

January 26, 2019

Dear Professor Zárata-Marco,

I have now received reports from three reviewers regarding your manuscript, “Regional Tax Effort in Spain” (*Manuscript Number 2886; Discussion Paper Number No. 2018-79*). I thought the three reviewers made a number of valid points, but that you and your co-author did an excellent job of responding to their concerns. Based on those responses, I am inviting you to submit a revision of your manuscript.

As you follow through on the things that you say you will do in your responses, I would also like your revision to address the following:

1) Be more compelling about the advantages of SFA. I am sure you can say it better than this, but say something like: “A key question is what percent of total tax capacity are governments capturing through their tax efforts? This requires identifying maximum potential tax revenue. This is what stochastic frontier analysis does: it identifies the maximum potential of the dependent variable. Non-frontier analyses can only estimate the mean of the dependent of the variable.”

2) Key in your analysis is the division of variables between capacity and effort. You need to better support your selection of variables for functions f and g in Equations (3) and (4). I suggest you make a table with two panels. The top panel are the variables in f . The bottom panel are the variables in g . The first column gives the variable name. The second column lists all the studies that clearly specify this as a tax capacity or tax effort. If no other studies have used a variable for tax capacity/tax effort, then list “None.” This would provide some structure for your discussion of variable specification, and should strengthen your arguments.

3) When you present your results, interpret the size of your coefficients (are they simply elasticities/semi-elasticities?). Do not just comment on their sign and statistical significance. Are the sizes of the coefficients “reasonable”?

4) In Table 3 and the text, do not refer to the OLS estimator as “XTSCC”. It is OLS (with fixed effects?). The Driscoll/Kraay procedure is simply the procedure used to calculate standard errors.

5) In your responses to Reviewers 2 and 3, you mention a new procedure for addressing endogeneity in SFA analysis. This procedure should be discussed in the revision with a good explanation. Presumably, endogeneity is addressed via instrumental variables? What instruments were used? Are there any diagnostics for instrumental validity that can be reported?

6) Further, it wasn't clear to me how you were able to report Wu-Hausman estimates in Table 1 of your response to Review 3, but also said that the *xtsfkk* command does not allow you to instrument the tax effort variables (the variables in the function g). Please explain.

7) Explain better how you obtained the estimates of Table 2 in your response to Reviewer 3. Did you simply replace INCOME with a predicted value of INCOME and then insert that into the SFA procedure? If that is what you did, can you justify that procedure?

8) I'm not sure what Figure 1 is supposed to demonstrate. It would be more interesting if you could identify the factors most responsible for the differences in Tax Effort that you report in Table 3.

Minor comments:

9) Page 14, line 12: There is a word missing in "Thus, all the and time-invariant effects..."

10) Page 17, line 10: "latter do not allowing us" should be "latter do not allow us".

11) Page 19, line 17: "so it looks like reasonable to refute the..." should be replaced with something like "refuting the...".

A revised version of your manuscript that addresses the instructions above will be reconsidered for publication. If you choose to resubmit a revision, be sure to confirm that you made the changes you said you would make in your responses to the reviewers. Also, include a point-by-point response to the items listed above.

Please note that submitting a revision of your manuscript does not guarantee eventual acceptance.

Once again, thank you for submitting your manuscript to *Economics; The Open-Access, Open-Assessment E-Journal*. I look forward to receiving your revision.

Sincerely,

Bob Reed
Co-Editor, *Economics E-Journal*