

## Chapter 8

# Personal Income Taxation and Its Effects on Economic Development and Growth

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### ABSTRACT

*This chapter reviews traditional and contemporary concepts of income taxation and their effects on economic development and growth. The author focuses on discussion issues related to the contemporary concepts of income taxation. The author also considers modern functions of personal income taxes relating to environmental protection and income inequality mitigation. Additionally, the author studies the potential of personal income taxation to apply as an instrument for maintaining sustainable economic development and social stability. This chapter analyzes the effects of progressive and proportional personal income taxation on economic development and growth. It presents a technological model of inspections and audits with the aim of improving the tax and social security control of individuals.*

### INTRODUCTION

Personal income taxation occupies a central position in the tax system. Additionally, it is one of the most discussed topics during the tax policy implementation since it has a significant impact on economic development and growth. Regardless of the usage of different methods of assessment and different sources of information, results of scientific research (Staykov, 2016) show that tax level has serious effects on economic growth. This is true even after researchers have eliminated the impact of factors such as government expenditure, business cycle development, and monetary policies.

Tax subjects, syndicates, any representation organizations of employers, government, and political parties, demonstrate heightened interest and sensitivity to income taxation of individuals and social security contributions. All of them have certain interests in the said aspects, which are often contradictory. For that reason, it is usually hard to reach a consensus on income taxation of individuals and social security contributions, and any decisions taken are regularly reconsidered and subject to changes in order to en-

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courage economic development and growth. Moreover, in the contemporary socio-economic conditions, issues such as income inequality, the harmful effect on the environment, and disturbance of ecological equilibrium come to the forefront of conversations. Thus, efforts of scientists and the government aim at ensuring conditions of sustainable economic development and growth through the implementation of the macroeconomic and tax policy. Stiglitz (2012) points out that the nature of growth is what is significant, and thus, the aspiration should focus on such growth that does not aggravate people's welfare and jeopardize environment.

The issue of finding a balance between economic effectiveness and social justice regarding taxation is related to the aim of ensuring both growth and sustainable economic development at the same time. Hristov (2014) points out that the supporters of the concept of the "minimal state" defend the thesis of limited state participation in the economy, low taxes and reduced government spending, which, according to them, stimulates economic growth and welfare of society. In this way, the funds will remain available to the private sector, which is considered to be able to spend them efficiently. This will reduce budget expenditures and the role of the state in the economy. Instead, Stiglitz (2012) proposes an alternative approach to stimulating the economy: simultaneously increasing taxes and spending so that the current account deficit remains unchanged. According to him, such a strategy will be based on a proven principle called the balanced budget multiplier. He acknowledges that taxes "suffocate" the economy, but costs stimulate it, and points out that the stimulus effect is significantly greater than the contraction effect of the economy. Stiglitz argues for the need to achieve greater economic efficiency and more equality at the same time. In this regard, he recommends the introduction of progressive income taxes. The author gives Scandinavian countries as a positive example of a nation's prosperity in the utmost degree in modern conditions, where the state's role in economy is enhanced through active redistribution of income and significant investments in public goods. The alternative for economic development, which Stiglitz argues, requires a better balance between the state and the markets. He believes that in these alternative frameworks, one of the roles played by the state is to redistribute income, especially if the results of market processes are highly contradictory. Soldatos (2016, p. 261) states: „There appears to be in operation a New Keynesian version of the national and international economy. Should tax policy be conducted as prescribed by this school of thought? The answer to this question lies beyond the scope of this paper, but one thing the spirit of the whole discussion makes sure is that taxation should be (i) inspired by the overall macroeconomic policy, (ii) accompanied by anti-monopoly policy. It is the spirit of the quest for efficiency as the driving force behind income and wealth redistribution, which is welfare-enhancing by itself and by sustaining economic growth.”

This chapter looks at current issues related to personal income taxation step by step. First, the author studies the role and functions of personal income taxation in the context of modern requirements for sustainable economic development and growth. Second, the author deduces any advantages and shortcomings of the application of progressive and proportional income taxation. Thirdly, the author examines the potential of increasing the effectiveness and efficiency of tax control over personal income taxation through improving implementation process.

## **BACKGROUND**

Two main economic paradigms - Keynesian and Neoclassical economics, have strongly influenced the formation of modern views and policies related to economic growth. Each of them has many followers.

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