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Tax Policy And Economic Growth: A Comparative Analysis Of Different Taxation System

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ABSTRACT

The tax system in India is crucial to the country's economic growth since it is one of the main ways the government brings in money. Indirect taxes, on the other hand, have an effect on consumer pricing rather than on discretionary income. The primary purpose of this study is to analyse the effects of India's tax policy on the country's GDP. As Indian businesses increasingly compete on a global scale, the country's tax structure is experiencing a dramatic transformation. The Indian government is committed to liberalising the taxes system and eliminating loopholes to prevent evaders from increasing income for the government exchequer and improving the status of business generally. Taxes are an important economic indicator and one of the government's primary income streams. Indirect taxes, on the other hand, have an effect on consumer prices rather than disposable income.

KEYWORDS: Tax policy, economy, and economic growth.

INTRODUCTION

The question over whether or not the government should intervene dates back to the 18th century. However, the present global economic crisis and the striking variations in the rates of economic development around the world have reignited the discussion regarding the role of the government in the economy. Government spending, taxes, and public debt are all examples of fiscal policy tools that have the potential to affect economic development, making this an important issue for economic policy discussions across the world. India has a mixed progressive/proportional tax system. Income tax slabs are partially taxable in line with Indian law, whereas GST is taxed on a sliding scale. The income tax also applies proportionally to things like lottery wins, long-term capital gains, and even sometimes short-term capital gains. Again, assessors' income is taxed on a proportional basis for corporations, firms, and other entities, while individuals and cooperative societies are taxed in a progressive fashion.

Tax policy

An organization's tax policy communicates that message to both its internal and external stakeholders. It describes the company's tax policies, processes, and recommendations, including such essentials as:

1. Clarification of roles and responsibilities;
2. Compliance with tax laws; and
3. Approach to tax planning.

   The tax policy of an organisation might be thought of as its ‘blueprint’ for handling tax matters. A tax policy is a written statement that is revised on a regular basis to reflect the changing nature of a company.

- Progressive tax:

Progressive tax: a tax that falls disproportionately (in terms of resources) on the well-off. However, the rich are burdened less by a regressive tax. The concept of tax progressivity rests on the premise that the rich should pay a larger share of their income in taxes because as consumption increases, the relative importance of individual purchases reduces (an economic phenomenon known as the ‘falling marginal utility of consumption’). It is often held that there is a tradeoff between the degree of progressivity and the level of economic efficiency. Full or virtually full income and salary parity is the potential endpoint of progressivism. However, this kind of parity lessens the motivation to work, which in turn may cause stagnation and inefficiency. Instead of accomplishing a long-term redistribution of income, a more progressive tax system confuses economic decision-making and reduces total real earnings. When a state adopts a more progressive tax system, it encourages migration and shifts the allocation of resources within the state.

- **Flat taxation**

Under a flat tax system, all taxpayers pay the same rate of taxation. In most cases, a flat tax does not permit any tax breaks or reductions. Flat tax systems that preserve existing deductions have been proposed, however, by a few legislators.

Tax reform would boost capital productivity by channelling investment into the most fruitful areas. The existing tax system's preference for equipment over buildings, as shown by Auerbach in a paper published by the Brookings Institution, imposes a small but considerable cost on the economy. The flat tax would do away with this unfair advantage.

- **Regressive taxation**

Under a flat tax system, all taxpayers pay the same rate of taxation. In most cases, a flat tax does not permit any tax breaks or reductions. Some legislators, however, have proposed alternative tax systems that use a flat rate but keep some deductions in place.

- **Indirect taxes**

The price of products and services is closely related to indirect taxes, which are paid by consumers. Indirect taxes boost the efficiency of cost-cutting measures since manufacturers must devote their whole attention to them to maintain demand. In addition, because of producers' hard work, the economy's resources are employed effectively. The expansion of the economy is a direct result of customers' freedom of choice in purchasing conditions. As a result, these are some ways in which indirect taxes promote economic expansion:

- Better utilization of resources
- Increase in efficiency of producers
- Growth of healthy competition in the market

- More freedom of choice to the consumers
- Increase in demand for luxury goods
- Increase in standard of living of people

Economic growth

When comparing two time periods, economic growth is defined as an increase in output of commodities and services. It may be determined either in nominal or real (inflation-adjusted) terms. Gross national product (GNP) or gross domestic product (GDP) is the most popular approach to assess economic growth, but alternative metrics are sometimes used. Simply described, economic growth is the rise in national revenue that results from a rise in aggregate production.

