

INFLUENCE OF TAX REVENUES ON THE ECONOMIC GROWTH OF THE COUNTRY

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ABSTRACT

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Tax Revenue, Economic Growth, Kyrgyz Republic, Fiscal Policy, Tax System, Indirect Taxes, Direct Taxes, Investment Activity, Macroeconomic Indicators, Optimisation of Tax Burden

In the conditions of the modern global economy, tax policy is a direct tool of management that influences the economic development of the country. This paper dwells on the assessment of the interconnection between tax policy and economic development of the Kyrgyz Republic. The paper considers the issue of adapting the country's tax policy to the conditions of the world economy, as well as to domestic needs and possibilities.

This research focuses on the specific features of Kyrgyzstan's tax system, including the structure and recent changes in the legislation and their influence on fiscal policy and economic indicators. The authors emphasize that to achieve sustainable economic growth and raise the population's well-being, it is important to create a tax system that would adequately react to the changes in the world economy.

This paper contains a detailed analysis of macroeconomic factors and key economic indicators that is aimed at determining the current trends and potential opportunities for the optimisation of the tax burden. Special attention is paid to the development of tax tools that facilitate the formation of a favourable environment for sustainable economic development and prosperity of the national economy. This research is a complete overview of the tax system of the Kyrgyz Republic, with an analysis of the recent changes in the context of their impact on fiscal policy and economic indicators. Summing up, this paper distinguishes the strategic significance of effective tax policy for the stimulation of sustainable economic growth.



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1. INTRODUCTION

In the conditions of globalisation and growing competition between countries, tax policy acquires a critical value as a tool for the active stimulation of economic growth. The tax system is one of the main mechanisms that allows countries to influence economic processes, regulate investment activity and move resources into strategically important and top-priority sectors of the economy.

The Kyrgyz Republic, similarly to many other developing countries, faces the task of the necessity to achieve sustainable economic growth in the conditions of limited resources and complications in the external economic environment.

In this context, it is important not only to effectively manage tax revenues but also to consciously use tax policy as an important tool for economic regulation. This

implies the adoption of the corresponding measures on optimisation and adaptation of tax mechanisms that facilitate economic growth and ensure the harmonious development of the country.

There are specific features in the structure of tax revenue in the Kyrgyz Republic, which are peculiar to the domination of indirect taxes and a significant role in the shadow economy. These factors create certain problems and challenges in the context of the implementation of tax policy and its influence on economic processes in the country.

The need for a deep understanding of the interconnection between tax revenues, utilised tax mechanisms, and the development of the country's economy, as well as the possibility of using them for the optimisation of tax policy, predetermines the importance of this research topic. Analysis and approbation of these interconnections can facilitate the development and use of effective strategies and tools that will help ensure the economic growth and sustainable development of the country.

This research is focused on the analysis of the interconnection between tax revenues and economic growth in the context of the Kyrgyz Republic.

The main goal of this research was to identify trends and determine interconnections and potential opportunities for the optimisation of tax policy to ensure the sustainable economic development of the country. The main emphasis is placed on the research and analysis of long-term trends and factors that may influence the effectiveness of the tax system and its ability to stimulate economic growth.

2. METHODOLOGY

This research is based on the analysis of statistical data for the last ten years. The method of correlation analysis was used to study the interconnections between tax revenues and economic growth; regression analysis was used to determine the influence of tax revenues on various macroeconomic indicators.

3. ANALYSIS

The Kyrgyz Republic, similar to many countries of Central Asia, is peculiar for the unique structure of the economy, which influences the specifics of its tax system. The additional financial burden on final consumers appears due to indirect taxes in the form of value-added tax and excise duties. Since these taxes are imposed on goods and revenues, consumers have to pay additional prices, which may influence their financial position and stimulate changes in their consumer behaviour.

3.1 Structure of tax revenue

As a result of the analysis of tax revenue, it was revealed that a large share in the total structure accounts for value-added tax and excise duties, but there is also a visible growth of the share of direct taxes in recent years, which may be a sign of shifts in the structure of the economy and an increase in the population's income level. This reflects changes in preferences and consumer behaviour and is a sign of the growth of the significance of direct tax liabilities for taxpayers.

