

**DO TAXES EFFECT AS A BARRIER FOR SMALL
BUSINESSES' PERFORMANCE: EVIDENCE FROM
ENTERPRISES IN UZBEKISTAN?**

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Abstract

Small business has attracted attention lots of researchers for last decade, as it is still one of main contributors of the economic growth. In our research, we have tried to find the effect of taxes on small businesses' performance and had a goal to define and prove that there are other stronger factors, which effect as a barrier on performance of small businesses. We have conducted a survey among small business entities in Uzbekistan and used 1628 full respond questionnaires for our analyses. We found that taxes are significant factor and can become a serious barrier for the development of small businesses; also, we found that level of regional infrastructure is stronger factor than taxes, which effects on performance of small businesses. Beside of it we have defined other barrier-factors which effect on performance of small businesses and provided with recommendations to overcome them.

Key words: small business, taxes, Uzbekistan, performance barriers, infrastructure

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1. Introduction

There are tremendous changes occurring in the way how business is conducted. Last two decades changes took into itself the liberalization of trade, increasing the level of regional economic integrations and development of information technologies and communications. These all changes still did not eliminate the significance of small business as a main component of overall economic activity (Leonidou 2004). Small businesses still continue to be important contributors to economic growth and development. They make a significant contribution in solving employment related issues and the provision of low cost goods and services. A large number of studies have confirmed that most of the new jobs come from the small business industry (Stanworth and Curran 1976; Burns and Dewhurst 1996; Glancey 1998). Although the small business sector represents a significant proportion of the global economy (Morrison and Ali, 2003), the role of small business is most critical in small developing economies where size, technology, capital and other resource constraints limit the establishment of large businesses. In such economies, small businesses have very important role in providing goods and services for the society.

The strong believe that taxes affect economic growth of the country and performance of firms has become the topic of most recent debates in the press and among economic scientists groups. That is in part because there are competing theories about what drives economic growth. Some subscribe to Keynesian, demand-side factors, others Neo-classical, supply-side factors, while yet others subscribe to some mixture of the two or something entirely unique. The facts, historical and geographical variation in key parameters for example, should shed light on the debate. However, the economy is sufficiently complex that virtually any theory can find some support in the data.

It is interesting to know in the end what does the academic literature say about the empirical relationship between taxes and performance? While there are a variety of methods and data sources, the results consistently point to significant negative effects of taxes on economic growth even after controlling for various other factors such as government spending, business cycle conditions, and monetary policy. We have thoroughly reviewed the literature, and found that twenty-three of twenty-six such studies up to 1983 and all studies in the last fifteen years conclude that taxes have a negative effect of on performance. Review shows that among of those effecting taxes corporate income taxes are found to be most harmful, followed by personal income taxes, consumption taxes and property taxes.

Most of studies done up to now mainly cover or macroeconomic indicators of growth or behavior of large corporations. In our study we have tried to find how do taxes effect on small businesses' performance and also had a goal to define weather taxes are the main barrier factor in the development and prosper of small businesses or there are other stronger factors which directly or indirectly effect on performance of small businesses.

2. Literature review

2.1. *Effect of taxes on small businesses' performance*

The large amount of empirical studies of taxes and economic growth published in a peer reviewed academic journal conclude that tax increases negatively impact on economic growth. Most of the recent studies differentiate by type of tax, rather than using some broad measure of taxes. Only noticeable exception is done in the research of Romer (2010), who look at the overall U.S. federal tax burden as a share of GDP since World War II. They use qualitative analyses methods where the narrative record of federal tax changes, including presidential speeches, congressional reports, etc., are used to identify legislated "tax shocks". This method allow them to minimize the statistical problem of reverse causality and as a result they had a finding which shows much larger negative effects of taxes as compared to earlier studies.

