

Tax Competition and Partial Tax Coordination under Fiscal Decentralization

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Abstract : This article analyzes the conditions where decentralization and partial tax harmonization in a coalition of asymmetric jurisdictions plays a role in the fight of fiscal competition (i.e. the race to bottom). Starting from a centralized economies, we use the ZM-W model to analyze the fiscal competition and coordination among three countries. We find that the asymmetry of jurisdictions facilitates partial tax harmonization between jurisdictions when these asymmetries are not too large. Furthermore, when the asymmetries are large enough, the level of labor tax plays an important role in the decision of decentralize capital tax. Accordingly, decentralization is achievable when labor tax is low. This result indicates that decentralization and partial tax harmonization between jurisdictions can be possible results in order to fight the negative externalities from fiscal competition, and more in the European Union countries where the asymmetries are substantial.

Keywords : centralization, decentralization, fiscal competition, partial tax harmonization

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