

Follow the herd. Spatial interactions in tax setting behaviour of Italian municipalities

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This paper seeks to shed light on the determinants of local tax rates in Italy by focusing on the mutual interactions between local fiscal policies and the features of the electoral system, which is the key insight of the yardstick competition theory. In a framework of asymmetric information, voters use tax rates set by adjacent municipalities as a yardstick to evaluate the performance of their incumbents. Local administrators anticipate this behaviour and move as a herd, mimicking each other. Within this analytical setup we study the extent and the sign of spatial correlation among Italian municipal property tax rates in the years 1998-2006. We follow a spatial panel approach in order to control for individual time-invariant characteristics and gauge the extent of genuine tax mimicking behaviour. Our results are supportive of positive spatial correlation among property tax rates. Own tax rates appear to react more strongly to neighbours policy choices than to standard determinants of tax setting decisions. Our conviction that tax herding is driven by information spillovers rather than resource flows comes from the low mobility of the tax base and from a counterfactual evidence of tax rates increasing over time. Furthermore, such evidence calls for measures aimed at containing the risk of tax collusion that may arise from herding behaviour.