



Effects of Income Tax Changes on Economic Growth

Smt. Usha Thakre and Dr. Ramsingh Kushwaha

Department of Economics

Government College Umranala, Chhindwara and Mandyanchal Professional University, Bhopal, MP, India
ushathakre82@gmail.com and ram.kushwaha2008@gmail.com

Abstract: *This paper examines how changes to the individual income tax affect long-term economic growth. The structure and financing of a tax change are critical to achieving economic growth. Tax rate cuts may encourage individuals to work, save, and invest, but if the tax cuts are not financed by immediate spending cuts they will likely also result in an increased federal budget deficit, which in the long-term will reduce national saving and raise interest rates. The net impact on growth is uncertain, but many estimates suggest it is either small or negative. Base-broadening measures can eliminate the effect of tax rate cuts on budget deficits, but at the same time they also reduce the impact on labor supply, saving, and investment and thus reduce the direct impact on growth. However, they also reallocate resources across sectors toward their highest-value economic use, resulting in increased efficiency and potentially raising the overall size of the economy. The results suggest that not all tax changes will have the same impact on growth. Reforms that improve incentives, reduce existing subsidies, avoid windfall gains, and avoid deficit financing will have more auspicious effects on the long-term size of the economy, but may also create trade-offs between equity and efficiency.*

Keywords: Income Tax

REFERENCES

- [1]. Altig, David, Alan J. Auerbach, Laurence J. Kotlikoff, Kent A. Smetters, and Jan Walliser. 2001. "Simulating U.S. Tax Reform." *American Economic Review* 91 (3): 574-95.
- [2]. Auerbach, Alan J. 2002. "The Bush Tax Cut and National Saving." Berkeley: University of California, Berkeley and NBER.
- [3]. Auerbach, Alan J., Laurence J. Kotlikoff, Kent A. Smetters and Jan Walliser. 1997. "Fundamental Tax Reform and Macroeconomic Performance." Washington, D.C: Congressional Budget Office.
- [4]. Auerbach, Alan J., and Joel Slemrod. 1997. "The Economic Effects of the Tax Reform Act of 1986." *Journal of Economic Literature* 35 (2): 589-632.
- [5]. Committee on Ways and Means. 2014. "Tax Reform Act of 2014: Discussion Draft." Washington, D.C: 113th Congress. 2nd Session.
- [6]. Congressional Budget Office. 2001. "The Budget and Economic Outlook: An Update"
- [7]. Congressional Budget Office. 2005. "Taxing Capital Income: Effective Rates and Approaches to Reform."
- [8]. Congressional Budget Office. 2006. "Computing Effective Tax Rates on Capital Income."
- [9]. Congressional Budget Office. 2010. "The Budget and Economic Outlook: An Update."
- [10]. Congressional Budget Office. 2013. "The 2013 Long-Term Budget Outlook."
- [11]. Dennis, Robert, et al. 2004. "Macroeconomic Analysis of a 10 Percent Cut in Income Tax Rates." Technical Paper Series. Washington, D.C: Congressional Budget Office.
- [12]. Debt Reduction Task Force. 2010. "Restoring America's Future: Reviving the Economy, Cutting Spending and Debt, and Creating a Simple, Pro-Growth Tax System." Washington, D.C: Bipartisan Policy Center.



