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Impact of Income Tax on Economic growth

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Abstract: *This paper explores the impact of changes to the individual income tax on economic growth over the long run. In order to achieve economic growth, the structure and finance of a tax reform are crucial. Tax rate cuts may motivate individuals to work, save, and invest; however, if they are not accompanied by rapid spending cutbacks, they will likely increase the federal budget deficit, which will reduce national saving and increase interest rates in the long run. Much estimation indicates that the influence on growth is either negligible or negative. Base-broadening policies can minimise the effect of tax rate decreases on budget deficits, but they also diminish the impact on labour supply, savings, and investment, so reducing the direct influence on economic growth. However, they also reallocate resources across sectors to their highest economic value utilisation, resulting in higher efficiency and maybe a larger economy overall. Results indicate that not all tax reforms will have the same effect on economic development. Reforms that increase incentives, eliminate existing subsidies, minimise windfall gains, and avoid deficit financing will have more favourable long-term effects on the size of the economy, but may also generate tradeoffs between equity and efficiency.*

Keywords: Economic Growth, Income Tax, Reforms, Budget

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