

# National Well-Being as an Element of Fiscal Policy Aimed at Economic Growth Acceleration

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**Abstract.** This study is reconsidering the current role of taxation regime in what concerns profit distribution within a country, with the division of countries in groups according to the levels of their well-being. The author determines the correlation between taxation regimes' development and the indices of macroeconomic development. Through such an approach, this study proves that the choice of a specific taxation regime can really influence the rate and success of macroeconomic growth. Moreover, it can influence on how attractive the country is both externally and internally. Finally, the author reaches the conclusion that efficiency of fiscal policy is vitally important for economic growth and trade attractiveness for the absolute majority of today's countries on this planet.

## 1. Introduction

The key function of taxation regime in a state is to prevent/fight market falls and resist socially unfair and too unbalanced income distribution. Another important function of taxation regime is promotion of continuous economic growth (this second function is especially relevant for developing nations). Thus, government choice of a taxation regime today is important as probably never before.

Economists worldwide have been always interested in how income distribution and economic growth are related. Literature shows that there are two most popular approaches to this problem. The first of them stems from the teachings of Simon Kuznets, more specifically, from the assumption that the depth of inequality directly depends on the level of income per capita: first, it increases in parallel to income rise but then, at some point, it starts decreasing despite further growth of income.

In contrast, the second approach originates from the teachings of Arthur Okun (1970), primarily his idea about a great trade-off between equality and efficiency.

At the very beginning of this century Amy Ickowitz (2001) managed to combine these two approaches and used them together to explain why some of today's public policies lead to greater inequality. Interestingly in this regard, S. Kuznets was of the opinion that in the long run policy interventions are not necessary, while A. Okun thought these intervention is often damaging in the short run.

In this context, of special interest for us would be the study by Lawrence W. Kenny and Stanley L. Winer (2006). These authors performed a research on 100 countries with both democratic and non-democratic regimes to compare the efficiency of taxation regimes across all these countries. Taxation regimes were evaluated from the standpoint of their overall effect on the country, taxation base and general efficiency as compared to the administrative costs involved in implementing and

managing these regimes. Lawrence W. Kenny and Stanley L. Winer (2006) managed to prove that there is a wide range of advantages from having more democratic fiscal strategies in today's world.

Very similar conclusions were actually reached by Philipp Harms and Stefan Zink (2003) who stated that the majority of present-day democracies opt for rather moderate taxation of wealth.

Günther Rehme (2007) also proved that public financial policy usually has a significant role in what concerns welfare (re)distribution within a country. Therefore, it contributes to future economic growth and high standards of well-being across all social groups.

Akihiko Kaneko and Daisuke Matsuzaki (2009) set their aim to test empirically the stimulating effect of indirect taxes (sales tax in the first place) on country's growth and development. In the course of their research, they came to the conclusion that a reasonable combination of fiscal and monetary instruments proves to be most efficient when it comes to economic growth promotion.

Quite an original vision on taxation regime was offered about a decade ago by Georg Tillmann (2010). His study concerned tax evasion practices and how they correlate with different levels of incomes. This author came to the conclusion that governments are able to use different instruments to maximize the total tax receipts and prevent capital outflow at the same time. Very close conclusion was reached by Verena Kley (2011) who was also studying the role of tax instruments and their optimization for more socially just redistribution of benefits inside a country.

There is another original direction in this research field - the socio-psychological approach to understanding and interpretation of welfare distribution and the related taxation strategies. The most famous representatives of this approach are probably Philipp Doerrenberg and Andreas Peichl (2013). Among many things, these authors concluded that the more progressive the tax policy is - the higher is the citizen's individual morale in relation to taxation behavior. And further, this positive impact from tax progressivity on morale and behavior tends to decline with the income volume getting higher. This curious observation can be actually treated as the core principle behind the progressive scale in taxation and public fiscal policy overall.

More applied studies on the issues of material benefits' distribution through the instruments of taxation also need to be mentioned in our literature review, especially considering the fact that all of them are based on relatively new data from various countries globalwide.

For example, (Vogel, 2014) divided all EU economies into three clusters - North, South and Central ones, and the division was based on the practiced methods and tax regulation instruments used in these countries. Through this division the author managed to determine several important regularities in the effects of national taxation regimes on welfare changes.

Keuschnigg C. and Dietz M. (2007) took the example of Switzerland for their research and proved that even in such a well-to-do country tax regulation still has sufficiently high potential to stimulate further economic growth.

