Abstract:
Consider jurisdictions of different size providing local public goods with positive spillovers. The socially-efficient expenditure levels can be induced by matching grants, but jurisdictions can exploit the rationale behind this system to induce bailouts. We formalize the too-big-to-fail result of Wildasin (1997) by giving an analytical proof that it can exist in a subgame-perfect Nash equilibrium. Furthermore, we examine the reasons why Crivelli and Staal (2013) and Kalamov and Staal (2016), using closely related models, come to opposite conclusions.