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# After the death of inflation: will fiscal drag survive?

Friedrich Heinemann

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## Abstract

Declining inflation rates might have negative consequences for tax revenues. Phenomena such as the inflationary bracket creep in a progressive income tax system do not work any longer. With this background, the paper analyses the extent of fiscal drag for OECD countries since 1965. Some consideration of the role of money illusion and indexation in this context lays the theoretical base. A framework is presented that allows for the classification of fiscal structures with regard to the type of fiscal drag. The subsequent econometric panel analysis is performed for total and disaggregated government revenues. The results back theoretical considerations of inflation's impact on different kinds of taxes, which tends to be positive for individual income taxes and social security contributions and is negative for corporate income taxation. The paper concludes that both declining inflation and changing tax structures limit the potential for future fiscal drag.

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