Consideration of the structure of the tax revenue in the Kyrgyz Republic is an important aspect, which is necessary for understanding, analysis, and assessment of its influence on economic growth. This allows for the evaluation of the effectiveness of the tax system and its correspondence to the economic needs of the country, as well as the determination of potential opportunities for improvement in the system of taxation.

Besides, this analysis facilitates the development of policy aimed at well-balanced and sustainable taxation, which can support economic growth and ensure social justice.

The existing practice of classification of taxes implies the classification of taxes into direct (property and income tax) and indirect taxes (transaction taxes) (Aronov & Kashin, 2019).

It is possible to distinguish several main components of tax revenue in the structure of revenues in the budget of Kyrgyzstan. Among them, it is possible to note direct taxes, which include income tax on individuals and legal entities, property tax, and income tax. There are also indirect taxes, such as value-added tax and excise duties, which are levied on the purchase of goods and services. An important component is also social contributions, which are contributions aimed at financing the system of social support and medical insurance.

Direct taxes

Direct tax liabilities, including profit tax and individual income tax, payments from entrepreneurs and organisations that use a simplified tax system, as well as property tax, have a significant role in the structure of the tax system, providing a substantial source of financing for government needs and domestic budget revenues of the country.

Profit tax is levied on organisations; it significantly influences the investment attractiveness and financial stability of the business sphere.

Individual income tax, in turn, is an important source of financing for the state budget, especially in the conditions of an increase in the population's income.

The use of the simplified taxation system based on the single tax was adopted by recent changes in the legislation for the subjects of small entrepreneurship, which are subjects that conduct activities based on a single tax and the rate and terms of payment of the tax. Effective administration of individual income tax, which is levied on the personal incomes of citizens, and a single tax for entrepreneurs, is very important for ensuring a just distribution of incomes in society. This is an important source of revenues for the state budget, especially in the conditions of an increase in the population's incomes, and stimulates social justice and economic sustainability.

Indirect taxes

Indirect tax liabilities, including value-added tax (VAT), and excise duties are the key tools of taxation in Kyrgyzstan. VAT, which is levied at each stage of the life cycle of goods and services, accounts for a large share of total tax revenues. This tax is based on an increase in the cost of goods and services, and its influence covers inflation and the population's purchasing power. The effective management of the process of charging VAT has an important role in the support of stability and effectiveness of the tax system. Excise duties, levied on certain categories of goods, including alcohol, tobacco, and fuel, also play an important role in tax revenues. They are used as a tool for regulating consumption and influence the prices and accessibility of these products. Excise duties are aimed at the achievement of various goals, such as reduction of consumption of harmful goods, support for the population's health, or limitation of environmental impact. Since excise duties facilitate the control and regulation of the market, influencing the prices and demand for the corresponding products, the rational management of excise duties facilitates the achievement of social and economic goals and support for sustainable economic development.

Social contributions

Insurance contributions for state social insurance play an important role in the formation of tax revenue and are aimed at the financing of the social protection system.

A study of the structure of tax revenue in Kyrgyzstan demonstrates that a large share of revenues comes from indirect taxes, primarily VAT. However, direct taxes and insurance contributions for state social insurance also have an important role in the formation of the state budget.

Given that the structure of tax revenues reflects the state of economic processes in the country, it is important to regularly analyse and optimise tax policy, to stimulate economic activity and ensure fair

distribution of income and support for the social protection of the population.

A significant proportion of revenues of the budget of the Kyrgyz Republic is formed by individual income tax. It should be noted that the existing system of taxation of individual incomes has a vivid fiscal character, which has a rather strong mechanism ensuring the replenishment of the state budget.

The main share of revenues from individual income tax (93%) is formed through payment by tax agents. In 2020, this share equalled 20.33% of the total revenues of the budget.

As shown in the graph, there has been a gradual increase in tax revenues in recent years. This growth can be explained by an increase in economic activity and a change in the tax base. However, the graph also demonstrates a quick reduction in tax revenues in 2020, which was probably due to the pandemic.

Due to the limitations and impossibility of conducting economic activities for many companies, tax revenues decreased. However, by the end of the year, the situation with tax revenues improved – when lockdown restrictions were cancelled – and the rate of tax revenues reduction equalled only 12%.