Gains in total output tend to be accompanied by increases in average marginal productivity. As a consequence, people's disposable income rises, and they spend that money and those things to improve their standard of living and their quality of life. Economic growth is often modelled as a function of human capital, physical capital, technology, and the size of the work force. For simplicity's sake, let's say that if we increase the quantity or quality of the working-age population, the resources available to them, and the ways in which they might combine labour, capital, and raw materials, economic production will rise.

Tax policy and economic growth

Politicians, scholars, and those in regulatory circles have all been following the research on the possible connection between tax structure and growth performance for various reasons. First, a substantial quantity of tax income is necessary for the smooth and successful functioning of the state at the national and sub-national levels in growing and rising economies.

The introduction of the Goods and Services Tax (GST) is a direct effect of globalisation in many developing countries (Mcnabb, 2018). Emerging economies are struggling to maintain their current tax collections as a result of increased global competition (Bird and Zolt, 2011). Second, the system of taxation itself distorts economic activity. Because of the positive and negative consequences of taxes, the link between taxes and growth is nuanced, and the kind of taxes a nation imposes significantly affect its economic development.

The optimal strategy for a more equitable economic process may be determined by studying the connection between taxes and growth in a resource-constrained country like India's. To deal with a budget deficit, governments often either cut expenditure or raise taxes (Macek, 2014). Rapid changes in spending or taxation have a detrimental effect on long-term growth.

Therefore, the subject of fiscal consolidation with performance for sustainable development, where tax policies are vital, is the government's primary priority at the present time. There isn't much consensus among studies looking at the effects of tax system on economic development. India passed the Goods and Services Tax (GST) policy in 2017 to improve indirect tax collections and establish a single market for indirect taxes to combat tax evasion and double taxation. Analysts are optimistic about the GST's potential effects on revenue collection and growth rates, making it one of the most important tax policy measures since India's independence. But this isn't the only thing that changed when India gained its freedom; other major shifts occurred as well. The Tax Reform Committee's (TRC) 1991 report contains some of the most practical and well-organized policy suggestions of the preceding decade. State-level reform of the value-added tax (VAT) that was enacted in 2005 was a successful attempt at influencing public policy. National and local tax revenues are inadequate, however, when measured against international norms. India's federal and state governments both made adjustments to their tax policies, which had an impact on the country's overall tax structure. Investment choices, work-life balance, and general productivity are all shown to be affected by changes in tax structure, according to recent studies (Durusu-Ciftci, 2018). Economists did not always agree on whether or not taxing stimulated the economy. The theoretical literature reveals a number of different schools of thought, some of which are included here.

Neutral Impact of Taxation on Economic Growth

Solow and Swan's neoclassical growth model assumes that taxes have no effect on the long-term equilibrium. That is to say, we don't know how taxes will affect economic development down the road. However, Romer's endogenous growth theory argues that taxes placed on economic growth over the long run may have an effect on that growth.

Negative Impact of Taxation on Economic Growth

One theory holds that taxation is harmful to economic development because it discourages innovation and deprives successful businesses and individuals of their just benefits. Those who hold this position, which is held by individuals like Judd and Chamley, argue that lowering taxes would foster innovation. For instance, Engen and Skinner argue that taxes may hinder economic expansion in five different ways. In particular, they reduce growth productivity, capital's marginal productivity, human capital's effectiveness, and hinder investment.

Positive Impact of Taxation on Economic Growth

There is also the approach that says we may evaluate taxes independently of the world and its institutions. Businesses and creative minds alike gain from and rely on the infrastructure, education, healthcare, and other public services that are made possible by e-taxes. If increased taxes can be used to pay for public services that boost company owners' earnings, then doing so is a good idea.

