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TAXATION AND ECONOMIC GROWTH- A CRITICAL ASSESMENT OF LITERATURES SPECIALLY RELATED TO INDIA

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ABSTRACT

The vital role of fiscal policies are cannot be denied whether it is developed economy, developing economy or transition economy. Tax system is not use by government authority just to collect revenue but also used to promote other objective like level of employments, inflation control through price stability, rapid growth of gross domestic product (GDP), favorable Balance of payments, equitable income distributions, promotion of infant industries etc. The relation of taxation and the growth is a long way discussion in economics. Tax is not directly affecting the growth of a country. But tax has a power to influence the economic choices of individuals that can affect growth. This paper has the main objective to critically analyses existing literatures on the theme 'Taxation and Economic Growth'- especially for India. Several areas have been found where researcher and policy makers can initiate in their studies.

Key Words: Taxation, Transition Economy, GDP, Balance of Payments.

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1. INTRODUCTION.

Public finance and fiscal policy has occupied a central role in economics. The vital role of fiscal policies are cannot be denied whether it is developed economy, developing economy or transition economy. The scope of public fiancé is very broad. The main areas of public finance can be summarized in five main heads- (1) taxation (2) public spending or expenditure (3) budget (4) public debt and (5) stabilization. Therefore the division of fiscal policymaking into three interdependent branches, - allocation, distribution and stabilization as formalized by Musgrave(1989). The current globalized economy like India is characterized by necessity of existence of fiscal policies to fulfillment of elementary state's function. The government budget and government spending is the two basic tool of fiscal policy and is conditioned by necessity of their financing, Where the tax revenues usually represent one of the most significant part of country's budget income. Policymakers, researchers and academicians are consistently discussing about the role of taxation in the economic growth in a country. Tax system is not use by government authority just to collect revenue but also used to promote other objective like level of employments, inflation control through price stability, rapid growth of GDP, favorable Balance of payments, equitable income distributions, promotion of infant industries etc.

In the long history of economics doctrine views have been expressed about the effect of taxation on the growth. The classical economists believed the free market economy and minimum interference of the state or the government. J.B.Say (1893) viewed that the tax imposed should be very least amount. The state's main concern was to protect itself against external aggregation. But the great depression of 1930s had paved the way of emergence of Keynesian economics. Keynes (1936) argued that state must take the responsibilities regarding economic stability, expanding employment and national income. Therefore the role of the government becomes vital and higher and higher revenues are necessary for conducting activities. As stated by Wagner (1893) and Peacock and Wiseman (1890), as a country progresses their activities also increases and there is a tendency of increase expenditure. On the theoretical front recently developed endogenous growth theories provided many insights and channels through which taxation can affect the growth. From the prospective of endogenous growth theories, the link between taxation and growth seems self-evident. These economic choices has built the channels through which tax policy changes can affect the rate of capital accumulation (both physical and human) , labor-leisure tradeoff , research and innovation, government expenditure and thereby the growth (Schumpeter 1934, Romer1986, Lucas 1988, Barro 1990, King &Rebelo 1990, Jones et al 1993).

The relation of taxation and the growth is a long way discussion in economics. Tax is not directly affecting the growth of a country. But tax has a power to influence the economic choices of individuals that can affect growth. On the other hand, tax revenue is one of the major source of revenue for any government. Adaptive and rational expectation regarding changes in tax policies can influential towards financial markets, consumer behavior and investment decisions. Voluminous amount of research and studies also devoted to explore the relationship between taxation and growth. This paper has the main objective to analyses existing literatures on the theme 'taxation and Economic growth'- especially for India and also tries to find out some untouched areas of study. The outline of the paper as follows- second section will be the discussion of literatures based on particular theme and the last section is meant for discussion of existing gaps.

The debate of how taxation is related to growth can be discussed in various aspects. Literature can be summarized in following forms- literatures related to (1) tax revenue and growth (2) tax rates and growth (3) Optimal taxation and (4) elasticity and buoyancy of tax system.

