IBIMA Publishing
Communications of International Proceedings
https://ibimapublishing.com/p-articles/42ECO/2023/4236023/
Vol. 2023 (7), Article ID 4236023

Aspects Regarding the Relationship Between Different Tax Income and Economic Growth, Analysts′ Opinions*

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* Presented at the 42nd IBIMA International Conference, 22-23 November 2023, Seville, Spain

Abstract

A number of analysts have followed, in their works, the effects of different categories of taxes (taxes on labour, capital, consumption and others) on economic growth, trying to establish to what extent they bring their contribution to growth or can have an unfavorable effect.
The purpose of the paper is to identify the relationship between different types of taxes and economic growth through the prism of different specialists′ opinions in the field, with consideration of effects brought to the economy.
The motive behind the study is given by the importance of studying the impact on growth, of different types of tax revenues and its implications in the economy.
The intention of originality of paper consists in the chosen theme that aims to highlight aspects regarding the relationship between tax revenues obtained on account of taxation and economic growth, possible influences and challenges that it implies.
The research methodology was the documentation from specialized literature, the study and interpretation of ideas, in the author's own vision, in order to elaborate the subject.
The findings of the paper Results refers to the fact that not all fiscal changes have the same impact on economic growth, this being different; some of them can be favorable, others unfavorable, as identified in the specialized literature. The impact of taxes on economic growth is different, with some of them having favorable effects and others, unfavorable effects, as identified in the specialized literature. So:
Generally, it could consider that taxes on property have a positive effect on economic growth and in the case of taxes on labour and consumption, the impact can be unfavorable. The observation would be that a tax system is growth-friendly if the tax burden is lighter on labour and capital, but with an emphasis on consumption and property.

Keywords: economic growth, tax income, taxation, impact, policy

Jel Classification: E60; H20; H30

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Cite this Article as: Florina POPA, Vol. 2023 (7) “Aspects Regarding the Relationship Between Different Tax Income and Economic Growth, Analysts’ Opinions " Communications of International Proceedings, Vol. 2023 (7), Article ID 4236023, https://doi.org/10.5171/2023.4236023

Introduction

The need to achieve macroeconomic research and outline the concept of economic growth was imposed in the first half of the last century, against the background of economic and social challenges and the distortions generated by the economic crisis at the beginning of the last century, which affected national economies.

The theory of economic growth, the object of classical and contemporary economists' concerns, has become a component part of economic science, both for the developed economies and for the developing ones.

"Through its content, the economic growth means a positive, upward evolution of the national economy, but which does not exclude conjunction fluctuations, even temporary economic regressions. The assessment that a national economy registers economic growth is based on the existence of real positive growth trends" (ASE, Catedra de Economie Politică, Dobrotă N., Ciucur D., Cosea M., Enache C., Gavrila I., Ghiţă Tănase P., Gogoneaţă C., Popescu C., 1995, p. 325) [1].

The results of economic growth are measured based on some indicators relevant to the dynamics of the economy. The growth reflects the quantitative aspect of changes in the economy, which distinguishes it from the concept of economic development. (A.S.E., Catedra de Economie Politică - Dobrotă N., Ciucur D., Cosea M., Enache C., Gavrila I., Ghiţă Tănase P., Gogoneaţă C., Popescu C., 1995, Grellet, 1994, Jula D., Jula N., Ailenei D ., Gârbovean A., 1999).
According to economic theory, growth in an economy is generated by three factors of production – labour force, capital and technological progress, which are related to a production function. However, taxes can distort the economic decisions of market participants with respect to these factors and thus, can negatively affect the economic growth. (Zipfel, F., Heinrichs, C., Böttcher, B..- Edt. 2012), DB Research Management Ralf Hoffmann, Bernhard Speyer) [2]

Review of specialized literature regarding the analysis of link between taxation of different types of income and economic growth

Personal income tax, social security contributions are part of income tax and together form *the labor taxation*. Taxation of labor is an important influencing factor for the labour market, capital accumulation, welfare and standard of living of employees (Kaplow, 2008) [3].
A number of analysts have followed, in their works, the effects of different categories of taxes on economic growth, trying to establish to what extent they bring their contribution to growth or can have an unfavorable influence on it.
The relationship between taxation and economic growth is followed from two perspectives (Stoilova, 2017):[4]

→ Of the impact of the *level of taxation, on growth*

Agell, Ohlsson, & Thoursie, 2006; Barro, 1990, 1991; Easterly & Rebelo, 1993; Folster & Henrekson, 2001; Koester & Kormendi; 1989; Levine & Renelt, 1992; Paparas and Richter, 2015 [5] studied the link between the global level of tax (or public spending) and that of economic growth without reaching a consensus. Higher taxes have been thought to have a negative impact on growth, but as they involve higher levels of public spending, they can also influence economic growth.

