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Publié le 15 décembre 2020 – Mis à jour le 15 décembre 2020

Date

Le 15 décembre 2020 De 12:30 à 13:30

Séminaire recherche

Inter-Ministerial Tax Competition: The case of Resource-Rich Developing Countries

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RÉSUMÉ

We formalize tax policy as the result of inter-ministerial tax competition. Focusing our analysis on resource-rich developing countries, we consider two Ministers: the Minister of Finance (MoF) and the Minister of Mines and Petroleum (MoM) and two tax instruments: a tax on capital and a mining royalty (or equivalently a Production Sharing Contract). Depending on the taxing power assignment between Ministers, some intragovernmental tax competition may take place, which determines tax policy for the whole economy. This competition is characterized by the strategic substitutability of the two tax instruments. We propose a numerical illustration to appreciate the effect of a resource boom. We observe that the inter-ministerial tax competition reduces total tax revenue and favors the concentration of the economy in the extractive industry curbing the economic development of the country (captured through the total stock of capital in the country). We test the tax reaction functions of each Minister for 41 Sub-Saharan countries from 1980 to 2010. We confirm empirically the strategic substitutability of tax instruments.

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