If to look at the problem of growth in macroeconomic scale the set of studies look at episodes of fiscal consolidation and fiscal stimuli and try to estimate how tax policy effectson economic growth. Alesina and Ardagna(2010) make very thorough study and cover a large number of cases occured in OECD countries between 1970 and 2006. They find that fiscal stimuli based upon tax cuts are more likely to increase growth than those based upon spending increases. If to compare these two strategies on spending cuts and tax increase we can see from IMF analyzes of 170 cases of fiscal consolidation in fifteen advanced countries over the last thirty years show that spending cuts are much less damaging to short term growth than are tax increases. They find a 1 percent spending cut has no significant effect on growth, whereas a 1 percent tax increase reduces GDP by 1.3 percent after two years. Fiscal consolidation researches of Goldman Sachs and others have similar conclusions.

We have mentioned before that most recent studies distinguish between different types of taxes according its effect on the economy. Corporate and shareholder taxes should mainly affect investment and capital formation, while income taxes affect labor and saving by individuals as well as investment by non-corporate business owners. (Hogdeand Raut, 2012) Consumption taxes, such as sales taxes, affect suppliers of labor and capital, but neutrally. Corporate and personal income taxes are not neutral, as they represent essentially additional, double taxes on

future consumption. These empirical studies typically find that corporate and personal income taxes are the most damaging to economic growth, followed by consumption taxes and property taxes.

In a series of OECD working papers (Johansson et.al, 2008), summarized by Arnold et al. (2011) OECD economists have determined a ranking of the most harmful taxes for economic growth. They find that corporate taxes are the most harmful, followed by personal income taxes, consumption taxes, and, the last, property taxes.

Lee and Gordon (2005) also state on the basis of empirical analyses that corporate taxes reduce growth by reducing entrepreneurial activity. Ferede and Dahlby (2012) update and confirm the results of Lee and Gordon, using data on statutory tax rates in the Canadian provinces over the period 1977 to 2006, averaging over five year periods.

Logically macroeconomic effects of factors should reflect in the same way in microeconomic level, that is why first we have looked through the effect of taxes on country level and then analyze the literature, which studies effect of taxes on performance. There are many studies and researches were conducted on the significance of small business in the development of economies. However, there are limited number of studies, which focus on the constraints faced by small businesses. There is a study done by Mambula (2002) about SMEs in Nigeria where he listed four key factors that pose problems to SME growth. These are defined as a lack of finance, poor infrastructure, difficulty in getting machines and spare parts, and difficulty in getting raw materials. Evidence from reviewed literature show that lack of finance, which can caused in some cases because of high tax rates, is a common problem on the way of small businesses in developing countries. To overcome this problem it became popular to establishment micro-financing schemes with less stringent requirements. Based on reviewed literature and discusses above we propose the following hypothesis:

Hypothesis 1. Taxes are significant barriers for small businesses' performance

2.2. Other factors which effect on small businesses' performance

There are many factors which has been discussed in analyze of most scholars who studied small business performance. Network links is one of factors, which have significant influence to the development of small businesses. Network linkages can help to mobilize resources quickly (Premaratne, 2001) thus providing extra resources that affect growth of small business. Cromie, et. al., (1994) based in his research claim that the greater the number of contracts available to small enterprise, the greater are the chances of acquiring the information and other resources needed at minimal cost. Brown and Butler (1993) argue that the types of information which are

obtained in networks play significant role in finding business opportunities and also can help ensure the success of a business. Gibb (1993) and Humphrey and Schmitz (1996) propose that small enterprises can achieve the additional skills and resources which can be essential in competition and help to survive in the market through business networks.

Management strategies and planning are also critical for business growth and success Gaskillet. al., (1994). Business and strategic planning is critical for family firm success (Brown 1995; Knight 1993; Jones 1982; Ward 1988) for growth (Astrachan and Kolenko 1994; Poza 1989; Ward 1987, 1997) and for performance (Aram and Cowen 1990; Schwenk and Shrader 1993).

