Do taxes generate more on economic development? Evidence from income's group and OECD countries

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Abstract

The theory of taxes that was created by traditional schools of thought believed that lower tax rates will generate greater economic growth. However, modern schools of thought propagated that higher tax rates actually will produce more economic development, especially for developed countries. An expert in tax policy, Slemrod (2003) supports modern schools of thought that mentioned a country can increase its economic performance through spending the higher tax revenue for education and infrastructure. He also suggested adopting more sophisticated econometrics methods to get the evidence of clear positive impact of taxes on economic growth. With that, this study have been investigated the recent impact of tax rates and the other components of taxes not only for economic growth but the other economic indicators, in which employed Arrelano and Bond-Generalized Method of Moments (GMM) estimator, system and different GMM and also fixed and random effects instrumental variables (RE/FE-IV). We were investigated the different impacts of taxes in low income, lower middle income, upper middle income and high income countries for the period of 2003-2009. In order to support the findings in high income countries, we also include 24 high income-OECD countries. This study found statistical evidence that the highest marginal tax rates and the other components of taxes have the positive and significant impact on economic development in high income and OECD countries which is supports the modern schools of thought. However, taxes in low income and middle income countries still burden for its economic indicators. We conclude that the different impacts of taxes are caused by the different optimum level of taxes, tax's elasticity and purchasing power among the group of countries.