Structural analysis of tax revenues in 2008 – 2021 showed that the structure of the revenues remained almost unchanged with small fluctuations. This trend can be observed based on the presented data in Figure 1.

Recently, there has been a vivid differentiation of people by the level of income in the Kyrgyz Republic. According to Article 161 of the Tax Code of the Kyrgyz Republic, individual income tax is levied on individuals – residents and non-residents – on income from sources located within the country.

It should be noted that most of the population of Kyrgyzstan is employed in the agrarian sector and small companies of the non-observed economy, where wages are not stable and depend on seasonal work. At that, wages are paid in cash and are not put into financial accounting.

The above circumstances lead to the fact that the volume of individual income tax can be accounted only for employees of state bodies, state establishments, and state-owned companies, while the determination of the volume of individual income tax that is collected from other organisations is connected with certain difficulties.

Moreover, workers in the agrarian sector and small companies do not frequently make purchases in supermarkets, which have detailed accounting of sales and stock of goods. As a result, the contribution of individual income tax to the economy of the Kyrgyz Republic is insignificant.

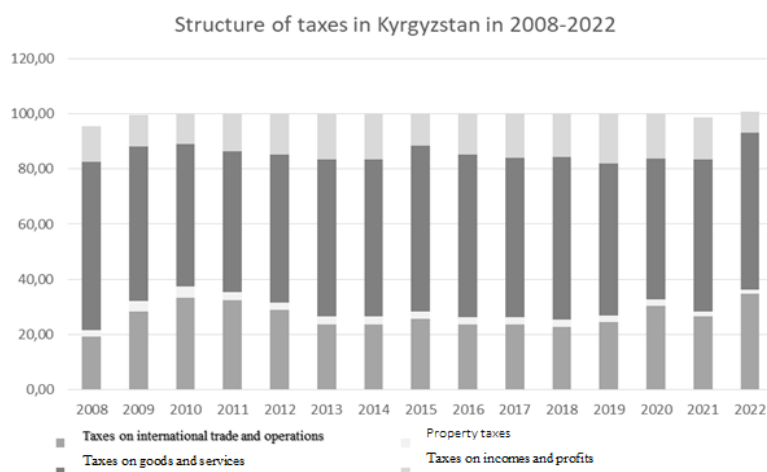


Figure 1. Structure of tax revenues

Compiled by the authors based on the National Statistics Committee of the Kyrgyz Republic: form 2.02.00.01 Revenues of the state budget

As a result, individual income tax has an insignificant impact on the economic activity in the Kyrgyz Republic, with a limited role in the formation of the budget and stimulation of national economic development.

The additional significant challenge, which is connected with the taxation of income, is the wide dissemination of the practice of "shadow" wages. Employers often use strategies for hiding real incomes, paying wages illegally or paying a part of wages without official accounting. This is done for the purpose of the reduction of the total volume of social contributions, which account for 17.25% of the total fund of wages, and is the main reason for such behaviour of the employers.

It should be emphasized that there is a danger of the emergence of corrupt practices during the use of special regimes of taxation. These regimes include simplified and mandatory patents, simplified taxation for small companies, and land tax for manufacturers of agricultural products, which replaces the obligation to pay all other types of taxes (Makarenko, 2006).

It is obvious that dealing with the problem of the shadow economy may stimulate an increase in the collection of income taxes. To achieve this goal, it is necessary to develop a tax system in which all parties would rather comply with their obligations than violate them. One of several proposed methods includes the reduction of mandatory contributions to various funds, with a simultaneous increase in employers' responsibility for the use of illegal employees. Besides, it is believed that the use of the progressive scale of taxation is preferable, for the use of a fixed rate of taxation violates the principles of social justice, uniting various social groups into one category and increasing social inequality. Thus, an increase in the level of tax collection can be achieved without raising the tax burden on the population, but through the optimal distribution of tax liabilities.

The use of the progressive rate of taxation is an effective means of tax collection; it implies a solution for increasing the sum of collected tax revenues. Additionally, an important direction for increasing tax revenues is the improvement of tax administration.

