Tax Reforms and Investment: A Cross-Country Comparison

Jason G. Cummins
New York University

Kevin A. Hassett
Board of Governors of the Federal Reserve System

R. Glenn Hubbard
Columbia University and NBER

This Draft: September 27, 1995

Abstract

We use firm-level panel data to explore the extent to which fixed investment responds to tax reforms in 14 OECD countries. Previous studies have often found that investment does not respond to changes in the marginal cost of investment. We identify some of the factors responsible for this finding, and employ an estimation procedure that sidesteps the most important of them. In so doing, we find evidence of statistically and economically significant investment responses to tax changes in 12 of the 14 countries.

We thank Alan Auerbach, Eric Bartelsman, Roger Gordon, Michael Haliassos, Jeffrey MacKie-Mason, Steve Nickell, three anonymous referees and participants at the NBER Summer Institute, the Seminar on International Perspectives on the Macroeconomic and Microeconomic Implications of Financing Constraints, and the Trans-Atlantic Public Economics Seminar for helpful comments and suggestions, and Sam Coffin for research assistance. Cummins gratefully acknowledges support from the Center for International Business Education, the Chazen Institute, a John M. Olin Foundation grant to the Center for Law and Economic Studies at Columbia University, and the C. V. Starr Center for Applied Economics at New York University. Hubbard is grateful for support from a John M. Olin Foundation grant to the Center for the Study of the Economy and State at the University of Chicago and from the Federal Reserve Bank of New York. The views expressed in this paper are those of the authors, and do not necessarily represent those of the Board of Governors of the Federal Reserve System.