- [13]. Desai, Mihir A., and Austan D. Goolsbee. 2004. "Investment, Overhang, and Tax Policy." *Brookings Papers on Economic Activity* 2004 (2): 285 – 355.
- [14]. Diamond, John W., and Alan D. Viard. 2008. "Welfare and Macroeconomic Effects of Deficit-Financed Tax Cuts: Lessons from CGE Models." *Tax Policy Lessons from the 2000s*: 145-193. Washington, D.C: The AEI Press.
- [15]. Diamond, John W., and George Zodrow. 2008. "Consumption Tax Reform: Changes in Business Equity and Housing Prices" *Fundamental Tax Reform: Issues, Choices and Implications*. Cambridge: MIT Press
- [16]. Economic Report of the President. 2003. Washington, D.C: United States Government Printing Office.
- [17]. Elmendorf, Douglas W., and N. Gregory Mankiw. 1999. "Government Debt." *Handbook of Macroeconomics* 1C. Edited by John B. Taylor and Michael Woodford. Amsterdam: Elsevier Science B.V.
- [18]. Elmendorf, Douglas W., and David Reifschneider. 2002. "Short Run Effects of Fiscal Policy with Forward-Looking Financial Markets." *National Tax Journal* 55 (3): 357-86.
- [19]. Engen, Eric, and R. Glenn Hubbard. 2004. "Federal Government Debts and Interest Rates." Cambridge: National Bureau of Economic Research Working Paper 10681.
- [20]. Engen, Eric M., and Jonathan Skinner. 1992. "Fiscal Policy and Economic Growth." Cambridge: National Bureau of Economic Research Working Paper 4223.
- [21]. Engen, Eric M., and Jonathan Skinner. 1996. "Taxation and Economic Growth." *National Tax Journal* 49 (4): 617-42.
- [22]. Favero, Carlo, and Francesco Giavazzi. 2009. "How Large Are The Effects of Tax Changes?" Cambridge: National Bureau of Economic Research Working Paper 15303.
- [23]. Feldstein, Martin. 1986. "Supply Side Economics: Old Truths and New Claims." *American Economic Review* 76 (2): 26-30
- [24]. Feldstein, Martin, and Douglas W. Elmendorf. 1989. "Budget Deficits, Tax Incentives, and Inflation: A Surprising Lesson from the 1983-1984 Recovery." Edited by Lawrence H. Summers. *Tax Policy and the Economy* (3). Cambridge: National Bureau of Economic Research.
- [25]. Foertsch, Tracy. 2004. "Macroeconomic Impacts of Stylized Tax Cuts in an Intertemporal Computable General Equilibrium Model." Washington, D.C: Congressional Budget Office.
- [26]. Fuchs, Victor R., Alan B. Krueger, and James M. Poterba. 1998. "Economists' Views About Parameters, Values, and Policies: Survey Results in Labor and Public Economics." *Journal of Economic Literature* 36 (3): 1387-1425.
- [27]. Fullerton, Don, and Y.K. Henderson. 1987. "The Impact of Fundamental Tax Reform on the Allocation of Resources" in M.Feldstein, ed., *The Effects of Taxation on Capital Accumulation*, Chicago: The University of Chicago Press
- [28]. Gale, William G., and Peter R. Orszag. 2004a. "Budget Deficits, National Saving, and Interest Rates." *Brookings Papers on Economic Activity* 2004 (2): 101-187.
- [29]. Gale, William G., and Peter R. Orszag. 2004b. "Tax Cuts, Interest Rates, and the User Cost of Capital." Washington, D.C: The Brookings Institution.
- [30]. Gale, William G., and Peter R. Orszag. 2005a. "Deficits, Interest Rates, and the User Cost of Capital: Reconsidering the Effects of Tax Cuts on Investment". *National Tax Journal* 58 (3): 409-426.
- [31]. Gale, William G., and Peter R. Orszag. 2005b "Economic Effects of Making the 2001 and 2003 Tax Cuts Permanent." *International Tax and Public Finance*. 12 (2): 193-232.
- [32]. Gale, William G., and Samara Potter. 2002. "An Economic Evaluation of the Economic Growth and Tax Relief Reconciliation Act." *National Tax Journal* 55 (1): 133-86.
- [33]. Garrison, Charles B., and Feng-Yao Lee. 1992. "Taxation, Aggregate Activity and Economic Growth: Further Cross-country Evidence on Some Supply-Side Hypotheses." *Economic Inquiry* 30 (1): 172-76.
- [34]. Gravelle, Jane G. 2014. "Dynamic Scoring for Tax Legislation: A Review of Models." Washington, D.C: Congressional Research Service.