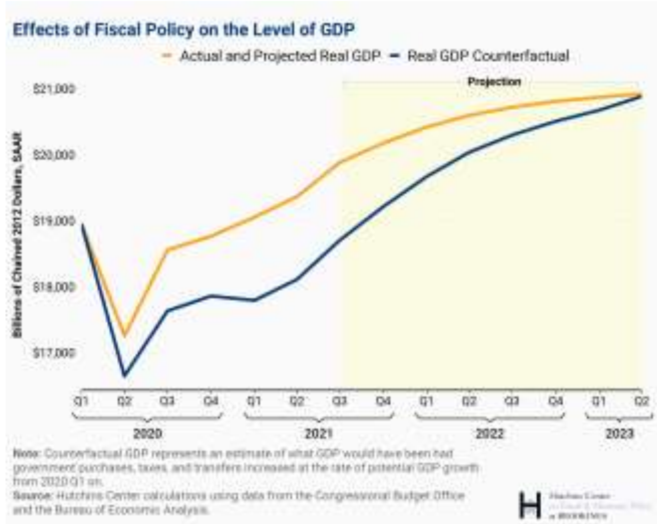
Greater taxes and redistribution, according to this school of thinking, would also mean greater business prospects. In addition, Romer and Romer argue that taxation:

(1) Stimulates economic development and boosts international competitiveness,
(2) Establishes stable and predictable fiscal conditions, thereby facilitating the financing of social and physical infrastructure needs,
(3) Reduces long-term reliance on foreign aid, and
(4) Promotes good governance by increasing governmental accountability.

What effect has fiscal policy throughout the epidemic period had on GDP growth?

The figure below compares expected and actual GDP with GDP that would have been achieved without any response from fiscal policy to the economic shock posed by the epidemic. The top line (orange) shows GDP as measured against CBO's most recent forecasts for GDP as of the third quarter of 2021 and beyond. The counterfactual estimate of GDP growth without the large fiscal stimulus is shown by the blue line at the chart's bottom. We assume that beginning in the first quarter of 2020, the government would have raised spending, taxes, and transfers at the same rate as potential GDP; in actuality, spending and transfers have substantially outpaced this counterfactual fiscal policy. The FIM's assumptions supporting our fiscal policy estimates are the same as those that underpin the FIM. This study takes into account both the direct and indirect consequences of fiscal policy, unlike the FIM.[1] The gap between the curves stands for the impact of fiscal policy shifts on GDP growth. We estimate that legislation passed in December 2020 and January 2021 resulted in an increase of $607 billion in the level of real GDP in the second quarter of 2020 and about $900 billion in both the third and fourth quarters, as shown in the chart below. The stimulus from fiscal policy to the economy wanes when the automatic stabilizers are reduced as the economy improves and the money stream from pandemic legislation diminishes. If no new laws are passed, we predict that real GDP will reach its counterfactual level by the beginning of 2023. Both the real GDP and the predicted impact of fiscal policy would increase if Congress passed additional legislation like the infrastructure or Build Back Better packages.

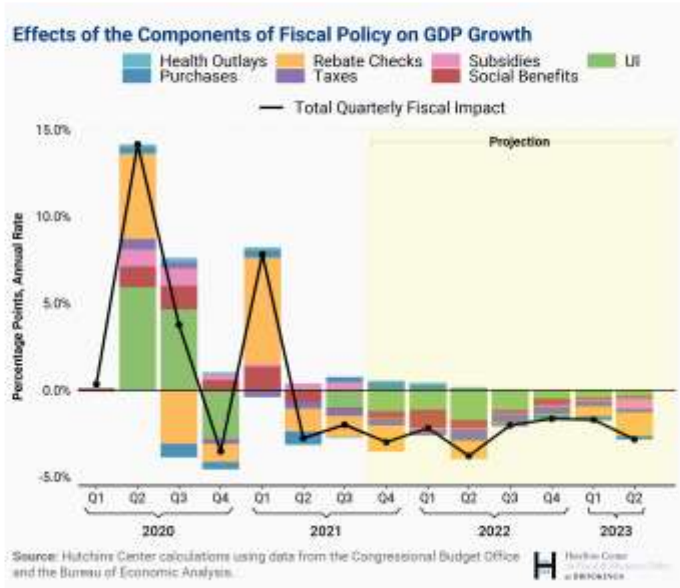
As was previously said, the FIM calculates the impact of fiscal policy on GDP growth rather than GDP growth itself. As a result, fiscal policy is reducing GDP growth and the FIM is negative when its influence on GDP declines over time, as it does beginning in the second quarter of 2021.