→Of *the impact of the fiscal structure, on growth* it was considered that direct taxes can have a more favorable environment for growth than indirect taxes.
Myles (2009) [6] considers the movement from income taxation to consumption taxation to be beneficial to growth.
The impact differs depending on the elements in the tax structure, as follows (Stoilova, 2017, p.1051):

✓ *The property tax* is not notable for its effects on economic growth, there is the assumption that this tax category is ***neutral*** in relation to economic growth, in European Union Member States.
✓ *Individual income tax and social contributions* prove to have a ***positive impact*** on growth. The aspects are observed by Canavire-Bacarreza, et al. (2013), Bernardi (2013), Stoilova and Patonov (2013), Havránek et al. (2015), Tanchev (2016) [7].

There are also different opinions for the same tax category:

Kneller, Bleaney and Gemmell (1999) [8]., following a group of OECD countries, in the period 1970-1975, found that income and property taxes have an ***unfavorable*** effect on growth. Arnold (2008) [9]., following the analysis of a sample of 21 OECD countries, in the period 1971-2004, observed that ***the taxes most favorable to growth*** are ***property taxes, followed by consumption taxes*** and the last, ***income taxes***; ***corporate taxes*** have negative effects on growth.

Szarowska (2013) [10] analyzed the data of 24 EU member states, for the period 1995 – 2010, finding that ***consumption taxes have a positive effect on GDP growth.***

Taxation on production and imports is directly correlated with economic growth as well as consumption taxes which are also favorable to growth.
Consumption tax, *such as VAT*, is considered to have a negative effect on economic growth, the results of studies showing that society does not obtain economic benefits from the imposition of VAT.

A comparative analysis of the Member States regarding ***the nature of tax revenues*** shows that the Eastern European countries are distinguished by a large share in the total tax revenues, of those coming from consumption taxes, and in the Central and Northern countries, the large share of tax revenues is held by those derived from labor taxation. Some Western countries, such as Germany, France, Belgium, Austria, apply, compared to the European Union average, high taxes on the labor factor and have a high share of social security contributions (Stoilova, 2017).

Acosta-Ormaechea and Yoo (2012) [11], after examining the ***relationship between fiscal structures and growth rates***, find that consumption or property taxes are favorable to growth, compared to income tax.
There is no a singular relationship between tax structure and growth.
The analysts' findings reveal both the potential benefits and possible risks of income tax reform, from the perspective of long-term economic growth.

The reductions applied to income taxes stimulate work, the interest in saving and investing, so they have a favorable impact on growth; at the same time, positive effects on income can reduce the need for involvement in productive activity and interest in new activities. The consequence of the tax cut on growth is uncertain and depends on the structure of the tax cut as well as the financing form (Gale, Samwick, 2014) [12].

Johansson et al. (2008) [13] shows that **income taxes** have a negative impact on economic growth.

Alesina et al. (1999) [14] considers that an increase in labor taxation, on personal income or social insurance contributions, preceded by an increase in employees'salaries, has as a consequence, the decrease in net profit, accompanied by the decrease in net investments.

Widmalm (2001) [15], based on the analysis of the data of the OECD countries, the period 1965-1990 found that the tax revenues obtained through the taxation of personal incomes "show a negative correlation with economic growth".

Relationships between tax structure and growth

In the relationship between taxation and economic growth, a higher rate of taxation can have the potential to lead to an increase in the productive capacity of the economy, by creating a favorable environment for investments. This statement is confirmed by the Barro (1990), King and Rebelo (1990) și Mendoza, Miless-Ferretti și Asea (1997) [16] models.

King and Rebelo (1990, p. 130, 140) [17] experiences the effect of an increase, in the production tax rate applied equally to all sectoral activities and finds that although taxation can influence growth in the sense of increasing it, its extent depends on production and the tax structure.

The Mendoza et al. (1997) [18] endogenous growth model take into account the effect of the marginal tax rate on human and physical capital as well as consumption on economic growth. Higher taxes on consumption, for example VAT, can impact labor supply because the reward for labor is lower (Arnold et al., 2011) [19].

Empirical studies have followed ***the relationship between fiscal policy and economic growth***, finding that taxes contribute to growth.

Economic theory shows that all taxes cause distortions in economic growth rates. For example, the effect of taxes on individual income or profit is felt to a higher extent than in the case of taxes on consumption (McNabb, 2018).