There are researches which have tried to define differences between an entrepreneur and a small business owner. It is important to mention that Schumpeter (1912) described the entrepreneur as one who does things in innovative ways by finding: new products/services, new markets, new methods of production, new forms of organization and new sources of supply. The Schumpeter-type entrepreneur is also a creator of jobs and a highly innovative harnesser of technology which generates economic growth and social change (Schumpeter 1934, Barth 1963, 1967).

There is another issue, which can affect the performance of small businesses, such as a local environment. North and Smallbone (1996) claim that there are various aspects of local environments that influence the development of SMEs. These aspects include the nature and size of local market opportunities, the opportunities for the local sourcing of inputs and subcontracting; the local transportation and communications infrastructure. Lee, and Osteryoung (2000) in their research classify these factors into four categories: government regulation factor, the marketing factor, managerial ability factor and technological factor. Mambula (2002) on his own states that other institutions in the private sector must cooperate with the government to support SME growth. Premaratne (2001) thinks that informal social capital plays an important role for small businesses on their way to success, where he proposes that social capital can help in reaching external additional resources. Based on above discussion we propose our next hypothesis:

Hypothesis 2. Level of development of regional infrastructure is stronger barrier to small businesses' performance than taxes

3. Data and methodology

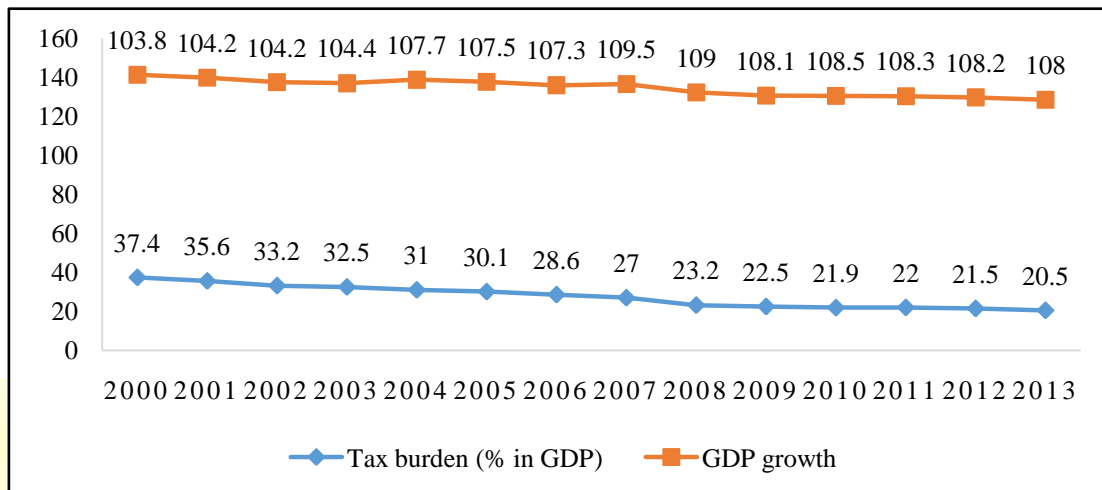
In our research to collect data, we have used a research-survey method. A research survey design is a method of collecting information by administering questionnaires to a sample of individuals; the research was performed through a survey using a mixture of semi-structured questionnaires. The population of the study is small business entities in Uzbekistan from different regions of the

country. We have collected sample frame on the basis of data provided from the local government offices, tax offices trade unions, trading houses in Uzbekistan. With sample random selection process, we have selected 2000 small business entities as a target firms for questioning. We have sent questionnaires with support of Chamber of Commerce and Industry of the Republic of Uzbekistan through its regional offices to all 2000 firms. Additionally we sent Survey Intention Letter to all firms in our sample. After the process of checking for mistakes and errata process, we have completed 1628 full questionnaires, which were successfully fulfilled and could be used for analyses procedure. Efforts were also made to select a range of firms with different characteristics such as market, size, duration of their operation, so the sample has a mix of homogenous and heterogeneous characteristics within the selected sample object there were CEOs, business owners, entrepreneurs who can give valuable information on our research subject. The research participants were given a clear written description of the purpose, scope and intended outcomes of the research. The type of information required for the research was clearly including the policy for anonymity and confidentiality. The survey questions were designed to examine only the barriers in improving their financial and innovation performance. Beside of proposed hypotheses as a research question we have goals to define all significant barriers for the development of small business.