For the full implementation of the potential in the sphere of tax collection, it is necessary to perform radical and principled action in the organisation of administrative work, which includes not only the optimisation of the structure of tax bodies but also active stimulation and bonuses for employees, as well as systemic and continuous improvement in the professional level of personnel.

3.2 Influence of taxes on economic growth

There is a positive connection between the volume of tax revenues and GDP, which shows that an increase in tax revenues is usually accompanied by an increase in economic activity. However, excessive tax burden may have an inhibitory effect on the development of business.

According to the experience, the result of the instability of economic processes and a wide range of government interference is usually an increase in inflation trends (Birimkulova, 2022).

The influence of taxes on economic growth has many aspects and depends on various factors, such as the structure of the economy, level of development, and external economic conditions. Let us consider several key aspects through which taxes may influence the economic growth of the Kyrgyz Republic.

Investment activity

The direct influence of taxes on economic growth is manifested through the change in investment activity. For example, corporate income tax may significantly influence the companies' decisions on investments in production expansion. High tax rates can limit available

resources for investments, while tax subsidies and periods of tax vacations may stimulate investment activity, facilitating economic growth.

Consumer expenditures

Indirect tax obligations, such as value-added tax and excise duties, have a significant impact on the prices of goods and services, which directly influences the purchasing power of the population. An increase in rates of these taxes may lead to a significant reduction of demand from consumers, which, in turn, negatively influences the level of production and investments. This may limit the possibilities for economic growth and general development of the economy.

Savings and capital formation

Individual income tax, profit tax, and property tax have a significant impact on the saving behaviour of the population and companies. Individuals and companies react to changes in these tax rates, which influences their decisions regarding saving financial resources, which have a key role in the formation of capital which is an important factor for ensuring economic growth and development. Similar changes have a significant effect on economic processes through the influence on the dynamics of accumulation and formation of capital.

Employment level and labour efficiency

Tax measures may have a deep and direct effect on strategic decisions of companies on hiring of employees and wages. For example, the introduction of high rates of social contributions may significantly reduce companies' motivation to create new jobs and raise wages. This may eventually lead to a negative influence on the employment level. Decisions that are connected with labour resources and wages are based on logical assessment of tax liabilities and costs since they play a key role in determining the competitiveness of companies and their financial sustainability. In this context, analysis of tax policy is an inseparable component during the study of the dynamics of employment and the level of wages in the economy.

Distribution of resources

State regulation through tax policy influences the distribution of resources between various spheres, which, in turn, influences the structure of the economy and its growth potential. For example, the provision of tax subsidies to top-priority spheres may be a stimulus for development and progress. Such regulation of the tax system is aimed at the creation of a favourable environment for the development of the selected sectors of the economy, which are considered strategically important for the achievement of the goals of national economic development. This approach allows the government to influence the structure of

sectors, facilitating their growth and strengthening of competitiveness in the world market.

In the Kyrgyz Republic, the tax system has a significant impact on economic growth through various mechanisms. Effective management of the tax policy, including the optimal choice of tax rates, use of tax subsidies, and effective mechanisms of administration, may stimulate investments, growth of the employment level, and optimisation of the distribution of resources, which, in its turn, will influence the sustainable development of the national economy in the long-term.

Potential volumes of tax revenues from tax on goods and services in the Kyrgyz Republic may be much higher, but their implementation is limited by the impact of the shadow sector of the economy, which is unofficial, non-registered, or non-transparent economic activities, which evade taxation and regulation by the government (Birimkulova, 2022). The presence of the shadow sector negatively influences the effectiveness of the tax system, since a large share of economic activities remain outside of the official turnover.

A shadow economy is present in any country, regardless of the level of economic development, but the effective system of state management must involve effective mechanisms aimed at the constant reduction of the level of the shadow economy. It should be noted that the shadow economy leads to distortion of statistical data and, as a result, ineffective managerial decisions (Adamkulova, 2003). The economic and mathematical modelling of the state budget of Kyrgyzstan has shown that even a slight increase in the volumes of corruption and "shadow" economy by 1 million soms may lead to state budget's losses of more than 630 million soms of tax revenue.

It should be noted that there are differences in the assessment of the scales of the shadow economy in Kyrgyzstan.

