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Lex:lead Group annual scholarship competition: summary

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How can tax law stimulate economic growth and finance development?

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This essay is concerned with how tax law is linked to stimulating economic growth and financing development. In order to achieve its purpose, it will first try to define the basic terms: tax law, economic growth and financial development. Then, it will try to find out the relationship of tax law with both economic growth and financial development. After that, it will discuss the impact of tax law on economic growth and financial development, with special reference to the different types of taxes (personal income tax, corporate tax and consumption tax, as examples). At last, a conclusion will be given.

The political, economic and social development of any country depends on the amount of revenue generated for the provision of infrastructure in that given country. However, one means of generating the amount of revenue for providing the needed infrastructure is through a well-structured tax system.[1]

Taxation is a means used by governments to generate revenue in order to counter its expenses. 'Taxation provides governments with the funds needed to invest in development, relieve poverty and deliver public services.'[2] Therefore, having clearly defined, certain, consistent, uniform and publicised tax laws will strengthen the economy and result in financial development. It is through tax reforms that we can achieve changes and progress in the economy of a country, and that is why, in most election campaigns, we see candidates vowing to make changes through tax reform.

Nature and scope of tax law

Tax law is an area of legal study dealing with the law applicable to taxation. Taxation is defined as the compulsory transfer or payment from private individuals, institutions or groups to the government.[3] Taxation is a means by which governments finance their expenditures by imposing charges on citizens and corporate entities. The importance of tax law in the system of taxation is to set out the principles by avoiding uncertainty and arbitrariness. It also helps the taxation method to be conducted in a more effective, efficient and equitable way by a legitimate body.

There are three basic objectives of taxation. They are 'to raise revenue for the government, to regulate the economy and economic activities and to control income and employment'.[4] These objectives can be fulfilled by the general functions of taxes, which are allocation, distribution and stabilisation of economic activities. The scope of these functions depends on the extent to which a government can perform its functions through its 'ability to design tax plans and administration as well as the willingness and patriotism of the governed'.[5]

Principles of taxation

The principles of taxation mean the appropriate criteria to be applied in the development and evaluation of the tax structure. 'In order to achieve the broader objectives of economic growth [and social justice], the tax system of a country should be based on sound principles.'[6] The basic principles that need to be followed are as follows:

- *The equity principle* states that every taxpayer should pay the tax in proportion to his income. The rich should pay more and at a higher rate than the other person, whose income is less. It is only when a tax is based on the taxpayer's ability to pay that it can be considered equitable or just. Sometimes, this principle is interpreted to imply proportional taxation.
- *The certainty principle* of taxation states that a tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, and the quantity to be paid ought to be clear and plain to the contributor and every other person.

- *The convenience principle* of taxation states that the time and manner should be convenient to the taxpayer. This principle of taxation provides the rationale for Pay-As-You- Earn (PAYE).
- *The economy principle* states that every tax should be economical for the state to collect and the taxpayer to pay. This principle implies that taxes should not be imposed if their collection cost exceeds benefits.
- *The productivity principle* states that a tax should be productive in the sense that it should bring large revenue that should be adequate for the government. This is the major reason why governments in all parts of the globe continuously employ tax reforms.
- *The simplicity principle* states that the tax should be plain, simple and intelligible to the common taxpayer. There should be no hidden agenda in the tax law.
- *The Diversity Principle* of taxation states that there should be a variety of taxes. It is risky for a state to depend upon too few sources of public revenue.[7]

Economic growth and financial development

Economic growth is defined as an increase in the total amount of production and wealth in an economy over time. It implies that national output should be composed of such goods and services that satisfy the maximum want of the maximum number of people. The growth of an economy is thought of not only as an increase in productive capacity, but also as an improvement in the quality of life to the people of that economy.[8]

Financial development is also defined as 'the establishment and expansion of institutions, instruments and markets that support th[e] investment and the growth process'.[9] Both economic growth and financial development imply an increase in the overall economic activity of the country. Therefore, in order to increase investment and productivity and to result in overall growth, the role of tax law is believed to be of great importance.

