Abstract

This paper uses REMS, a Rational Expectations Model of the Spanish economy designed by Boscá et al (2007) to analyse the effects of lowering the overall tax edge to the level prevailing in the US. Our results partially confirm previous findings in the literature: a reduction in the overall tax wedge of 19.5 points, in order to reach the US levels, has a positive effect in the long run, increasing total hours by about 7 per cent and GDP by about 8 percentage points. In terms of GDP per adult, these results account for ¼ of the gap with respect to the US, but imply a reduction of only one percentage point in the labour productivity gap. The rise in total hours per adult is explained by a similar increase in both hours per employee and the employment rate of about 3.5 percentage points, allowing hours per adult to converge to levels only slightly lower than those in the US.

Key words: general equilibrium, tax wedge, tax reforms, fiscal policy, labour market

JEL classification: E32, E62