4. Analyzes of results and discussion

During the years of independence in Uzbekistan, fiscal policy had an aim to develop the production, to increase real incomes, and further strength the economy. The process of liberalization of budget and tax spheres, which are carried out in Uzbekistan, is an important factor for stable development of the economy. Through these processes government can influence on small businesses' economic performance, can stimulate development of new types of businesses and solve urgent social problems. Structural transformation of the economy, increase of economic activity and financial stability of the business entities is a result of conducted rational tax policy for small businesses, where focus was on reducing the tax burden. For example, in 2011 the total tax burden, compared to 1991 decreased almost twice - from 41.2 to 22 per cent of GDP (Figure 1). Consistent improvement of tax policy creates conditions for each subject of small business not to evade from paying taxes, not to hide their income, on contrary, to try to develop their production and increase their profit.

Figure 1. Tax burden and the growth of GDP in Uzbekistan



Source: www.stat.uz (2014)

The most important result of ongoing tax reform is a gradual reduction in the tax burden on the economy, which was one of the most important factors in maintaining high economic growth. So, if in 1994 the rate of corporate income tax was 45%, in 2014 it dropped to 8%. From January of 2012, the rate of single tax for producers of industrial products (which several years ago was set at 13%) reduced up to 5%. In recent years, rate, and all other taxes tend to decrease. For example, the minimum tax rate on income of individuals also decreased from 13% in 2008 to 7.5% in 2014.

However, survey results show that 30.6 percent of respondents have mentioned that decreasing the tax rates had no any effect on their activity. It is known that the amount of net profit, which is left in their accounts, is very crucial for them. Net profit is directly related to tax mechanisms and in most cases this can define their future prosperity. Net profit is not only the source for dividend payments but also is a source for different-purpose funds which are formed in enterprises. Beside of it, net profit is one of sources of financing firm's investment and innovation activities. Here, it is important to mention that this indicator is directly related to profitability. Based on analyses above in today's processes of liberalization of the economy it is reasonable to define minimum level of firms' profitability and based on this indicator to achieve implementation of tax reforms. In our opinion if to imply profitability level relatively to overall income in 12-17 percent range, net profit might be around 8-10 percent. This, as a result can positively effect on small business performance and to the development of innovation and investment activity.

Table 1. Survey results conducted in Uzbekistan on effect of taxation on activity of small businesses

Factors		Respondents (1628)
Geographic location of tax payer	City	798
	Countryside	689
	Far territories with difficult access	141
Status of tax payer	Microfirm	709
	Small enterprise	618
	Individual entrepreneur	301
Regime of taxation	In general form	195
	In simplified form	947
	Single land tax payer	185
	Others	301
Form of activity	Production	679
	Trade	349
	Public catering	206
	Services	173
	Construction	108
	Other	113
Does your firm submit electronic tax reports?	Yes	706
	No	922
Does your tax payments result in removing of current assets?	Yes	1073
	No	555
Was there any effect of recent changes in taxation to your firm's performance?	Positive	731
	Negative	398
	Indifferent	499
What kind of tax measures should be undertaken to stimulate the activity of small businesses?	Perfection of tax offices activity	332
	Increase tax incentives	344
	Decrease the tax rate	339
	Other	613

On a question about perfection of tax system in Uzbekistan 20.4 percent respondents mentioned that there is a need for perfection of the activity of tax offices; 21.1 percent said that there is a need for more tax incentives; 20.8 think that tax rates should be decreased and 37.6 percent of respondents showed other measures which are need to be undertaken.