Based on the data of the National Statistics Committee of the Kyrgyz Republic, it was revealed that the share of the shadow economy varies from 20% to 25% of the total volume of gross domestic product (GDP).

However, a study performed by the international company PricewaterhouseCoopers revealed that the volume of non-observed economy can reach 37% of GDP. In the course of parliamentary hearings devoted to the discussion of the project of the Tax Code, the deputy minister of economy and commerce of the Kyrgyz Republic said that, currently, the share of the shadow economy equals approximately 40% of the country's GDP. This is a sign of a large share of the non-observed economic activity, which is not taken into account in the official statistics and has a significant effect on the economic activities and development of the country.

Table 1. Rates of growth of the non-observed economy in 2014-2021

Indicators	Measuring unit	2013	2014	2015	2016	2017	2018	2019	2020	2021
Value added that is received as a result of hidden and informal production (excluding agriculture)	Billion soms	70.5	92.8	102.3	116.7	125.2	133.4	145.2	124.9	155.1
% of GDP	%	19.8	23.2	23.8	24.5	23.6	23.4	23.5	20.8	21.0
The growth rate of the share of the non-observed economy			117.2	102.6	102.9	96.3	99.2	100.4	88.5	101.0

Source: compiled by the authors based on the National Statistics Committee of the Kyrgyz Republic: form 2.02.00.01 Revenues of the state budget

3.3. Fiscal policy and investments

Changes in the tax law for the stimulation of investments may have a positive effect on the dynamics of economic growth. For this, it is necessary to take into account the specifics of various sectors and regions of the country. Fiscal policy, which includes the adoption of tax rates, management of government expenditures, and regulation of public debt, has an important role in the formation of investment activity in the country's economy. In this context, let us consider how fiscal policy can influence investments in the Kyrgyz Republic, based on analysis of the data.

Tax regulation and investment climate

Tax policy and the level of tax burden have a significant impact on the investment climate. High tax rates and complex administration may scare off potential investors. At the same time, reduction of the tax burden and provision of tax subsidies may stimulate investments and facilitate economic development. A properly balanced tax policy, which takes into account the interests of investors and the needs of the government, is the key factor in the attraction of investments and the creation of a favourable investment climate.

In the Kyrgyz Republic, there have been changing dynamics of investments in the country's economy recently. However, after the implementation of effective tools in the tax law, aimed at the creation of a favourable investment climate, provision of equal conditions of competition, and fight against illegal product turnover, there took place a substantial increase in investments in the country's economy.

Government expenditures as a stimulus for investments

Government expenditures, including allocations for the development of infrastructure, the sphere of education, and healthcare, may stimulate the creation of conditions for the facilitation of private investments. Qualitative development of infrastructure raises the accessibility of markets, and the presence of skilled labour stimulates an increase in efficiency and innovative activity.

Government debt and access to financing

The level of government debt may have a significant effect on the access to financing for the private sector. If the government borrows actively in financial markets, this may lead to the growth of interest rates and aggravation of crediting terms for companies and businesses.

Special investment regimes

The creation of the mechanisms of special investment regimes, which include the provision of tax subsidies and guarantees for investors, is a potentially effective tool for attracting investments, especially in the sectors of the economy that are considered top-priority ones. These regimes can create additional stimuli for investors, reducing the tax burden and providing additional guarantees that set transparent and stable rules of the game aimed at the protection of property rights and reduction of risks connected with investing and stability of the legislative environment. Such measures stimulate an increase in the inflow of investments and development of the economic sectors. For this, it is possible to develop special legal, tax, and regulatory measures aimed at the improvement of the investment climate.

In the Kyrgyz Republic, effective use of fiscal policy could be the key mechanism for the stimulation of investments.

To achieve this goal, it is necessary to perform an in-depth analysis and optimisation of the tax burden, given not only economic but also social aspects. This includes assessment and reconsideration of tax rates, subsidies, and regimes, for the creation of a favourable investment climate. Besides, it is necessary to direct government expenditures to the development of a favourable infrastructure and the creation of conditions for the attraction of investments. Special attention should be paid to the development of the transport system, communication and energy infrastructure, and educational and scientific centres, which will support the innovative development of the economy.

