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It's Elementary

A Monthly Column by EFAP Director John Yinger
November 2015

In Memory of Wallace Oates

Professor Wallace Oates, a long-time faculty member at the University of Maryland and a star in the field of local public finance, passed away in October. In the fall of 1971, Wally was my public finance professor at Princeton, where he taught before moving to Maryland. His class had a profound impact on my career.

Wally taught me about three local-public-finance topics out of his own research that I have continued to think and write about ever since I took his class: capitalization, the impact of poverty and other environmental factors on public service costs, and the equivalence between intergovernmental aid and resident income.¹ I have touched on each of these topics in many previous columns.

To students of local public finance, “capitalization” is the impact of local public service quality and property tax rates on the price of housing. Wally taught me about his now-famous paper (Oates 1969) in which he both estimated service and tax capitalization for a sample of cities in northern New Jersey and connected his analysis with the article by Tiebout (1956) that initiated the field of local public finance. Oates’ article inspired dozens, if not hundreds, of imitators.² I wrote a paper on capitalization for his class and I have continued to write about the topic over the years. In fact, here it is, forty-four years since I took Wally’s class, and I just published an article that presents a new way to estimate public service capitalization (Yinger 2015). Moreover, this topic continues to be vital to understanding the U.S. system of local governments, and many scholars continue to investigate capitalization and related issues.³

¹ Wally did not introduce me to local public finance. That distinction goes to Dr. Joseph Pechman, who was my boss when I was a research assistant at the Brookings Institution for two years before I went to graduate school. Joe asked me to write a report comparing the finances of Washington, D.C. with the nation’s city-counties, such as San Francisco. This episode provides more evidence that I like to stick to topics, as I went on to write a book with Helen Ladd on the finances of all the nation’s large cities (Ladd and Yinger 1991). But it also provides more evidence of Wally’s impact on my career, because a central part of that book was the estimation of public service costs—topic two in this column.

² Tax capitalization studies are reviewed in Yinger et al. (1988) and studies of school quality capitalization are reviewed in Nguyen-Hoang and Yinger (2011).

³ The literature on local public finance related to capitalization is reviewed in Ross and Yinger (1999). This review cites eleven of Wally’s articles. He did not stop being my teacher in 1971!

Wally also taught me about his now-famous article on the costs of local public services (Bradford, Malt, and Oates, 1969). This article explains that the cost of public services depends on the environment in which they are provided. The same level of fire protection costs more, for example, in a community with old, wooden apartment buildings than in one with brick ranch houses on two-acre lots. Working mainly with William Duncombe, who was also fascinated by this topic, I have contributed many articles to the large literature that builds on this insight (e.g. Duncombe and Yinger 2005). A review of this literature can be found in Duncombe, Nguyen-Hoang, and Yinger (2015).

Finally, Wally taught me that intergovernmental aid flowing into a community is in some sense equivalent to an increase in the income of the voters who live in that community (Bradford and Oates 1971; Oates 1972). This equivalence requires an adjustment for the fact that \$1.00 of aid does not necessarily save a voter \$1.00 in taxes. Suppose, for example, that half the property taxes in a community are paid by a large factory. If the community receives another dollar of aid and uses it to reduce property taxes, then the voters only save \$0.50. In another community with no factory, they might save the full dollar. A more formal statement of this result is that state aid adjusted for voters' tax share is equivalent to voter income.

Although this equivalence makes sense in theory, it does not work out so well in practice; \$1.00 of aid has a much larger impact on the demand for local public services than \$1.00 of voter income. This is called the flypaper effect: the money sticks where it hits. There is also a large literature on the flypaper effect, to which Wally contributed (see Gamkhar and Oates 1996). For some reason, however, this literature largely skips the Bradford/Oates logic; that is, it estimates a flypaper effect without adjusting for tax share. As a result, most studies greatly underestimate this effect. My work on this topic is based on the Bradford/Oates logic and it finds much larger flypaper effects than most other studies (see Eom, Duncombe, Nguyen-Hoang, and Yinger 2014). One my current projects (with Phuong Nguyen-Hoang) investigates the extent to which a correctly specified flypaper effect can be explained by the notion from behavioral economics that people place resources received from different sources in different mental accounts. I'm still pursuing this topic, too.

Wally published articles on many topics in local public finance other than these three, of course, and he also made important contributions to environmental economics. He will be greatly missed. I will remember Wally as a stimulating and supportive teacher, a pioneering scholar, and the man who put three big ideas in my head that I cannot seem to stop thinking about.

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