

# Stabilization Effects of Taxation Rules in Small-Open Economies with Endogenous Growth

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## Abstract

This paper studies stabilization effects of nonlinear income taxation in small open economies with endogenous growth. We show that in the standard setting where domestic households freely lend to or borrow from foreign households under an exogenously given world interest rate, progressive taxation gives rise to equilibrium indeterminacy, while regressive taxation establishes equilibrium determinacy. These policy effects do not necessarily hold, either if the time discount rate is endogenously determined or if the world interest rate is elastic.

*Keywords:* Taxation Rules, Equilibrium Indeterminacy, Small-Open Economies, Endogenous Growth

*JEL Classification:* E62, O41