Government debt management is an inseparable part of an effective fiscal policy with a strategy aimed at the provision of the sustainability of government finance, which will prevent excessive pressure on private

investments. This may include diverse methods, such as optimisation of the structure of the debt, management of bond issue, and search for new sources of financing.

In conclusion, the effective use of fiscal policy in the Kyrgyz Republic to stimulate investments requires the use of the systems approach. Optimisation of the tax system and directing government expenditures at the creation of a favourable infrastructure, management of government debt and creation of special conditions for investors – all these measures can stimulate the attraction of domestic and foreign investments, especially in strategically important and top-priority sectors of the economy.

4. CONCLUSIONS

Analysing the importance of tax revenues for the economic growth of Kyrgyzstan, it is possible to see the obvious necessity for the systems approach to the formation of tax policy for the achievement of sustainable growth. This requires reconsideration of the structure of tax revenues given the reduction of dependence on indirect taxes, development of measures on stimulation of investments and entrepreneurship, and strengthening of measures on the fight against tax evasion.

To ensure the long-term sustainability of the Kyrgyz economy, it is important to adapt tax policy to the conditions of the world economy and to take into account the internal needs and capabilities of the country. This may involve additional research and the formation of strategic approaches to tax policy. The main goal of these efforts is to create foundations for sustainable economic growth and an increase in the well-being of Kyrgyzstan's population. The use of the systems approach in the tax policy will facilitate the establishment of stable and predictable conditions for business, attraction of investments, expansion of production, and creation of new jobs.

5. RESULTS AND DISCUSSION

The main results and analysis of the influence of changes in tax revenues on the economic growth of the Kyrgyz Republic show that research on the structure of tax revenues and their influence on various aspects of the country's economy helps assess the effectiveness of fiscal policy and outline possible ways of stimulation of sustainable economic growth.

The analysis leads to the conclusion that dynamics of tax rates and modifications of tax policy lead to a complex influence on economic growth. In particular, the reduction of tax rates can be a driver of investments and entrepreneurial activity. However, it should be noted that it can also be accompanied by a reduction of revenues in the budget. At the same time, increased taxes on consumption may lead to pressure on demand

and negatively influence the business climate. This means that to ensure the balance between the stimulation of economic activity and the provision of financial sustainability of the state, it is necessary to use a detailed approach.

The research also indicates that high rates of social contributions can deal with excessive pressure on companies and limit their growth potential. However, balancing between the level of social contribution rates and the provision of social protection of the key aspect for supporting stability in the economy and ensuring the population's well-being.

Additional analysis confirms that the optimal combination of tax stimuli and investment mechanisms facilitates progress in infrastructure, technological development, and an increase in competitiveness. Operational tax strategy requires attention to economic and social aspects, including the distribution of resources in the economy, to ensure sustainable and well-balanced economic growth.

The results of the research emphasize that transparent and predictable tax regulation stimulates the formation of a favourable investment atmosphere. Simplifying tax procedures and cancelling barriers for business also stimulate the attraction of foreign investments and the development of domestic entrepreneurship.

The analysis also showed that correctly directed government expenditures can become an effective tool for the stimulation of investments, which can create favourable conditions for long-term economic growth.

It is important to note that an analysis of the effectiveness of government debt management, which plays an important role in ensuring access to the financing of investment projects, was also performed.

As a result of this research, it is possible to conclude that tax policy plays a significant role in the economic development of the Kyrgyz Republic. To achieve stable and quick economic growth, there is a need for skilful interaction between tax rates, social protection, and support for investments.

As for the issue of the adoption of the single tax rate for individual entrepreneurs, it should be noted that this initiative is aimed at moving most entrepreneurial activities from the shadow sphere and at simplifying tax administration.

Given this prospect, the Cabinet of Ministers of the Kyrgyz Republic prepared rates for various types of economic activities to ensure a more just, moderate, and competitive tax structure. All these novelties were implemented by changes to the Tax Code of the Kyrgyz

Republic dated 30 June 2022, No. 51 and 3 April 2023, No. 78.

It is supposed that the main benefit from this initiative will be the reduction of government expenditures for tax

administration due to the document turnover's transition to the electronic form and automatic calculation of the single tax and other allocations with the formation of electronic systems of tax control.

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