility existed and every left-behind determined her residence via a single-variable calculus that maximized redistributive transfers,[95] this does not undermine the existence of the relationship identified here. Recall that I have defined the fiscal units in reference to population size. Were all residents of the community to be perfectly responsive to redistributive outcomes, this would simply mean that, over the long run, fiscal units are *always maximally large*—that they never vary in size at all, because the poor will simply follow the superearners. That might be true in a theoretical model that doesn't include any geographic "stickiness" (that is, under conditions of perfect mobility and responsiveness), but we know that it does not describe the real world. Under this extreme assumption, the

---

92. *See* Michelle Wilde Anderson, *Mapped Out of Local Democracy*, 62 STAN. L. REV. 931, 935–41 (2010).

93. *See* Pierre Salmon, *Horizontal Competition Among Governments*, *in* HANDBOOK OF FISCAL FEDERALISM 69 (Ehtisham Ahmad & Giorgio Brosio eds., 2006) ("[The high cost of moving] is often considered a decisive objection to models—like the Tiebout model or the Oates and Schwab model (1988)—that are dependent on the assumption of mobility.").

94. David Schleicher, *Stuck! The Law and Economics of Residential Stagnation*, 127 YALE L.J. 78, 78 (2017) ("People are not leaving areas hit by economic crises, with unemployment rates and low wages lingering in these areas for decades. And people are not moving to rich regions where the highest wages are available.").

95. This is an admittedly extreme assumption, but it underlies many forms of Tieboutian reasoning described above.

most that can be said is that there is no relationship between inequality and economic segregation—not that the relationship goes the other way, but just that in practice it will tend to be small.[96]

That is to say, the existence of mobility does not defeat the argument that economic inequality is linked to geospatial segregation—it merely reduces the strength of the relationship. Even the strongest form of this argument is that rising individual inequality does not necessarily lead to rising inequality in geographic space—it just very likely does so. But note what is required for this to not be true. It requires that *every single poor person* follow the superearners. If even one is left behind, then the relationship is descriptively correct. In other words, this criticism in its strongest form is about the *strength* rather than the *existence* of this relationship.

That is, the central recommendation of the model holds as long as mobility is not both *perfect* (every individual has the ability to relocate, and no barriers are allowed), and *perfectly responsive* to these changes (every individual actually does relocate on this basis). We know that the world does not look like this. In reality, the poor often face practical boundaries to relocation; the rich have a variety of legal and practical mechanisms that can be used to exclude, and even perfectly mobile people will sometimes choose factors—like proximity to family or the availability of work—that lead them to reside in a community other than the one that would maximize their potential receipt of redistribution or public services.

---

96. Moreover, this counterargument is actually consistent with my broader point. The only way to argue that this relationship is not true is to suggest that, as a result of mobility, the fiscal unit will include both the superearners and all of the poor. But the point of my argument is that we should ensure that this happens. If this already is happening—and again, there is plenty of evidence that it is not—then it does not undermine my argument, it simply limits its applicability to cases where mobility is imperfect.

V. CONCLUSION

Many have missed the deep implications of economic inequality for core tenants of fiscal federalism. This framework shows that debates about the proper assignment of redistribution assume a different character depending on the preexisting level of inequality within the political community. Specifically, economic inequality raises the stakes of "fiscal splintering" for redistributive outcomes and possibilities: where economic resources are unevenly distributed across geography, the spatial definition of fiscal units takes on great significance. And the presence of economic inequality places a ceiling on local governments' ability to provide public goods or achieve redistribution, absent centrally-coordinated fiscal transfers.

Traditional models of fiscal federalism overlook this important relationship. Orthodox models of decentralization argue that location-mobility of residents is a disciplining measure for local governments. The consensus view is that mobility limits the ability of local governments to achieve redistribution, because high-income people will exit when it is attempted.[97] Others point to evidence showing that locations decisions are relatively inelastic to support their conclusion that redistribution can happen at the local level.[98] I show that this debate does not need to be settled in order to conclude that rising levels of economic inequality support moving redistribution to higher levels of governance.

Just as scholars have argued that the competitive forces of residential mobility have the effect of making local redistribution impossible, these examples suggest that—on a static basis—high levels of inequality will tend to have the same effect. So as long as there are *some* constraints on mobility, then it can be said—without qualification—that rising inequality will always and necessarily have the effect

---

97. *See* discussion *supra* Section II.B.

98. *See supra* Section III.C.

of increasing the geographic clustering of resources. This follows mathematically from the fact that inequality *is defined as* an increasing concentration of economic resources across a population, and that people are indivisible economic units—they exist at only one place in time. And to the extent that economic resources are unevenly spread across a political community, then the exercise of line drawing—of determining the size and placement of the fiscal units—becomes increasingly important as a determinant of the practical availability of inter-unit economic redistribution.

For public finance scholars, the predominant policy response to the trend of economic stratification has been to increase the burden of taxation on very high-wealth individuals.[99] But as the model supporting this framework demonstrates, the case for centralizing redistribution depends in large part on the level of economic inequality in a polity—and is thus greatly strengthened by rising inequality. The significant implications of this basic relationship have not been fully explored. Service devolution to lower, smaller geographic units has been praised for various virtues according to America's favorite versions of democratic theory.[100] But under a set of straightforward assumptions, these structures will also have the inevitable effect of deepening inequality and making the efficient provision of public services less likely. As a policy matter, it suggests that we should focus on either increasing the size of fiscal units of redistribution to include ultra-wealthy or alternatively shifting the site of redistribution to the circle that is large enough to include both the haves and the have-nots.

---

99. *See, e.g.*, Emmanuel Saez, *Income and Wealth Inequality: Evidence and Policy Implications*, 35 CONTEMP. ECON. POL'Y 7, 7 (2017); Emmanuel Saez, *Questions and Answers: Income and Wealth Inequality—Evidence and Policy Implications*, 35 CONTEMP. ECON. POL'Y 26, 26–28 (2017).

100. *See, e.g.*, New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) ("It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.").

I argue here that on policy matters involving some element of redistribution—that is, almost everything the government does—fiscal decentralization, under the background condition of economic segregation, will *always* result in increased inequality, compared to centralized redistribution. The existence of rising income inequality thus provides support for shifting the site of revenue collection to higher levels of government as a general policy, even as decision-making may be retained at local levels. This conclusion represents the opposite direction of recent policy debates, which have proposed sharply curbing or even eliminating federal support to states and local governments.

The federal government can easily capture the tremendous wealth that our economy produces, no matter how it is distributed over geographic space within the country. From this basic insight, we can both better understand the shortcomings of the current system and also make specific recommendations for reform. Instead of devolving the financing of public investments—whether schools or courts or infrastructure—to ill-equipped cities and states, the federal government should respond to rising economic inequality by assuming responsibility for their funding.