

On the Effects of Tax Policy through Credit Channel*

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Abstract

The main purpose of this paper is to investigate the effectiveness of taxation policy under the existence of financial friction. The present paper specifically focuses on the role of banking sector. We then introduce taxation policy into the two-periods version of Gertler and Kiyotaki (2010) that established the model in which banking sector is introduced. We investigate the effect of taxation through credit channel under the both cases in which policy determination is exogenous and endogenous. We show that introduction of taxation is effective in the sense that the government can prevent default, but at the same time, it is necessary to keep it in mind that the policy effect alters depending on whether the government has a commitment technology.

Keywords: Tax Channel; Credit Channel; Financial Friction; Commitment.

JEL Classification: H22,E61.

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URL: <https://dl.dropbox.com/u/1705261/taxchannel.htm>

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