Increasing taxes on consumption, while reducing taxes on labor and capital, can stimulate economic growth, and taxation of labor and capital should be kept low to prevent disturbance in the decisions of economic agents. (Zipfel, Heinrichs, Böttcher-Editor, Hoffmann, Speyer) [20]

Lee and Gordon (2005) shows the "negative relationship between the corporate tax rate and GDP growth rates" [21].

It was also found that the increase in the profit tax has as an effect, a greater reduction in GDP than in the case of the increase in the personal income tax Arnold et al. (2011) [22]. As such, the corporate tax is unfavorable to economic growth, comparatively with the income tax (McNabb, 2018).

The characteristics of the fiscal system favorable to growth

Economic growth depends on three factors: labor, capital and technological progress; taxes can affect the economic decisions of market participants in relation to these factors, so they can negatively affect growth.

Tax burden on labor (taxation of the labor force factor)

⇒ *Labor taxation* has an impact on the decisions taken by economic agents (Zipfel, Heinrichs, Böttcher -Edt., Hoffmann, Speyer, 2012) [23]:

✓ Distorts the decision to participate in the labor market (number of working hours, number of employed personnel);
✓ Progressive taxation of their income influences the decision of market participants to seek higher skill levels.
✓ Taxation can attract the reduction of entrepreneurial activity.

⇒ *Capital taxation* (Zipfel, Heinrichs, Böttcher -Edt., Hoffmann, Speyer 2012):

✓ It influences households′ decisions regarding investments and savings;
✓ It influences business′ decisions. The profit tax has as effect, choosing the location and volume of investments; influences considerations concerning profit localization, which can lead to capital outflows from countries taken individually.

⇒ *Property and inheritance taxes* that fall into this category, unlike those previously commented, are favorable to growth.
In a growth-friendly system, it is assumed that the level of taxes on capital and labor is kept at a lower level, relative to excise duties. (Zipfel, Heinrichs, Böttcher -Edt., Hoffmann, Speyer 2012).

⇒ *Consumption taxation*
Consumption taxation is often considered to be more growth-favorable because it distorts the decisions of market participants (such as decisions about saving, decisions between work and leisure) less than labor taxation. In many cases, however, even taxation of consumption does not give optimal results. However, in case of most excises (indirect taxes), effects of distortion are desired. (Zipfel, Heinrichs, Böttcher – Edt., Hoffmann, Speyer 2012).

⇒ *Value Added Tax - VAT has the largest weight in the category of indirect taxes and has unfavorable effects on consumption behavior and decision-making, between work and leisure.*

⇒ *Environmental taxes are designed as incentives for companies to achieve ecological production and reduce the tax burden on the labor factor.* (Zipfel, Heinrichs, Böttcher – Edt., Hoffmann, Speyer 2012).

⇒ *Taxation of the labor factor can be considered unfavorable to growth, having a high progressive level of income taxation rates.*

⇒ *Profit and capital taxes hinder, at the highest level, economic growth; lead to capital outflows and hinder innovation.*
✓ *As such, taxation systems should be designed so that the tax burden on labor is reduced, and higher taxes are levied on consumption*. (Zipfel F., Heinrichs C., Böttcher B. – Edt., Hoffmann R., Speyer B.– Deutsche Bank DB Research Management, 2012).

In an optimal design of a tax system, several factors come into play, different from one country to another. A number of aspects play an important role: a growth-favorable tax system is recommended, which minimizes the distorting effects of taxation on growth factors (labor, capital, technological progress).

Basically, in economic theory, the tax system is favorable to growth if the tax burden is lighter on labor and capital and heavier on consumption, property and inheritance.

✓ In the European Union, tax systems were reconsidered, in a positive direction: consumption taxes were increasing, the tax burden on capital was decreasing. The exception is the taxation of the labor factor, which continued the orientation in the opposite direction (Zipfel, Heinrichs, Böttcher – Edt., Hoffmann, Speyer, Deutsche Bank DB Research Management, 2012).

Income inequality and the link with economic growth

Income inequality and the impact on growth, existing both in the Member States of the European Union and in other advanced economies, required special attention from the decision-making authorities, due to the negative economic consequences that may occur: the weakening of aggregate demand, the decrease of investments in human capital, reducing labor productivity. *At the same time, aggregate policies, in order to reduce these inequalities, can have negative effects on economic performance*, with reference to ”incentives for work, education, entrepreneurship, and investment”. (European Commission, 2018, p. 5)·[24]

The main tool available to governments, in addressing income inequalities, is *the reform of the tax and benefit system* that must ensure a balance of growth and equity reasons. (Kalyva A., Princen S., Leodolter A., Astarita C., 2018, p.5):

The growth reason presupposes an efficient tax system.

