

FOCUSING ON CAPITAL MOBILITY: THE SOURCE OF PETER MIESZKOWSKI'S CONTRIBUTIONS

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IT IS ITSELF AN HONOR TO HAVE TAKEN PART IN a symposium honoring Peter Mieszkowski, whose work has influenced and guided so many researchers working in public finance and urban economics. Since George Zodrow and James Hines have provided broad overviews of Peter's achievements, I will take a different approach by focusing narrowly on the key focus that, in my view, is the source of his most important contributions.

To me, Peter's key contributions are the new view of the property tax and the basic model of tax competition. The new view was presented in a 1972 *Journal of Public Economics* paper, and the tax-competition model was developed in a 1986 *Journal of Urban Economics* paper with George Zodrow (a closely related paper by John Wilson was in the same *JUE* issue). I want to argue that both contributions arose from the same fundamental source: *a penetrating focus on the implications of capital mobility across jurisdictions.*

To understand this claim, start by considering the logical structure of the "new view" argument. The question concerns the effect of an increase in community i 's property tax rate. The property tax is modeled as a tax on capital, which is mobile across jurisdictions. Here is the resulting sequence of effects under the new view:

Jurisdiction i raises its property tax rate.

- > **capital's net-of-tax return in i falls below the prevailing level p**
- > **capital relocates to other jurisdictions $j \neq i$**
- > **capital's marginal product rises in i , raising its gross-of-tax return there**
- > **the capital inflow depresses its marginal product in $j \neq i$, reducing the net-of-tax return p outside i**
- > **Capital migration stops when the net-of-tax return in i equals new lower return in $j \neq i$.**

The consequences of these adjustments are a lower net return p to capital throughout the economy and a higher gross-of-tax return in jurisdiction i . Since

the first effect depresses the income of capital owners, the new view says that the property tax is partly a "profits tax." But since the second effect raises the cost of goods such as housing that use capital as an input, thus putting upward pressure on their prices in jurisdiction i , the new view also says that the property tax is an "excise tax."

The "classical" view of the property tax missed its profit-tax component by assuming that jurisdiction i is small relative to the outside economy, so that outward capital migration has no effect on the prevailing net-of-tax return. The classical view thus said that the gross-of-tax return in i would have to rise by the full amount of the tax, generating a pure excise effect. Alternatively, if capital is viewed as immobile, then an increase in jurisdiction i 's property tax would have no effect on the gross-of-tax return, with the net-of-tax return falling by the full amount of the tax. In this case, the property tax is a pure profits tax. By recognizing the full implications of capital mobility, the new view argued that the truth lies between these two extremes.

The tax-competition model, Peter's other important contribution, asks how the capital tax should be set, taking mobility into account. The capital-tax revenue is used to provide a public good for consumers, and the model takes a classical view, assuming that the jurisdiction is small relative to the outside economy. Here is the logic of the tax-competition model:

Higher capital-tax rate in jurisdiction i

- > **capital flight to other jurisdictions (with no effect on net-of-tax return)**
- > **smaller tax base in i**
- > **reluctance to raise tax rate**
- > **underprovision of public goods**

Thus, the implications of capital mobility are developed here in a different direction, leading to a striking conclusion about public-sector inefficiency. The tax-competition model therefore provided a dark picture of the effects of interjurisdictional competition, which stands in stark con-

trast to the sunny depiction offered by the Tiebout tradition.

While the basic tax-competition model was developed in a classical context, further work considered the case of “larger” jurisdictions like those in the new view, whose decisions can affect capital’s net-of-tax return. Then, an increase in jurisdiction i ’s tax rate has profit as well as excise effects, which are both taken into account in setting the rate. With this structure, communities interact in their choice of tax rates, so that a Nash equilibrium must be analyzed.

Peter’s key contributions thus followed from an imaginative exploration of the implications of capital mobility. The new view demonstrated the

role of mobility in determining how the property tax affects the returns to capital, while the tax-competition model showed how capital mobility can distort the provision of public goods. These are important lessons, both derived from a common source.

References

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