The role of tax law in economic growth and financial development

Several empirical studies have been conducted by scholars on the impact of taxes on economic growth. And they have provided different explanations on the relationship of taxes to economic growth. However, all the studies conclude that reducing the distortive effects of the tax structure would result in permanent economic growth. But, the question is: how?

Too often, public office-holders first embrace lowering taxes and creating tax incentives as their chief economic development tools, in order to attract investment. But, this does not have to be at the expense of the public. Governments use tax proceeds to provide public goods, maintain law and order, defend against external aggression, regulate trade and business, and render other functions maintained by the government.[10] When setting up the tax system, their goals and objectives have to benefit the taxpayers as well as the government.

In a study provided by the OECD, focus on tax structure is more important than on tax level. The tax structure of a country needs to be set up to minimise taxpayers' compliance costs and the government's administrative costs, while also discouraging tax avoidance and evasion. Taxes 'affect the decisions of households to save, supply labor and invest in human capital, the decisions of firms to produce, create jobs, invest and innovate, as well as the choice of savings channels and assets by investors'.[11]

Since the system of taxation affects almost everyone, tax reforms should be based on small tax changes rather than on shifting the revenue base entirely to one particular tax instrument.[12] 'A revenue-neutral, growth-oriented tax reform would be to shift part of the revenue base from income taxes to less distortive taxes.'[13] '[A] greater revenue shift could probably be achieved [through] consumption taxes.'[14] However, with consumption taxes being less progressive than personal income taxes, or even regressive, such tax shifts 'imply a nontrivial trade-off between tax policies that enhance GDP per capita and equity'.[15] More generally, most taxes would benefit from a combination of base broadening and rate reduction' in order to improve efficiency, and maintain tax revenues.[16]

'Most of the personal income tax reforms have tried to create a fiscal environment that encourages saving, investment, entrepreneurship and provides increased work incentives.'[17] 'Likewise, most corporate tax reforms have to be driven by the desire to promote competition and avoid tax-induced distortions.'[18]

'Reducing corporate tax rates and removing special tax relief can enhance investment… if the primary aim is to reduce distortions that hold back the level of domestic investment, and to attract foreign direct investment.'[19] This can in-turn result in a high production rate and the creation of job opportunities by reducing the unemployment rate. 'In addition, multinational enterprises are attracted by tax systems that are stable and predictable, and which are administered in an efficient and transparent manner.'[20]

Consumption taxes, and particularly VAT (indirect taxes), are often thought to have a less adverse influence on the decisions of households and firms, and thus on GDP per capita, than income taxes. However, these advantages have to be balanced against equity concerns that arise from their lack of progressivity.[21]

In particular, there is little evidence that tax cuts, when paid for by reducing public services, stimulate economic activity or create jobs.[22] However, 'there is evidence… that increases in taxes, when used to expand the quantity and quality of public services, can promote economic development and employment growth.'[23] Therefore, the best solution is to know the right mix and to employ the different types of taxes without creating distortions. Policymakers will need to examine very carefully the tradeoff between these growth-enhancing proposals and other objectives of tax systems and particularly equity.

The role of tax law in the economic development of selected African countries

The amount of revenue generated in developing countries, which includes African countries, has not been that satisfactory. According to a study conducted by the International Monetary Fund (IMF), tax revenues have been stagnant across developing countries for decades, especially in Low Income Countries (LICs) and in Sub-Saharan Africa (SSA).[24] The reason is viewed as something of a mystery. But, it can be said that a large proportion of the population is in agriculture or informal sectors. So it becomes difficult to tax them, since they have low income.[25]

For example, Uganda's difficulty in taxing the informal sector has contributed to low tax revenue, even after they have reformed their tax system.[26] To the contrary, the Ghanaian government has tried to tax the informal sector.[27] The government used the Standard Assessment method, which uses a single tax; that is, a fixed lump sum tax was levied on individuals or businesses on the basis of occupation or the business activity in which they were engaged.[28] Ghana's experience in taxing the informal sector can be taken as an example for other African countries.

