

Tax competition and public input provision with imperfect labor markets*

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Abstract

Incorporating a labor market imperfection caused by fixed wages into a tax competition model, this paper analyzes the equilibrium characteristic when jurisdictional governments provide public inputs to cope with regional unemployment. The results show that public input provision cause the first and second order externalities on the regional employment. These employment externalities induce the governments to levy tax on capital even if a head tax is available. The degree of the employment externalities is shown to vary depending on the level of fixed wage. The efficiency of public input provision and composition of public spending and are also discussed.

Keywords: Tax competition; Unemployment; Public input provision; Composition of public spending

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