

About International Tax Competition

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Opinion

Within the international tax competition context, the competition on capital taxation has received much attention in the last decades focused on the corporate tax. Additionally, this topic is attracting an increasing attention from media and policymakers.

As Stewart and Webb [1] properly exposed, “the intuition is simple and, at least at the level of popular debate and policy discussion, compelling: when corporations face few barriers to locating in the lowest tax jurisdiction, revenues from corporate taxation will shrink as governments are forced to cut taxes to compete for mobile capital and companies take advantage of increased opportunities for international tax avoidance. The implication is that in an era of economic globalization - that is, international economic integration and an accompanying increase in capital mobility - governments may find themselves drawn into an internecine ‘race to the bottom’ in capital taxation, undermining the financing of the welfare state and the provision of public goods generally. Further, taxes must then come to fall unduly on immobile factors, specifically labour, exacerbating labour market rigidities and unemployment”.

From a theoretical perspective, there is not a unique prediction, as it depends on the models and assumptions considered. Excellent reviews of theories regarding tax competition can be found in Wilson [2] and, more recently, in Keen and Konrad [3]. Most approaches build on the tax competition among sub-national jurisdictions [4-7]. Hence, the “race to the bottom” is a possible end of the tax strategies, but for example Mendoza and Tesar [8] developed a dynamic, neoclassical general equilibrium model of tax competition with mixed results, closed to the Nash equilibrium. Following Stewart and Webb [1], “there is no reason to expect either a race to the bottom or even the weaker form of simple convergence. Indeed, some Tiebout models even predict increasing divergence in corporate tax burdens, with some governments able to increase taxes and others forced to cut taxes (or see investment outflows that reduce tax revenues)”. Regarding the race to the bottom hypothesis, see for example the recent paper by Razin and Sadka [9] based on migration. They conclude that when a group of host countries faces an upward supply of immigrants, tax competition may lead to higher taxes than coordination, contrary to the Tiebout paradigm.

Indeed, some studies had focused on the effects of the competition on the EU and specifically on the EU-enlargements. For example, Goodspeed [10] stated that “one implication for the EU is that enlargement that increases tax base disparities within the EU (and is not accompanied by an EU-level income tax) will tend to lower national income tax rates, although this must be qualified because it also depends on the mobility of the population”. To date, this prediction did not come true as European income tax rates remain high. Also following Goodspeed [10] again, he stated that “a second implication is that fiscal expansion of the EU to include an EU-level

income tax may tend to lower the reliance of national governments on income taxes through the vertical externality, but may also tend to equalize tax bases across countries, and so increase reliance on national income taxes through the horizontal externality”. The European authorities have not approved such EU-level income tax, indicating the scarce progress in the politic and fiscal union among the European countries.

Empirically, the results are clearly inconclusive, with different measures and methodological approaches. Cross-section versus time series models, tax burdens versus tax rates, or statutory versus marginal effective tax rates are some of the decisions that the researchers must take and so the results are not always comparable. See Genschel and Schwarz [11], with a survey of the literature on tax competition, and Adam, Kammas and Lagou [12], with a survey of the empirical literature on the effect of globalization on capital taxation.

An interesting issue within international tax competition is the existence of fiscal strategic interactions among countries. Redoano [13] studies the EU and she concludes that countries interact over capital and income tax rates; more specifically, for corporate taxes, European countries follow large countries in order to attract capital; and for income taxes, fiscal interactions exist but they are mainly due to yardstick competition. Kammas [14] analyses OECD countries and finds that domestic capital tax rates react positively to changes in capital tax rates in neighboring countries, and negatively to changes in public investment spending in neighboring countries. Finally, Duncan and Gerrish [15] study the personal income tax in a world sample; they find evidence of personal income tax mimicry: countries increase their own tax rate when their neighbors’ rate increases.

To conclude, in my opinion, although much research on international tax competition exists, several issues remain still open:

1. We need further research on the nature, mechanisms and effects of the international tax competition. New theoretical and empirical evidence from EU and OECD countries is necessary. The fiscal decisions made in the last years with a deep economic crisis can bring us new insights on this issue. Further discussion on the harmful (or not) character of (all) tax competition is also welcome [16].
2. The problems derived from the existence of tax havens have increased - or at least have been more visible- with the Great Recession. It is necessary a strong coordination among the countries to go ahead and the information exchange is absolutely essential; the low tax territories are not always a problem, if they provide the tax information. A further study about the problems and opportunities of the tax havens would be crucial to better understand this phenomenon.
3. Tax avoidance by multinationals and evasion by high-income individuals must be in the fiscal world agenda. Initiatives as Base Erosion and Profit Shifting (BEPS) or the Global Forum on

Transparency and Exchange of Information for Tax Purposes will allow making progress in the good direction.

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