# Globalization, Increasing Returns and Tax Competition

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**Abstract**

Mobile capital is an important production factor in forming international trade. Leading by the so-called footloose capital model, almost all models in the existing new trade theory assume mobile capital as the fixed input of production and immobile labor as marginal input, this paper considers the other case that immobile labor is the fixed input and mobile capital is the marginal input. There is only one manufacturing sector and we do not assume any homogeneous good so that wages are endogenously determined. This general-equilibrium model turns out to be totally solvable. We obtain a closed-form solution for the wages, showing that the larger country has a higher wage. We then prove that globalization is always beneficial to both large and small countries, although the nominal wage rate is not monotonic. This framework is then applied to examine a tax competition game that two governments levy tax (or subsidy) on mobile capital. Being able to incorporate the income effect, it is shown that the larger country subsidizes capital less and the tax differential decreases in the globalization level.

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