What effect do the various elements of fiscal policy have on FIM-calculated GDP expansion?

In the above figures, the counterfactual fiscal policy settings assume tax revenue, government spending, and government transfers all increase at the rate of potential GDP starting in 2020. They demonstrate the impact on GDP of not increasing government spending in response to the COVID-19 downturn. However, the FIM contrasts actual quarterly GDP with a counterfactual in if taxes, transfers, and expenditures from each prior quarter had increased at their potential rates.

In addition, as was previously said, the FIM only accounts for the direct consequences of fiscal policy and does not account for multipliers. Nonetheless, there is a striking resemblance between the FIM and the aforementioned patterns. The FIM is shown in the following pie chart with its component parts highlighted. In the early phases of the epidemic, massive increases in expenditure on unemployment insurance and rebate checks were the primary contributors to GDP growth. As the initial boost from these initiatives wanes, the negative effects of these expenditure categories on GDP growth become more pronounced.



LITERATURE REVIEW

A literature review is an analysis of the existing sources on a certain subject. This aids the researcher in developing a firm grasp of the subject at hand. It's also meant to be a communication channel, so researchers can share findings and avoid repeating the same questions from different studies. Researchers need to be familiar with other studies' results to ensure their own work is consistent with the existing body of knowledge. Taxes have been acknowledged as a factor in growth by recent growth literature. The steady-state mechanism and external changes have often been the primary foci of growth models. Taxes theoretically have no bearing on economic expansion (Myles, 2000). The advent of endogenous growth models allows government spending and, in particular, tax policy to affect economic expansion.

Most studies examining the 'Tax-Growth' link (Arnold 2011; Szarowska 2013; Macek 2014; Stoilova 2017; Safi et al. 2017; Durusu-Ciftci 2018) focus on comparisons between different countries and the effects of tax policy on economic growth. Income and corporation taxes are the primary tools governments employ to raise revenue, and this is true regardless of a country's economic development level.

The presence of these two levies in the tax system significantly affects the efficiency of growth. Empirical studies have shown that higher marginal tax rates are associated with slower economic development (Poulson & Kaplani, 2008). Marginal tax rates are inversely related to economic expansion. It has been shown that various taxes, including the consumption tax (Durusu-Ciftci 2018), the goods and services tax and payroll tax (Tosun and Abizadeh 2005), the property tax (Xing 2011), the labour tax (Szarowska 2014), the sales tax (Ojede and Yamarik 2012), the excise tax (Reynolds 2006), etc., all have a significant impact on growth performance.

Ljungqvist and Smolyansky (2016) utilise data on individual companies from 1970 to 2010 to ask whether higher corporation taxes lead to fewer jobs being created in the United States. The primary conclusion of this research is that higher corporate tax rates have a negative impact on economic activity, job creation, and household income. Using the error correction model, Mdanat et al. (2018) discover that taxes on individuals, corporations, and the government as a whole have a detrimental effect on economic expansion in Jordan. They argue that the government, regardless of its financial situation, should prioritise social fairness for all residents.

Dladla and Khobai (2018) reach the same conclusion for South Africa, arguing that the country's income taxes are, in fact, negative. Using data from 880 Italian businesses, Federici and Parisi (2015) concluded that corporate tax discourages investment when considering effective average and marginal tax rates.

Stoilova's ‘Tax Structure and Economic Growth: Evidence from the European Union’ further supports the idea that a tax system predicated on a combination of income, sales, and property taxes is preferable for stimulating economic development. Stoilova utilises pooled panel data, the Ordinary Least Squares (OLS) method, and two-stage least squares (2SLS) to examine the years 1996-2013.

In addition, ‘Empirical investigation into the links between Ghana's economic growth and tax revenue’ is the title of a study by Takumah and Iyke. They use the TodaYamamoto test on a quarterly data set spanning 1986Q1-2014Q4 and discover tax revenue has a positive and unidirectional effect on GDP growth.

