Tax Competition for Mobile Capital

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Abstract

Because of the mobility of capital, most theoretic results on tax competition predict negative tax on the income from capital. In contrast, most capital tax rates in the real world are positive. The aim of this paper is to disclose this puzzle by incorporating two important effects, the income effect and the pro-competitive effect in a tax competition game by a general equilibrium approach.

Given two countries which are symmetric, probably except for the size. The first model employs the CES utility function to capture the income effect. In this model, we find that tax rates are still negative in the case of symmetric countries. In the case of asymmetric countries, positive tax rates are possible but the tax rate in the larger country is higher.

The second model employs the CARA utility which may capture both the income effect and the pro-competitive effect. Then we find that the tax rate may be positive even in the case of symmetric countries, and the tax rate in the smaller country may be higher.

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