In this context, studies on the Latin American economies clearly stand out. Researchers from this region (Jean-Yves Duclos, Paul Makdissi, Abdelkrim Araar, 2014; Enlison Mattos and Ricardo Politi, 2014) tend to focus on the role of indirect taxes (primarily sales tax and VAT) as the key instrument for fair distribution and for fighting social inequality overall.

For a range of economic and social reasons, the problem of economic growth stimulation through efficient taxation is vitally important for still developing countries in the first place, since for them, poverty and fair distribution of economic benefits in the society are potential zones of social tensions, requiring particular attention on the side of state authorities. In this context, African studies can be of interest. A study by Raghendra Jha (2008) on Zambia and Zimbabwe, for example, states that taxation systems in these two countries should be first of all oriented in their development on increasing external attractiveness of the country. At the same time, Imogen Patience and Bonolo Mogotsi (2009) took the case of Botswana to ground the opinion that improvements in taxation systems must be aimed at levelling the quality of life indicators in different regions of a countries (big cities vs rural areas, in the first place).

A relatively new direction in taxation research is studying international fiscal administration mechanisms and redistribution of welfare/economic benefits between the states. Active interest to such

issues today can be partially explained by much disappointment by the free economy principles globally.

One of the most curious studies in this regard is (Janský, 2015). This author offers the so-called Commitment to Development Index, which ranks rich countries depending on what effect they have on poor countries. Further, the author states that this index can be successfully applied for tax administration on the regional/world level and international financial regulation overall.

In a very similar vein, Nuno Trindade Magessi and Luis Antunes (2014) underlines that today there exists an urgent necessity to standardize and universalize fiscal practices at the global level. This urgent necessity was explained by these authors from the standpoint of fighting illegal and semilegal financial mechanisms and shadow economies overall.

Back in 2009, at the very end of the global financial crisis Stanislaw Soltysilski (2009) made an interesting attempt to predict what could be the potential consequences (economic, social, geopolitical) if international competition between the countries in the field of taxation shifts to across-countries cooperation. This author was quite persuasive in proving that there are indeed horizons and new prospects if tax administration starts to be developed and managed at the global level.

Taking all these research conclusions into account (both theoretical and practical ones), we would like to start our own research with classifying the countries into the groups, depending on their well-being level.

In this study below we are trying to measure the efficiency of taxation regimes in various countries. Also, we are trying to explain why these regimes come to very different outcomes for their nations' well-being and economic development.

## 2. Research methodology

Our study stems from the correlation between the indicators of tax reforms' speed and success and the parallel macroeconomic trends in the states worldwide. Our key source of data was the World Bank Database. More specifically, from it we used the following data:

On GDP and GDP per capita;

On the growth of exports' and imports' volume (in both relative and absolute terms).

As it has been mentioned above, we have divided the countries into several groups according to their economic well-being status.

**Table 1.** Groups of countries as per their well-being status.  
(authors' own proposition)

<i>Group #</i>	<i>Denomination</i>	<i>GDP per capita, in USD</i>	<i>Number of countries in the group</i>
1	Most developed	Over 40,000	18
2	Overperforming	25,000-39,999	10
3	Sufficiently developed	15,000 – 24,999	20
4	Underperforming	5,000 – 14,999	22
5	Least developed	4,999 or below	61
	Total:		131

For our analysis and comparison in the first place we also needed on tax rates, taxation regimes and so on. "Doing Business" indicators turned out to be most convenient in this regard for the purposes of our research. Therefore, we have used the following parameters from "Doing Business":

Overall rank of a country's taxation system;

Time spent on doing taxes in a country;

The number of tax reports per year per country;

The synthetic indicator of all tax rates, for both businesses and private individuals.

The time frame chosen for our study is 2009 to 2016. Earlier years were till influences by the crisis phenomena, thus, earlier data could be distorted. As of later than 2016, the data we need is, unfortunately, partially missing.

### 3. Research results

Tax ranking is one of the key determinants of economic development dynamics for any country. It may also have quite a significant influence on foreign trade of a country, in case of developing countries especially. As Table 2 shows, in the least developed countries the average tax rate usually has much more influence as compared to taxation comfort indicators, still, the tax rate is less influential than the impact of international ranking of a certain country's taxation system overall. In the case of sufficiently developed countries the nearly equal positive effects on the local economy's development have the indicator as taxation comfort, that of the tax rate and the country's rank in the taxation global ranking.