Martin, R. and Fardmaneshi, M. (1990) in their paper analyzed the impact of key fiscal variables- taxes, expenditure and deficits using reduced form of model and cross sectional data for a sample of 76 developed and developing countries for the period 1972-1981. Deficits were contractionary and deficits reducing tax and expenditure cuts were positively associated with growth. The relation of economic growth on government tax revenues were investigated for Malaysia by Tahait, R. (2011).The inappropriate allocation of resources has always halt the economic growth for any country. Results of this studyproves unidirectional relationship between economic growth and total tax revenue with 21% speed of adjustment in the short run. GDP was taken as growth proxy and direct and indirect tax revenues as explanatory variable. Gale W. G. Et al (2015) in their research paper evaluated that tax revenues or top income tax rates not hasa stable relation with economic growth or employment. Real personal income per capita has been taken as dependent variable. Explanatory variables were total tax revenues as share of personal income, productive investments, social spending and state as dummy variable. Akhor and Oshoke, S. (2016) in their Study analyzed the effect of indirect taxes revenues on economic growth in Nigeria. Value added tax (VAT) revenue, custom and excise duty revenue were taken as independent variables and economic growth (GDP) as dependent variable. Negative and significant relationship has been foundin between VAT and real gross domestic product. And custom and excise duty had weakly significant (-ve) impact on real GDP of Nigeria.

In a recent sphere of time, Ojong C. M. et al (2016) analyzed the relation of tax revenue and economic growth of Nigeria also. Main objective of the paper was to analyze the impact of petroleum profit tax, income tax and non-oil revenues on the Nigerian economy. Finding reveals that there is a significant relationship between petroleum profit and non-oil revenue with the GDP of Nigeria. But no significant relationship between company income tax to GDP. Consequences of tax revenues components on economic growths has been studied by Zeng, K. et al (2013). They conduct a study in China to justify the relation of tax and growth. Main aim of their paper was to evaluate the mechanism of growth and tax reform and its effect on total tax revenue with structure using descriptive statistics.Their paper has main focus on how tax reform and economic growth affect the tax revenue with its structurefrom thethree aspects, viz.corporate income tax, and the value added tax and total amount of tax. Results showed that the growth has a long term stability relationship with total tax revenues. For the Indian case, Venkataraman S and Urmi A (2017), Mishra, P.K. (2011)investigated the long run relationship between the economic growth and tax revenue. Mishra applied Johansen's co integration test and vector error correction model to solve the purpose. On the other handVenkataraman S and Urmi A employed ARDL bound test for cointegration. Their results shows that long run equilibrium exists tax revenue and economic growth in India.

Theories also stated that tax rates also has its impact on household behavior, consumption pattern and investment decisions. Acosta-Ormaechea, S. and Yoo, J. (2012), in their working paper of IMF, investigate statistical relationship in between changes in tax composition and economic growth in long run. Considering 69 countries during the period 1970-2009, and segmented those countries into 21 high income, 23 middle income and 25 low income countries. Results revealed that increase in income taxes and reduction in consumption and property taxes was related with slower growth in the long run. Engen, E. and Skinner, J.(1996) studied the marginal cuts has a positive relation with the growth rate of U.S. they prove it by taking historical records of U.S., secondly by taking evidence of large sample of countries and thirdly by analyzing micro level studies. They estimated modest effect of 0.2 to 0.3 percentage point of tax reform on to growth rate. Casbin, P. (1995) in his IMF staff paper with the development of endogenous growth models, dealt with the influence of public investment, public transfers and dictionary taxation on the rate of economic growth of 23 developed countries for the time period of 1971 to 1988 and time series cross sectional results were obtained. Park, H. And Philippopoulos, A. (2005) studied the dynamics properties of an endogenous growth model in which government consumption and production services are financed by capital taxes. Author generalizes the existence and its stability property of commitment Ramsey equilibrium, when government spending is productive and taxation is distortionary. He then established a sufficient condition for uniqueness of the positive balanced growth path and determinacy of transitional dynamics. Feng and Eko (2014) proved that tax revenue has a positive effect on GDP maximization in Hobei province. Data collected from 1978 to 2011. Relationship was established by using simple and amended tax multiplier effect theory and polynomial distributive lag model(PDL).Results revealed that tax cuts has more positive effect on GDP of Hobei province. In this respect marginal tax rate was an essential component in tax multiplier theory. Loe&Gordan conduct a study of 70 countries during the period of 1970-1997 in cross section data set found that corporate tax rate significantly negatively correlated with the economic growth. As in a same kind of study by Anastassiou&Dritsak (2015), has examined the relationship between three variables – (1) ratio of gross savings to GDP (2) the marginal direct tax rate and (3) tax revenues. Their results revealed that unidirectional causal relationship between the marginal direct tax rate and the rate of economic growth (i.e. GDP).Tax revenues and the rate of economic growth showing same way relationship.