It is important to state that most of respondents have suggested additional measures to undertake such as improving current tax calculation methods, reduce the legislative base, reduce the changes applied in legislative framework, cancel inefficient incentives, simplify tax calculations for some tax types, and make the process of calculation mechanism for single tax tariffs simpler. Additionally, 21.1 percent of respondents who have participated in survey said that tax incentives should be increased. However, there are several measures were undertaken on this direction in Uzbekistan. If we look at Tax codes, President's decrees and decrees of government

in 2009, the 94.7 percent of all tax incentives were given for the development of production and service industries.

According to opinions of respondents, considering that in the first year of firm's activity there are limited opportunities to gain profit, it would be reasonable to give the right to pay general taxes for small businesses later and allow them to postpone this process until firms do not start to have sufficient amount of income. According to their answers, it will help small businesses during the first year of their activity if to leave the amount of cash for their own usage, which had to be deducted as general tax.

Interesting that 20.4 percent of respondents sure that the activity of tax offices should be improved and that some more additional measures must be implemented on this direction. Of course, up to now there were plenty of actions undertaken in our sample country. For example, in order to increase the transparency of government control system on entrepreneurship, eliminate facts of abuse by officials, to create a unified legal base for giving permissions, to unify permission processes in authorized bodies, to overcome bureaucracy barriers on the way of small business there was accepted a new law "About rules and regulations in giving permissions on entrepreneurship".

As a result of undertaken actions, number of regulations for giving permissions were decreased from 333 to 271. "Single window" concept was realized and it has been clearly defined that in situations when it is necessary to take permissions from two government bodies, the one where it was applied should undertake actions on agreeing with another government body.

In order to find major barrier on the way of small businesses to respondents from our sample was given a question where they had to show the factor which plays significant role in development of small businesses and can become a serious barrier for their performance. Respondents had options to choose, such as taxation, stable legislation, high rate of bank credits, regional infrastructure development, and currency exchange. The evaluation scale was defined from 1 to 6, where higher numbers represent stronger effect and lower numbers weaker effect of the factor in small business performance. According to respondents of the survey from proposed six factors, taxation has high negative impact on small business performance. (Table 3). 18.4 percent of respondents have chosen this factor as a main barrier for their performance and in our list of factors taxation is a third important factor.

Table 2. Changes made in taxation legislation for 2010-2014 period in Uzbekistan

Indicator	2010	2011	2012	2013	2014
Total number of changes in tax legislation during the one calendar year	54	56	64	79	108

These results show that despite of fact that it is third factor, it still one of the most significant once as it is in top five main barriers on the way of development of small business. Thus, we can say that our first hypothesis found its support. So, what is the reason that taxation after all reforms still stays a serious barrier for business? If to pay close attention on changes made in tax legislation in 2013 there were made 79 changes and in 2014, it reached 108 changes (Table 2).

These kind of changes can lead new established firms unintentionally break laws and can bring number of inconveniences to unexperienced young firms. Because to get in pace with current changes in tax legislation and implement them in their activity it requires additional time for firms and high skills of personnel. Thus, it is reasonable to eliminate the number of changes done to the legislation at least during a year period. Survey results show that today's changes in laws and regulations make serious problems for firms to understand them and make negative impact on their activity.

We can see from survey results that 39.2 percent of survey respondents consider the regional infrastructure development level as a main barrier in economic growth, as well as a factor, which can increase the performance level.

Table 3. Survey results on defining main factors, which effect on small business performance

Factors	Importance level	
	Responses	%
Regional infrastructure development level	638	39.2
Stability of legislation	305	18.7
Taxation	301	18.4
Currency exchange	285	17.5
High rates of bank credits	52	3.2
Others	47	2.9

Here we find that our second hypothesis was supported and indeed most of respondents consider this factor more crucial for their activity than taxation. It coincides with another survey organized by group of NGOs in Uzbekistan on the framework of State program "Year of entrepreneurship and small business" conducted in 2011.

