The Limits to Regional Redistribution

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Resumen

We analyze a federation composed of two regions (one rich and one poor) choosing whether to secede. There is a central government that provides public service, that enter the production function, independently form the tax revenue collection in the region. Then we allow social conflicts to affect the supply side of the economy so that regional redistribution may improve productivity

This decision to secede depends on the costs of secession (no private capital mobility, barriers to trade, running a new central government, etc.) relative to the costs of federation (distorsions introduced by the central government through taxation and redistribuion). We derive an upper limit to redistribution between regions that makes a region indifferent between seceding and not.

This limit depends, among other things, on how interregional transfers impact on productivity. If the effects of these transfers are large this may compensate the direct negative effect that these transfers have on the reallocation of private capital across regions.