

## Taxation, Debt and Relative Prices in the Long Run: The Irish Experience (with Adnan Velic)

### *Abstract*

This paper examines the effects of debt and distortionary labour taxation on the long-run behaviour of relative prices of non-tradables. In a two-sector open economy model we demonstrate that higher taxation, associated with higher public debt, contracts labour supply in both tradable and non-tradable goods sectors. Relative prices move inversely with shifts of relative supply which, in turn, depend on relative factor intensities. At the empirical level we find significantly negative effect of taxes and public debt on the relative price of non-tradables. Accordingly, public debt and taxation bear implications for the international price competitiveness of Ireland.