Table 4. Survey results organized by group of NGOs in Uzbekistan

Barriers	Respondents	%
Problems with connection to engineering networks	24 000	26.6
Cut-offs in electricity systems	32 000	35.5
Problems with banks	11 700	13
Problems with preparation of architectural and land distribution related documents	2500	2.7
Problems with exploitation of free buildings and constructions	3100	3.4
Problems with finding foreign partners, investments and technologies	7600	8.4

Source: www.chamber.uz (2014)

To realize the program there was conducted a survey where 356 000 questionnaires were sent to respondents and 200 000 of them were fulfilled, after checking for suitability 90 000 of them left and main ideas were unified to propose conclusions and to define main barriers for small businesses. Table 4. shows that 35.5 percent of respondents have pointed that electricity supply is the main barrier in their activity, which is also part of infrastructure, thus supports our hypothesis. However, it will be reasonable to mention that by the government of Uzbekistan it was defined that, services on connection to electricity systems by electricity providing companies should not overpass 3 days (Decree of CM, 2011) and that the amount of necessary documents to get the permission for using equipment of electricity systems was decreased from 79 to 13. Thus providing more support to solve the problem of infrastructure barrier.

In our conducted survey, second most important factor which effects on small business performance was shown as stability of legislation with 18.7 percent. Indeed, most of respondents are interested in stability of legislation system where changes into the existing laws should be minimized during the calendar year period. Businesses claim that changes done in a short period cost and require time to adopt, which can negatively impact on their performance.

And finally, the lowest effect among proposed factors is given to the high rate of credits in banks (3.2 % of respondents).

5. Conclusions and limitations

In the scope of our research, we have conducted literature review where we found that there are not a lot of dissenting opinions coming from peer-reviewed academic journals. Most of researches have a consensus that taxes on corporate and personal income are particularly harmful to economic growth and to the financial performance of firms.

This study examines the effects of several factors, particularly effect of taxes on performance of small businesses. In our research, we have conducted a survey among small business representatives in a chosen sample of regions in Uzbekistan. The study concludes that there are several factors, which can become a serious barrier on the way of the improving of the performance of small businesses if these factors are not structured well or operating in a way of harming the business. These defined important factors are the following five factors: regional infrastructure development level, stability of legislation, taxation, currency exchange, high rates of bank credits. We proposed that taxation is significant barrier for small business performance and we got supportive evidence that indeed taxation is still significant factor for businesses and that constructive attempts towards finding optimal balance of interests should be continued. We also found that taxation is not only factor, which significantly effects on performance of small business. It is important for business entities, as well as to government authorities who are responsible for infrastructure development to pay attention on the development of regional infrastructure as our survey results show that it the most concerning factor for firms.

We are sure that small businesses have an important role in the country's social and economic progress. However, to be able to fully exploit the potential of small business to contribute in this regard, the various stakeholders, the government, the operators, financial institution and educational institutions must take heed of the problems and barrier factors that have been highlighted in the discussions above and work towards eliminating them in order to create the right conditions which are imperative for the prosperity of small businesses.

Beside of in our opinion it is important to use stimulation function of taxation more efficiently in order to increase the role of small enterprises in economic growth and to improve the small businesses own performance. These can directly influence on the sustainable development of macroeconomic performances, as well, due to the widening of the scope of small businesses activities and the increasing the contribution of small enterprises in the share of GDP. Indirectly this all can bring to the improvement of other macroeconomic indicators of the economy such as unemployment rate.

Future research is suggested to empirically test the validity of the framework and hypothesis in other countries and industries. Secondly, we use only descriptive quantitative aspects of data, managers and future researches can use it by checking same hypotheses through inferential statistics methods or through qualitative in-deep analyses.

Analyses here are based on opinion of small business entities; however, there can be other factors, which are hidden from the view of business, and it can be that small business subjects may not know exactly from which mechanism they can benefit more.

Therefore, the findings of this study have to be used cautiously. Future research can include other sources, such as secondary data sources from National Statistics Offices and examine moderate effect of various factors with the use of regression analyses, future research can explore how these or other factors contingently contribute to improve or deprave the impact of barrier factors on performance of small business.

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