

Optimal Fiscal Policy in a Dynamic Multi-Country World with Public Services

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Abstract

We construct a dynamic one-good multi-country growth model with productive government spending and perfect capital mobility to study fiscal interdependence among countries. In the case of a source-based tax we find that there is no strategic interaction and that the equilibrium spending/tax mix coincides with the optimal one. In the case of a residence-based tax system, however, we find that there is strategic interaction across countries and that, under non-cooperation, countries tend to spend and tax over and above the optimal Pigouvian level.

JEL Classification: F42, O41, H87.

Key Words: International Policy Coordination, Government Spending, Optimal Tax, Endogenous Growth.

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