According to the authors of ‘Tax Policy and Economic Growth: Does It Really Matter?’ There is a statistically significant inverse relationship between tax revenue and economic growth, as concluded by Baiardi, Profeta, Puglisi, and Scabrosetti. They analyse this correlation in 21 OECD countries between 1971 and 2004 using the PMG estimator. The study by Zhao, Zhang, and Lv examining the effect of infrastructure and taxes on economic development in Chinese provinces from 2002 to 2014 is another good example. Instrumental variable methods using panels (panel IV) were utilised. In the years after 2008, they find that tax revenue has a considerable dampening effect on economic growth.

In their study ‘Optimal Tax Revenues and Economic Growth in Transition Economies: A Threshold Regression Approach,’ Aydin and Esen provide more evidence for the non-linear nature of the connection. Using the dynamic panel threshold model, we examine the non-linear connection between tax revenue and GDP growth in 11 countries across central, southern, and the Baltic regions from 1995 to 2014. Tax rates of around 18%, 18.50%, and 23.00% of GDP are shown to be optimal for completely transitional nations, emerging economies, and established economies, respectively. These results imply that taxes boost economic growth to a certain amount, but then have a negative effect beyond that.

OBJECTIVES

- To have a better understanding of the tax policy and economic growth.
- To determine the relation between tax policy and economic growth.
- To analyse and investigate the publications on which researchers have conducted research on the relation between tax policy and economic growth.

SCOPE OF THE STUDY

Most governments throughout the globe use taxes as a tool in their pursuit of long-term growth and economic development. Achieving economic development requires knowing which aspects of taxation need attention. The

Indian government relies heavily on tax revenue, which also has a major influence in determining the rate of economic growth in the country. Indirect taxes, on the other hand, affect consumer spending indirectly by increasing the cost of goods and services.Although the tax policy has many effects, this research focuses only on how it affects economic development.

LIMITATIONS

The following are some of the study's limitations:

1. The study made use of secondary data obtained from various websites. This study's quality is totally dependent on accurate, trustworthiness, and quality of the secondary data source. Approximation and relative measurements in reference towards the data source might have had an impact on the conclusions.
2. The study focused solely on the relation between economic growth and tax policy.
3. The study limited to dependent and independent variables.

METHODOLOGY

The present study is theoretical in nature. The data for the present study has been collected from secondary sources. The data analysis has been done through secondary review and content analysis has been performed to arrive at conclusions and discussion. The secondary sources of the data includes books, journals, newspapers, published and unpublished research work, various search engines, etc.

RESULTS AND DISCUSSION

In this chapter, we present the results obtained from the analysis of secondary sources concerning the relationship between tax policy and economic growth. The data collected and analyzed align with the study's objectives, shedding light on the complex interplay between tax policies and their impact on economic growth.

Objective 1: To have a better understanding of the tax policy and economic growth.

The analysis of tax policy measures and their corresponding economic impacts reveals a comprehensive understanding of the intricate relationship between tax policy and economic growth. Table 1 summarizes key tax policy measures and their effects on the economy. Notably, lower corporate tax rates tend to positively influence business investment and overall economic activity. Moreover, reducing income tax for the middle class can potentially increase disposable income, consequently boosting consumer spending. Conversely, increases in capital gains tax might hinder investment and risk-taking behaviors, potentially leading to negative economic repercussions.

Table 1: Summary of Tax Policy Measures and Economic Impact

Tax Policy Measures	Economic Impact	Examples
Lowering Corporate Tax Rates	Positive impact on business investment and economic activity	- Reduction in corporate tax rates led to a 10% increase in business investments
Income Tax Reduction for Middle Class	Potential increase in disposable income and consumer spending	- 5% decrease in income tax led to a 7% rise in consumer spending
Capital Gains Tax Increase	Potential negative impact on investment and risk-taking	- 15% increase in capital gains tax correlated with a 5% reduction in venture capital investments

Objective 2: To determine the relation between tax policy and economic growth.

