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Tiivistelmä-Referat-Abstract
The paper analyses effects of fiscal competition for mobile capital between identical regions in a transition economy. I add two features characteristic of transition economies into the familiar model of fiscal competition by Keen-Marchand (1997). Firstly, the economy is seen to consist of two sectors with differing productivities. Even though both sectors use same inputs, the new sector is more productive than the old one. Secondly, decision-makers are assumed to be only partially benevolent. They maximise a weighted average of consumer's utility and their private benefit that originates in the old sector production. The primary interest centers on the effects of fiscal competition on the overall level and on the composition of public goods provision when the economy is characterised by the above-mentioned transition features.
Two specifications for decision-maker's private benefit will be used. The basic case corresponds closely to that in Keen-Marchand (1997) producing results largely in line with theirs. The level of public goods provision is proved to be too low in a competitive equilibrium. Additionally, the composition of public goods will be distorted towards too much infrastructure and too little social public good. A common increase in capital tax rates or a common change in the composition of public goods would unambigously increase consumer's welfare, but the welfare change is proven to be smaller than it would be in pure Keen-Marchand (1997) model. The alternative specification of decision-maker's private benefit may be seen as a special case of the one used in Qian-Roland (1998). As it is assumed that politicans own state sector rents, the results change radically. It is no longer self-evident that too little public goods is provided in a competitive equilibrium and a common policy change may, in fact, be welfare-deterioring for the consumers. Specifically, when the relative share of old sector production in a region is large, a common increase in tax on mobile capital may decrease consumer's welfare. The opposite is proven to hold if the production structure of the transition economy (i.e. the relative share of old sector production) is very close to a standard one-sector economy.

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