Investigation of channels through which taxation can affect growth performance of any country is serious issues of debate. Johansson, A et al. (2008), Myles, G. D (2007) and Engen,E and Skinner, J (1996) in their paper had reviewed practical and empirical evidence of how taxation affects the rates of economic growth. They argued that theoretical models is not satisfies the objective of number of channels bywhich taxation can affect growth and interesting results may be found out.RaghbendraJha (1986) in his book 'Modern Thoery of Public Fianace' stated many theoretical models for investigation of channels. But these models are very much theoretical and empirical estimation is too much complex. Data availability is also an important drawbacks of these models.

Change in tax structure can also be one important determinants of the growth performance. OECD is frequently published paper in respect of this. Arnold, J. (2008) is his study found that growth-friendly behavior of recurrent taxes on immovable property, but it also found that consumption taxes and personal income taxes and corporate income taxes is most negatively related to the growth. Same kind of results also found by Leea, Y and Gordon,H R. (2004). They also argued that cut down of corporate tax by 10% may increase annual average growth rate of GDP by 1% to 2%.Michaelis, J and Birk, A in their discussion paper has analyzed pattern of savings and incentive to create job in respect of wage income taxes, payroll taxes, capital income taxes and taxes on capital cost. Results revealed that payroll tax is the most neutral one.

The theory of optimal tax policy is known one. Economist like Ramsey (1927) and Mirrlees (1971) has developed the concept of optimal taxation.Mankiew, N G et.al. (2009) has discussed the theory and practice of optimal tax very briefly in their study. For the case of U.S., Akerlof (1978) argued that theory and practice of optimality should be based on personal characteristics. Recent work of Alesina, Ichino, and Karabarbounis (2008) have suggested that gender consideration should be the main objective of tax policy where in the same year Mirrless and Weinzierl (2008) have point out that height dependent tax. Authors like Atkinson and Stiglitz (1976) have argued that optimal tax should be equal for all final consumption goods. Peter Birch Sorensen (2006) also discussed the policy relevance of optimal taxation. If one is more interested in study theories and practices of optimal taxation, I would recommend writings of Tenhunen, S (2007). He briefly discussing the development of optimal taxation and how this tax system is related to externalities.

In case of India, few studies have been done. India is a federal state where Centre and states have their taxation policies. Chatterjee, P and Barman R T (2018) studies this federal relationship under optimal taxation setup and with GST purview.Murty, S (2017) also studied the applicability of GST in India with the prospective of optimal taxation.Tax elasticity and tax buoyancy also taken into consideration by academician and policy makers for examining its linkages to the growth path. In India several studies, Patnaik D and Pillai A (2017), Krushna V A.(2005), Upender M (2008), Rajaraman I et. Al. (2006)etc calculated and analyzed tax buoyancy and elasticity for Indian case. Two classical report of Chelliah and Agarwal also to be mentioned. Chelliah, R.J. and Nath, S. (1977) had estimated trends and composition of major indirect taxes levied by the state governments and measure buoyancy and income elasticity for the period of 1960-61 to 1974-75 in India. For calculating elasticity proportional adjustment method was used. Buoyancy and elasticity was computed for general sales tax, sales tax on motor spirit, taxes on motor vehicles and passengers and goods and entertainment tax. A report of Aggarwal, P. K. (1984) had calculated and analyzed the nominal income elasticity, price and real income elasticity and tax –to-base and base-to-income elasticity.

2. CONCLUSION.

These are few areas related to existing literature on the relation of taxation and economic growth. The paper does not implies that all the literature commentated and reviewed. It is a small initiative provide a bunch of good papers and to create hunch amongst the researchers and policy makers for further works especially for India. Channels through taxation can affect growth rate is still a debatable issue and a very few studies have been done. In Indian case there is no such kind of study. Tax rates has its impact growth performance. Further study in this respect of India and sub-Indian context can be examined but availability of suitable data is important drawbacks. Existing literatures and domain of public finance has proved the fact that taxation always has impact on growth performance. Researchers and policy makers should done extensive studies and research on this filed.

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