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Evidence-based policy making

# Is high-skilled migration harmful to tax systems' progressivity?

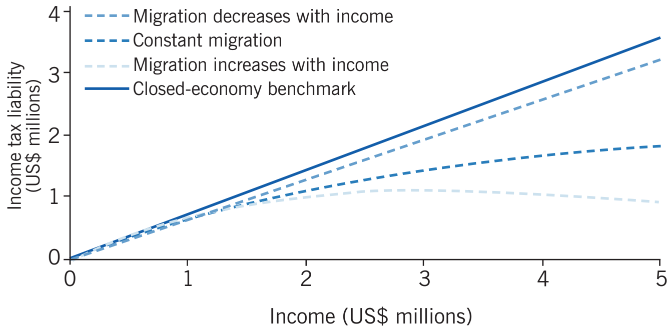
## Understanding how migration responds to tax changes will aid in setting the progressivity of a tax system

Keywords: tax competition, top income earners, migration

## ELEVATOR PITCH

Decreased transportation costs have led to the transmission of ideas and values across national borders that has helped reduce the barriers to international labor mobility. In this context, high-skilled individuals are more likely to vote with their feet in response to high income taxes. It is thus important to examine the magnitude of tax-driven migration responses in developed countries as well as the possible consequences of income tax competition between nation states. More specifically, how does the potential threat of migration affect a country's optimal income tax policies?

Optimal tax liabilities for three possible migration responses, US




*Source*: Author's own calculations using data from [1].

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## KEY FINDINGS

**Pros**

- Some types of taxpayers do move in response to taxation levels, most notably highly paid (and highly skilled) workers.
- Increasing tax competition for high-income earners may damage the "social contract" that resulted from the historical development of the welfare state in developed countries.
- The response of migration to post-tax earnings must be precisely understood in order to derive the optimal income tax schedule.
- If very rich people are very sensitive to tax changes, and in particular more sensitive than others, then tax progressivity may not be optimal.

**Cons**

- The best current estimates of taxpayers' migration responses are essentially useless, because they do not estimate the correct parameter.
- Because those who move in response to taxation are a small share of the overall population, estimating the relevant statistic requires rather exhaustive data sets.
- The link between tax competition and increased inequalities has not been clearly established.

## AUTHORS' MAIN MESSAGE

Migration responses of highly skilled workers to tax changes are usually studied through looking at migration elasticities with respect to post-tax earnings (i.e. what percentage of workers migrate due to a change in their post-tax earnings). However, the generally accepted theory relies upon the wrong measure of elasticity. This calls for a new direction in empirical work regarding the estimation of migration responses to tax changes. Policymakers should avoid "tax tagging," intended to draw highly skilled foreign workers into their labor market, and instead work to strengthen international cooperation on both corporate and income tax levels.


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