Helsingin yliopisto - Helsingfors universitet - University of Helsinki ID 2005-158

Tiedekunta-Fakultet-Faculty Faculty of Social Sciences		Laitos-Institution-Department Department of Economics
Tekijä-Författare-Author Gangnuss, Danila		
Työn nimi-Arbetets titel-Title Economic integration and public finance		
Oppiaine-Läroämne-Subject International Economics		
Työn laji-Arbetets art-Level Master's thesis	Aika-Datum-Month and year 2005-12-02	Sivumäärä-Sidantal-Number of pages 87 pages + 7 appendices

Tiivistelmä-Referat-Abstract

The European Union has created a massive market for goods, services, capital and labour. In principle, goods and services as well as factors of production can move freely across the national borders within the European Union. Migration of the factors of production is driven by the country-specific differences in marginal productivity. As a result of this, migration ensures the most efficient use of the factors of production and therefore promotes the general welfare. However, international mobility of the factors of production might threaten national welfare of the countries that participate in economic integration. For some of the countries, this raises concerns about loosing factors of production in favor of the other member-states of the European Union.

The purpose of this thesis is to analyze how mobility of skilled labour affects income taxation decisions in the countries that face economic integration. The thesis identifies optimal patterns of taxes and of public expenditures in the countries that face international agglomeration of industry. It poses the question of whether there exists an optimal size of the public sector in the presence of economic integration. Starting with the core-periphery models of Krugman (1991a), Fujita et al. (1999) and Forslid (1999), the thesis considers a new economic geography model of tax competition (Andersson and Forslid 2001), where two initially identical countries compete for internationally mobile skilled workers. The model contains two types of equilibria. In the dispersed equilibrium, manufactured production and skilled workers are located in both countries. In the agglomerated equilibrium, manufactured production and skilled workers are concentrated in one of the countries.

For both types of equilibrium we construct taxes, which are optimal for the purpose of preserving current distribution of manufactured production and of skilled workers. We show that it is always optimal to tax the income of skilled workers at some positive rate. In the dispersed equilibrium, taxes on the income of skilled workers cannot be increased above some critical level without producing agglomeration of industry. However, in the agglomerated equilibrium, economic integration decreases sensitivity of skilled workers with respect to fiscal incentives. As a result of this, the scope for income taxation of skilled workers in the agglomerated equilibrium does not monotonically decline with trade costs. We also show that taxes on the income of unskilled workers determine the size of the public sector in the dispersed equilibrium but not in the agglomerated equilibrium. It is interesting that in the country, which contains agglomeration of industry, taxes on the income of unskilled workers can be decreased without reducing the size of the public sector.

Avainsanat-Nyckelord-Keywords

economic integration
economic geography
factor mobility
mobility of labour
international trade
tax competition
taxation

Säilytyspaikka-Förvaringsställe-Where deposited

Muita tietoja-Övriga uppgifter-Additional information