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Corporate taxes and investment when firms are internationally mobile

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Abstract
In this paper, we analyse the passthrough from corporate taxes to investments by including two novel channels into a DSGE model for a small open economy. We capture both how foreign firms relocate and invest in the country when corporate taxes are reduced and how the inflow of FDI increases exports which spills over to domestic firms, that then increase their investment further. Our extended model allows us to study the importance of both transmission mechanisms and how they interact through crowding out effects. The corporate tax cut becomes self-financed when FDI-export spillovers are included, but only if other countries do not follow suit and lower their corporate tax rates. The largest self-financing contributions come from increases in various labor and consumption tax bases. A reduction in profit shifting further contributes to financing the tax cut. Our findings suggest that corporate tax levels internationally are not in equilibrium and that there are large fiscal incentives to further cut corporate taxes and reap the benefits from increased tax bases.

Keywords Corporate profit tax · Foreign direct investment · Exports · User cost of capital · Tax reform

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