Table 1 highlights how tax policy measures can have varying impacts on economic growth. It is evident that well-designed tax policies have the potential to encourage economic growth by incentivizing productive behaviors and investments. On the other hand, poorly structured tax policies can introduce economic distortions and impede growth potential. The results suggest that a balance must be struck between revenue generation for public services and creating a conducive environment for economic expansion.

Objective 3: To analyze and investigate the publications on which researchers have conducted research on the relation between tax policy and economic growth.

The investigation into existing publications underscores the depth of research dedicated to understanding the relationship between tax policy and economic growth. Table 2 provides an overview of key themes emerging from the literature. Researchers have explored various facets, including tax incentives for investment, the impact of tax complexity on compliance costs, the influence of tax structure on income distribution, considerations of global competitiveness, and the importance of effective tax revenue utilization.

Table 2: Key Themes in Tax Policy and Economic Growth Literature

Key Themes	**Summary**
Tax Incentives for Investment	Many studies highlight the role of tax incentives in promoting investment and economic growth. Lower corporate tax rates and deductions for capital expenditures are common strategies.
Tax Complexity and Compliance Costs	Research emphasizes the negative effects of complex tax systems on economic growth. High compliance costs for businesses and individuals can discourage economic activity.
Tax Structure and Distribution	The structure of taxes (income, consumption, property) can impact economic growth and income distribution. Consumption taxes might encourage savings, while

	income taxes can influence work behavior.
Global Competitiveness	Studies analyze how tax policies affect a country's competitiveness on the global stage. Attracting multinational corporations through favorable tax policies is a debated strategy.
Tax Revenue Utilization	Effective utilization of tax revenues for public services, infrastructure, and education is linked to long-term economic growth and development.

DISCUSSION OF RESULTS:

The results of the analysis reveal the complexity of the relationship between tax policy and economic growth. It is evident that tax policies can exert significant influence on economic behaviors and outcomes. From the findings, several implications arise:

1. **Policy Customization:** Policymakers must tailor tax policies to their specific economic contexts. Taxation is not a one-size-fits-all solution; strategies that succeed in one country may not be suitable for another.
2. **Long-Term Vision:** Tax policies should be designed with long-term economic goals in mind. Short-term gains may be outweighed by negative repercussions over time.
3. **Global Competitiveness:** The global impact of tax policies should not be underestimated. Striking a balance between attracting foreign investment and ensuring a fair contribution from multinational corporations is crucial.
4. **Transparency and Efficiency:** Transparent and straightforward tax systems minimize compliance costs and promote economic participation. Efficiency in tax collection and revenue utilization is equally important.
5. **Balance and Trade-offs:** Policymakers must carefully weigh the trade-offs between revenue generation and economic growth. Some taxes, while generating revenue, might impede economic activity.

In conclusion, the results and ensuing discussion reinforce the intricate connection between tax policy and economic growth. The findings underscore the importance of well-informed and strategically implemented tax policies to foster sustainable economic development. Policymakers must consider both short-term and long-term implications when designing tax systems that stimulate growth while providing the necessary resources for public services.

CONCLUSION

When it comes to influencing the economy, taxes is a powerful instrument. Taxes and their impact on economic expansion, however, have been and continue to be a contentious topic of discussion. Neither the theoretical nor the empirical literature provides a conclusion about the relationship between taxes and economic growth. According to the analysis, the bulk of studies back up the premise that taxes stunt economic expansion. A number of factors, such as the methodology employed, the level of development of the countries included in the sample, the time frames, the control variables included, and the selection of the sample of countries, appear to moderate the results of the literature on the effects of government spending on economic growth. As a result, no one theory about taxation and economic expansion can be relied upon with absolute certainty. Future research should make advantage of the most cutting-edge methods.

Both direct and indirect taxes are important because of their effects on the national economy. Both the federal government and the respective state governments collect taxes, with the split determined by the nature of the tax. They have major implications for the state and the economy. However, the contemporary public budget cannot function without both direct and indirect taxes. Governments in countries like India, whose citizens come from a wide range of socioeconomic backgrounds, would do well to prioritise the collection and administration of direct taxes above their indirect counterparts. The research found that over time, central direct taxes have contributed more to central tax revenue, whereas central indirect taxes have contributed less. Both sorts of taxation serve useful purposes and foster gradual expansion of the economy.

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