The equity reason implies, for people with similar incomes, the payment of a neutral tax, and for those with high incomes, the payment of a progressive tax.

Within the fiscal system, it hold attention, *the labor taxation system*, a fiscal instrument that most Member States approach, which has high potential in reducing inequalities.

As such, the following are important in the fiscal structure (Kalyva, Leodolter, Princen, Astarita, 2018) [25]:

▪ *Personal income taxes*, with a special role in reducing income inequality.
▪ *Property taxes* that have a more limited potential for generating income.

▪ *Other types of taxes*, less effective in generating revenue.
▪ *For the majority of Member States, the fiscal structure emphasizes labor taxes, with a significant role in ensuring revenue growth.* There is a broad base of the social system of contributions to income tax and social insurance.

▪ A fiscal structure in which labor taxes are significant has the potential to diminish growth and employment.
▪ It is worth noting that *high taxes on labor force* can be an obstacle to stimulating economic activity and increasing employment. The negative impact of these taxes is more strongly felt by vulnerable groups, who may be discouraged from integrating into work, the consequence being the decrease in the performance of the labor market. It must be considered the interaction of labor taxes with the way wages are set, with the minimum wage.

The reduction of labor tax constitutes an incentive for consumption, for the supply of labor force, increasing the profitability of companies. That is why it is important to support job creation and increase demand.

As such, the structure of a country's tax system and the distribution of the tax burden, by income category are of particular importance (Kalyva, Princen, Leodolter, Astarita, 2018).

Conclusions

One finding is that not all fiscal changes have the same impact on economic growth.
Changes made to the tax system in the sense of tax cuts can lead to economic growth by stimulating employment, saving and investment. (Gale William G., Samwick Andrew A., 2014)

The impact of taxes on economic growth is different, with some of them having favorable effects and others, unfavorable effects, as identified in the specialized literature.
From some studies, it appears that property taxes have a positive effect on economic growth and labor taxation and consumption taxes have unfavorable effects on growth. (Macek, R., 2018). Personal income taxes and social security contributions are unfavourable for long-term economic growth. Property taxes contribute to economic growth, but some analyzes consider that this effect is valid only for high-income countries, and in the case of countries low-income or middle-income countries, the effects on GDP (Gross Domestic Product) growth may be limited. (Stoilova, D., 2017; McNabb, K.,2018)**.**

Increases in consumption taxes and decreases in taxes on labor and capital can lead to boosting the growth factors of the economy. The tax system and its structure can have a different impact on economic activity, different from one country to another, depending on the conditions and particularities of each country. Creating an optimal tax system differs between countries and depends on a variety of factors. (Stoilova, D., 2017)

It is considered that a tax system is growth-friendly if the tax burden is lighter on labor and capital and heavier on consumption and property.

✓ A growth-friendly fiscal system is an opportunity for the government to generate revenue. These are achieved to the extent that a lower tax burden on labor and capital and a higher tax burden on consumption and property are practiced. (Zipfel F., Heinrichs C., Böttcher B. – Edt., Hoffmann R., Speyer B.– Deutsche Bank DB Research Management, 2012).

Labor taxation is the primary tool used to reduce income inequality. The labor taxation system requires an increased attention in ensuring a good structuring, so that it can ensure the achievement of these objectives (economic growth, reduction of inequalities).

The Member States of the European Union practice tax systems that emphasize the taxation of labor force, adversely influencing economic growth, as well as labor supply and demand.
Member States practice fiscal spending on a wide range of objectives. Even if these economic and social objectives are motivated as a necessity, tax expenditures are not an effective tool in relation to costs and may, sometimes, result in economic disruptions.

There is the possibility of lowering taxes on labor or changing the tax base from labor, to property, to consumption, to environmental taxes that would less disturb the growth.
In situations where a high tax percentage is practiced, for those with low incomes, there is a risk of being discouraged from participating in the labor market, of creating economic distortions.

A tax program which should not be distorted must have the potential to limit discouragement to work, investment, entrepreneurship, avoiding high marginal tax rates that lead to economic disturbances.
A system of progressive taxation of individual incomes can favor equity, the effects on growth being insignificant.

The design of a labor tax system must consider a wider context of policy and tax revenues, taking into account the specifics of the country (Kalyva, A., Princen, S. Leodolter, A. and Astarita, C., 2018).

Endnotes

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Acknowledgment

This article is a part of the research paper achieved in the year 2023, by a research team of Institute of National Economy, Romanian Academy - Etica fiscalizării câștigurilor din muncă și creșterea economică. România în context European.

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