Estimating Dynamic Income Responses to Tax Reform*

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Abstract

We study income responses to income tax changes by using a large panel of Swedish tax payers over the period 1991–2002. Changes in statutory tax rates as well as changes in tax bracket thresholds provide exogenous variations in tax rates that can be used to identify income responses. We estimate dynamic income models which allow us to distinguish between short-run and long-run effects in a straightforward fashion. For men, the estimates of the long-run elasticity of income with respect to the net-of-tax rate hover in a range between 0.10 and 0.30. The estimates for women are statistically insignificant. We simulate the fiscal consequences of a tax reform that reduces the top marginal tax rate by five percentage points. Such a reform may have negligible effects on tax revenues when the interactions between income taxes and other taxes are taken into account.

KEYWORDS: marginal tax rates, progressive taxes, earned income, tax reform

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