

"Culture and Taxes: Towards Identifying Tax Competition"

Abstract:

We propose a difference-in-differences strategy to identify the existence of inter-jurisdictional tax competition, and to estimate its spatial reach. Our strategy rests on differences between desired tax levels, determined by culture-specific preferences, and equilibrium tax levels, determined by interjurisdictional fiscal externalities as well as by preferences. While fiscal preferences differ systematically and demonstrably between French-speaking and German-speaking Swiss municipalities, we find that local income tax burdens do not change discretely at the language border but exhibit smooth spatial gradients. Our estimates imply that tax competition constrains tax choices of jurisdictions with a preference for higher taxes up to a distance of around 20 kilometers. Hence, tax competition does constrain income taxation by local governments but its effect is confined to a small spatial scale.