- Gravelle, Jane G., and Laurence J. Kotlikoff. 1989. "Corporate Taxation and the Efficiency Gains of the 1986 Tax Reform Act." Cambridge: National Bureau of Economic Research.
- [35]. Grier, Kevin B., and Gordon Tullock. 1989. "An Empirical Analysis of Cross-National Economic Growth, 1951-80." *Journal of Monetary Economics* 24 (2): 259-76.
- [36]. Harberger, Arnold. 1962. "The Incidence of the Corporation Income Tax." *Journal of Political Economy* 70 (3): 215-40.
- [37]. Huang, Chye-Ching. 2012. "Recent Studies Find Raising Taxes on High-Income Households Would Not Harm the Economy: Policy Should Be Included in Balanced Deficit-Reduction Effort." Washington, D.C: Center on Budget and Policy Priorities.
- [38]. Huang, Chye-Ching, and Nathaniel Frenzt. 2014. "What Really is the Evidence on Taxes and Growth." Washington, D.C: Center on Budget and Policy Priorities.
- [39]. Hungerford, Thomas. 2012. "Taxes and the Economy: An Economic Analysis of the Top Tax Rate Since 1945." Washington, D.C: Congressional Research Service.
- [40]. Joint Committee on Taxation. 2003. "Macroeconomic Analysis of H.R. 2, The Jobs and Growth Reconciliation Tax Act of 2003." Washington D.C: 108th Congress. 1st session.
- [41]. Joint Committee on Taxation. 2014. "Macroeconomic Analysis of the Tax Reform Act of 2014." Washington, D.C: 113th Congress. 2nd Session.
- [42]. Jones, Larry E., Rodolfo E. Manuelli, and Peter E. Rossi. 1993. "Optimal Taxation in Models of Endogenous Growth." *Journal of Political Economy* 101 (3): 485-517.
- [43]. Kneiser, Thomas J., and James P. Ziliak. 2002. "Tax Reform and Automatic Stabilization." *The American Economic Review* 92 (36): 590-612
- [44]. Laubach, Thomas. 2009. "New Evidence on the Interest Rate Effects of Budget Deficits and Debt." *Journal of the European Economic Association* 7 (4): 858-85.
- [45]. Lim Rogers, Diane (Now Diane Lim). 1997. "Assessing The Effects of Fundamental Tax Reform With The Fullerton-Rogers General Equilibrium Model." Washington, D.C: Congressional Budget Office
- [46]. Lucas, Robert E. 1990. "Supply-Side Economics: An Analytical Review." *Oxford Economic Papers* 42 (2): 293-316.
- [47]. Macroeconomic Advisors. 2003. "A Preliminary Analysis of the President's Jobs and Growth Proposals." Washington, D.C.
- [48]. McBride, William. 2012. "What Is The Evidence on Taxes and Growth." Special Report No. 207. Washington, D.C: The Tax Foundation.
- [49]. Mendoza, Enrique G., Gian-Maria Milesi-Ferretti, and Patrick Asea. 1997. "On the Ineffectiveness of Tax Policy in Altering Long-Run Growth: Harberger's Superneutrality Conjecture." *Journal of Public Economics* 66 (1): 99-126.
- [50]. National Commission on Fiscal Responsibility and Reform. 2010. "The Moment of Truth." Washington, D.C: The White House
- [51]. Nishiyama, Shinichi, and Kent Smetters. 2005. "Consumption Taxes and Economic Efficiency with Idiosyncratic Wage Shocks." *Journal of Political Economy* 113 (5): 1088-115.
- [52]. Padovano, Fabio, and Emma Galli. 2001. "Tax Rates and Economic Growth in the OECD Countries (1950-1990)." *Economic Inquiry* 39 (1): 44-57.
- [53]. Piketty, Thomas, Emmanuel Saez, and Stefanie Stantcheva. 2011. "Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities." Cambridge: National Bureau of Economic Research Working Paper 17616
- [54]. President's Advisory Panel on Federal Tax Reform. 2005. "Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System." Washington, D.C.
- [55]. Reifschneider, David, Robert Tetlow, and John Williams. 1999. "Aggregate Disturbances, Monetary Policy, and the Macroeconomy: The FRB/US Perspective." *Federal Reserve Bulletin* 1999 (January): 1-19.



- [56]. Romer, Christina D., and David H. Romer. 2010. "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks." *American Economic Review*. 100 (3): 763-801
- [57]. Slemrod, Joel. 1995. "What Do Cross-Country Studies Teach About Involvement, Prosperity, and Economic Growth?" *Brookings Papers on Economic Activity* 1995 (2): 373-415.
- [58]. Stokey, Nancy L., and Sergio Rebelo. 1995. "Growth Effects of Flat-Rate Taxes." *Journal of Political Economy* 103(3): 519-50.
- [59]. Taylor, John. 1993. "Discretion versus policy rules in practice." *Carnegie-Rochester Conference Series on Public Policy*(39): 195–214.
- [60]. Toder, Eric, and Alan D. Viard. 2014. "Major Surgery Needed: A Call for Structural Reform of the U.S. Corporate Income Tax." Washington, D.C. FDASF – ADFS