Trade Structure and Growth Effects of Tax Policy in a Two-Country World

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abstract

This paper explores long-run impacts of tax policy in two-country model of endogenous growth with variable labor supply. We focus on international spillover effects of tax policy under alternative trade structures. It is shown that if the instantaneous utility function of the representative family in each country is additively separable and if international capital mobility is absent, then tax policy in one country does not directly affect capital formation in the other country. Such a conclusion is fundamentally modified if international lending and borrowing are allowed. In the presence of financial capital mobility, a change in tax policy in one country directly diffuse to the performance of the other country, even though preference structures are assumed to be simple, log-additive forms.