

ADJUSTMENT RATES AND THE SECOND-BEST LEVEL OF GOVERNMENT SPENDING

by

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ABSTRACT

The level of public service, financed by a commodity tax, is compared with the efficient level. The rate at which the tax base adjusts to a price change is a critical - and previously ignored - parameter. If the tax base adjusts rapidly to a change in the tax rate, the "second-best" public service level is likely to be less than the efficient level (Pigou (1928)). However, if the tax base adjusts slowly to a change in the tax rate, the public service level in the steady state exceeds the efficient level.

JEL Classification #: H2, H3, H4.

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* The technical assistance of the C.V. Starr Center for Applied Economics is gratefully acknowledged.