

# TAX COMPETITION AND MIGRATION: THE RACE-TO-THE-BOTTOM HYPOTHESIS REVISITED

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## Abstract

Oates reminds us that tax competition among localities in the presence of capital mobility, may lead to inefficiently low tax rates (and benefits). In contrast, the Tiebout paradigm suggests that tax competition yields an efficient outcome, so that there are no gains from tax coordination. This paper demonstrates that when a group of host countries faces an upward supply of migrants, labor and capital income tax rate under competition are higher than under tax coordination.

The rationale for this somewhat surprising result is quite basic: a fiscal externality associated with the volume of migration. There are gains and losses brought about by migration. A host country has an infra-marginal gain from migration because of the diminishing productivity of labor for a given stock of capital. On the other hand, the native-born population shares with migrants the tax collected from capital income (we plausibly assume that migrants have no capital): the welfare state benefit that the migrants receive is not financed fully by their labor income tax. That is, the capital tax revenues paid by the native-born population "leak" also to the migrants<sup>9</sup>. Each host country in a competitive regime evidently balances on the margin the gains and losses from migration. In doing so, each country takes the well-being of the migrants as given. It ignores the fact that a tax-migration policy that admits an extra migrant raises the well-being that must be accorded to migrants by all host countries, in order to elicit the migrant to come in. As a result, it offers migrants too high level of  $b$ , levies too high taxes, and admits too many migrants. Indeed, the number of both types of migrants is higher in the competitive than in the coordinated regime. We also note that tax rates on capital income are lower than tax rates on labor income. This is a way that native born who is endowed with capital take advantage of the migrants, who have no capital.