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The effect of globalization on capital taxation: What have we learned after 20 years of empirical studies?

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ABSTRACT

This paper applies meta-regression analysis to the empirical literature that examines the impact of international market integration on capital taxation. The main objective is to explore whether particular data, model specification and estimation procedures exert systematic impact on the reported findings. Our results provide empirical evidence that differences across studies can be attributed to differences in the measurement of globalization. Moreover, in contrast to the conventional wisdom, study characteristics related to the measurement of the tax burden on capital appear to have an insignificant effect on the above mentioned relationship. Finally the meta-analysis fails to confirm a negative effect of globalization on the taxation of capital.

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1. Introduction

Increased international market integration – also known as globalization-has affected significantly the design and the scope of fiscal policy. Focusing on factor income taxation, theory suggests that international factor mobility leads national government, in an attempt to attract mobile factors, to cut the tax rate on the relatively mobile factors – capital- and increase the tax burden fallen on the relative immobile factors (see e.g. Wildasin, 1988; Persson and Tabellini, 1992).[1]

Although a large number of empirical studies examine the effect of increased international market integration on national tax policy, the results of the relevant literature appear to be rather inconclusive. Regarding capital taxation, a branch of the empirical literature concludes that higher international market integration is associated with higher capital taxation (see e.g. Garrett, 1995; Quinn, 1997; Swank, 1998) whereas another strand provides empirical evidence of a negative impact of globalization on capital tax rates (see e.g. Bretschger and Hettich, 2002; Winner, 2005; Bretschger, 2010).

Contradicting findings are mainly attributed to particular choices made by the researchers concerning the measurement of capital taxation and globalization. Specifically, a large part of the literature shares the view that employing average effective tax ratios (AETRs) based on the Mendoza et al. (1994) approach or statutory tax rates instead of tax revenues as a share

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[1] The possibility that competition across national jurisdictions in order to attract capital results in inefficiently low tax rates and public good provision dates back to Oates (1972). However, the "benchmark tax competition model" has been first articulated by Zodrow and Mieszkowski (1986) and Wilson (1986). For surveys on international tax competition literature see Wilson (1999), Schulze and Ursprung (1999), Wilson and Wildasin (2004) Haufler (2001) and Leibrecht and Hochgatterer (2012).

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of GDP, may give rise to different findings.[2] Moreover, it is widely believed, that employing corporate profits instead of capital tax revenues as a proxy of capital taxation may be of crucial importance concerning the obtained results (see e.g. Devereux et al., 2002; Kammas, 2011).

Finally, a large strand of the literature places the spotlight on the alternative globalization measures employed. According to this view, globalization is a multifaceted phenomenon and alternative proxies highlight different aspects of it. Specifically, measures based on actual flows (e.g. international trade as a percent of GDP) may better reflect international economic integration on goods market. In contrast the capital account restrictions index developed by Quinn (1997) focus mainly on international capital market integration. Finally the KOF index of globalization developed by Dreher (2006) may better capture the various political and social features of globalization. Therefore, employing some specific indexes of globalization instead of others may be of crucial importance regarding the empirical findings (see e.g. Bretschger and Hettich, 2005; Dreher, 2006; Quinn et al., 2011).

The above mentioned contradicting empirical results form the main motivation of our analysis. The present paper aspires to examine the results obtained by different empirical studies and to relate them to their particular characteristics. To this end, we proceed by making an analytical review of the relevant literature and then we perform a meta-analysis by employing data from a total number of 23 different empirical studies. Meta-analysis allows us to summarize the main results of the literature in a systematic way, investigate the presence of biases and examine how particular choices made by the researchers affect the empirical findings. Ultimately it highlights the potential systematic impact of data, specifications or estimation procedures on the reported findings.

Our main results are as follows. We find that study characteristics related to the way capital taxation is measured do not exert any systematic impact on the obtained results, whereas study characteristics related to globalization measures give rise to totally different findings concerning the relationship between globalization and capital tax rates. More precisely, studies employing: (i) international trade as percent of GDP and (ii) the globalization index developed by Quinn (1997) are more likely to report a negative impact of international market integration on capital taxation, whereas studies employing the KOF index of globalization developed by Dreher (2006) are more likely to report a positive effect of globalization on capital tax rates. Moreover, we provide empirical evidence that several other study characteristics (i.e. the length of the sample employed whether the paper has been published in an economics or in a political journal) do exert systematic impact on the reported results.

The structure of the paper emerges along the following lines; in the next section, we present the theoretical considerations and data issues; in Section 3, we proceed by making a detailed review of the literature and we discuss the methodology followed in order to code the empirical studies and to construct the meta-sample employed; in Section 4, we present the meta-analysis and the results. Finally, Section 5 concludes.

2. Globalization and capital taxation: Theoretical considerations and data issues

2.1. Do capital taxation measures matter?

A major issue in the empirical studies examining the determinants of capital taxation is how to approximate the tax burden on capital. The simple measure of statutory tax rate cannot capture the complexity of the whole tax system nor provide a clear image of the implied tax policy. Since the overall tax burden does not depend solely on the statutory tax rate, but also on what is defined – by the tax legislation – as tax base, researchers are in need of some more sophisticated tax measures that take into account changes in the tax base (changes in allowances, deductions, etc.). For these reasons there are various alternative measures employed as proxies of the tax burden on capital. Namely; (i) the AETR based on the methodology of Mendoza et al. (1994), (ii) the capital tax revenues as a share of GDP or as a percentage of total taxation, and (iii) the AETR and marginal (METR) effective tax rates developed by Devereux et al. (2002).

A large branch of the literature shares the view that alternative measures of the tax burden give rise to different results with respect to the impact of globalization on capital taxation. Specifically, it is believed that studies employing effective tax rates, tend to verify a negative impact of globalization on capital tax rates (see e.g. Bretschger and Hettich, 2005; Winner, 2005; Bretschger, 2010) while studies relying on tax capital revenues (either as a share of GDP or as a percentage of total taxation) tend to confirm a positive impact of market integration on capital taxation (e.g. Garrett, 1995; Quinn, 1997; Swank, 1998). According to this view, different results can be attributed to the fact that the capital tax revenue proxy misleadingly presents possible changes in the tax base (that may be driven by changes in the rate of profitability or the size of corporate sector) as if they are changes in the tax burden (Bretschger and Hettich, 2002; Adam and Kammas, 2007).[3]

[2] For example Bretschger and Hettich (2002), Adam and Kammas (2007) and Plumber et al. (2009) argue that studies employing effective tax rates, find a negative impact of globalization on capital taxation and therefore verify the validity of the efficiency hypothesis, while studies relying on tax revenues (either as a share of GDP or as a percentage of total taxation) share the view that corporate taxation is positively associated with market integration and hence seem to reject the efficiency hypothesis.

[3] More precisely, the relevant literature concludes that in the last decades, the share of corporate profits in GDP has increased substantially in most OECD economies (see e.g. Devereux et al., 2008). This shortcoming (namely, that higher tax revenue are due to larger tax bases rather than higher tax rates) seems to be behind the positive relationship between higher economic integration and corporate tax revenues found in the data. Moreover, the proxy for tax revenues as a share of GDP is not the appropriate decision variable of the government. This is because the government is able to determine – through tax legislation – the statutory tax rate and the tax base but not GDP.

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