**Table 2.** Taxation regime impact on macroeconomic indicators and external trade dynamics by groups of countries, 2009 to 2016<sup>1</sup>

Groups of countries	Taxation regime indicators <sup>2</sup>			
	Taxation rank of the group	Taxation comfort Duration of overall tax formalities	Number of tax payments	Average tax rate
Most developed	82	61	60	80
Overperforming	75	41	67	65
Sufficiently developed	97	80	100	99
Underperforming	61	49	84	77
Least developed	100	77	89	96

As for the most developed countries, we need to note that their rankings of national taxation systems and their tax rate size tend to have the maximum impact on the indicators macroeconomic development.

Table 3 below provides a more detailed description of how specifically separate components of a taxation regime impact the macroeconomic indicators and external trade attractiveness of countries. As we can see in this table, the strongest stimulating effect on economic growth overall and trade attractiveness in particular have taxation regimes of the least developed, sufficiently developed and finally most developed countries.

At the same time, we can also see that taxation regime has minimal influence on other, also vitally important indicators, such as dynamics of export & import operations, GDP per capita changes and so on. Interestingly, in the group of underperforming countries taxation demonstrates no stimulating effect as such.

<sup>1</sup> Correlation calculated by the author

<sup>2</sup> 100 is the maximum value

**Table 3.** Interdependence between taxation regime elements and the indicators of economic development and trade by country groups, 2009 to 2016.

Country groups	Doing Business indicators			Average tax rate
	Taxation rank	Time spent on doing taxes	Number of tax transactions	
Most developed				5
Overperforming	1,2,3,5	5		3
Sufficiently developed	3,5,7	1,3,7	7	5,7
Underperforming				
Least developed	1,3	7		1,3,7

- 1- GDP, relative value
- 2- GDP growth, in %
- 3- GDP per capita
- 4- GDP per capita growth, %
- 5- Export, absolute value
- 6- Export growth, in %
- 7- Import, absolute value
- 8- Import growth, in %

#### 4. Conclusions

In the research study presented above we have proved that taxation has serious stimulating effects on macroeconomic development of various countries and their trade attractiveness in particular.

However, we also need to mention that this effect tends to fluctuate significantly, depending on country's development level and its macroeconomic indicators. We have also confirmed our initial assumption that the stimulating effects of taxation rank, taxation comfort and valid tax rates can be very different. Therefore, we think it would be wise to apply a multivector approach to tax levers as part of overall stimulation of the economic development.

Since we have initially divided all the studied countries here into several groups, it would be logical to divide our recommendations and forecasts in a similar manner:

- In the group of the most developed countries, the most significant stimulating effect on economic development demonstrate the global rankings of their taxation systems as well as the average tax rate. This can be partially explained by the fact that developed countries, generally speaking, manage to provide much higher levels of taxation comfort. This conclusion is fully in line with the one formulated in (Ushakov, 2016 ): once a country reaches a certain level of well-being, taxation comfort in it gets also higher, as bureaucracy reduces and overall, state authorities perform their regulatory functions in a much more efficient way. Under such circumstances, further increase of tax rates often becomes unreasonable asu such. At the same time, we also need to keep in mind that higher tax rates in the most economically advanced countries of the world mean these countries already reached quite impressive rates of efficiency in economic development stimulation

- For the least developed countries high value have tax rates and also taxation system ranks. At the same time, taxation comfort parameters seem to be of secondary importance. Interestingly, taxation comfort demonstrates significant stimulation power in the sufficiently developed and underperforming countries. We are of the opinion that this might be partially explained by the ongoing trends of taxation liberalization in both these groups of countries.

- In most developed and overperforming countries the tax rates tends to boost the development of national exports. In the absolute majority of countries in both these groups we can observe preferential treatment when it comes to taxation of the actively exporting enterprises.

- Another side of foreign trade - import - is also strongly dependent on national taxation systems. This is especially relevant for the least developed countries as well as sufficiently developed countries. One of the reason for this -- lack of internal trade offer within these countries. Therefore, in these two groups state regulation of tax rates and higher taxation comfort may relatively quickly revive national consumption an internal competition development.

- In three groups out of five (that is, we can fairly assume that this is applicable to the larger share of the world as such), taxation ranks and taxation comfort parameters have significant influence on the population well-being (measured through GDP per capita), at the same time, we can hardly observe any meaningful impact on GDP dynamic development (measured here through both GDP growth and GDP per capita growth).

We are hopeful that our conclusions could be taken into account in the course of national policies' modernization. We strongly believe this can be especially helpful for the developing economies, in part of newer tax instruments' implementation for economic growth intensification purposes.

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