Weak tax administration and poor governance in African countries encourage non-compliance and increase costs of enforcement, which, in return, encourage tax avoidance and evasion; so this also contributes to low tax revenues.[29] Compliance costs are high in LICs: there are lengthy processes, frequent tax payments, bribes and corruption.[30] Estimates of tax revenue losses from evasion and avoidance in developing countries are limited by lack of data and methodological shortcomings.[31] For example, even though 'Uganda has worked hard at improving the administration of its tax system… it is still not collecting sufficient revenue, debt loads continue to rise, and budget deficits continue to mount.'[32]

'The reduction of import tariffs and the elimination of many export taxes as part of trade liberalisation policies have [also] contributed to declining tax revenues[.][33] For example, in Eritrea, goods produced for direct export are exempted from the payment of taxes, which results in low tax revenue in countries that follow the same approach.

'In many LICs[,] the majority of revenue is collected from a narrow tax base, sometimes due to a limited range of taxable economic activities.'[34] 'There is therefore dependence on a few taxpayers', which results in low tax revenue.[35] VAT performance in LICs is the weakest.[36] While only few countries in SSA have VAT, implementing a broad-based VAT and improved compliance might raise the revenue from tax collection in these countries.[37] For example, in Eritrea, the tax base is narrow, which mostly depends on income tax, sales and excise tax, and tax from mining and petroleum operations. If it is critically studied, this kind of taxation system hinders economic growth, since there are many kinds of taxes like VAT, capital gains tax and a more developed corporate tax that have not been incorporated in with the overall tax laws of the country. As a similar example, the dependence on oil revenue by all tiers of government in Nigeria has also made the federal government reform its existing tax laws. So the concept of broader base and reduced rate needs to be worked on in African countries in order to increase revenue and to achieve long-term economic growth.

Conclusion

It is evident that a good tax structure plays multiple roles in the process of economic growth and financial development of any nation. The tax structure of any country has to be reformed by broadening the base and reducing the rate. The different types of taxes have to be employed, rather than limiting them to the specific types of taxes. Striking the right balance between an attractive tax regime for domestic and foreign investment, by using tax incentives, and securing necessary revenue for public spending, is a key policy dilemma. Having the right mix and less distortion is the best way to improve the tax structure.

As the choice of taxes exercised by policy makers affects everyone, policy makers have to be careful in designing the tax structure. It should have to be simple, transparent, efficient and, most of all, equitable. Above all, accountability and transparency on the part of government officials in the management of tax revenues for the benefit of the citizens is as important as designing an effective tax structure.

Notes

1 G N Ogbonna & Appah Ebimobowei, 'Impact of Tax Reforms and Economic Growth of Nigeria: A Time Series Analysis', 4 *Current Research J of Soc Sci* 62, 62 (2012), available at www.maxwellsci.com/print/crjss/v4-62-68.pdf accessed 24 November 2014.

2 IMF, OECD, UN & World Bank, *Supporting the Development of More Effective Tax Systems*, 8 (2011), available at www.imf.org/external/np/g20/pdf/110311.pdf accessed 24 November 2014.

3 See n 1, above at 63.

4 *Ibid,* at 64.

5 *Ibid.*

6 *Ibid.*

7 *Ibid* (alterations and citations omitted).

8 John L Cornwall, 'Economic Growth', *Encyclopedia Britannica*, available at www.britannica.com/EBchecked/topic/178400/economic-growth accessed 11 November 2014.

9 Valpy FitzGerald, 'Financial Development and Economic Growth: A Critical View', *World Econ & Soc* Survey 2006 1 (Oxford Univ 2006), available at www.un.org/en/development/desa/policy/wess/wess_bg_papers/bp_wess2006_fitzgerald.pdf accessed 18 November 2014.

10 See n 1, at 63.

11 Åsa Johansson, Christopher Heady, Jens Arnold, Bert Brys & Laura Vartia, *Tax And Economic Growth, Economics Department*, OECD 5 (2008), available at www.oecd.org/tax/tax-policy/41000592.pdf accessed 11 November 2014.

12 *Ibid*, at 7.

13 *Ibid.*

14 *Ibid*, at 8.

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19 *Ibid*, at 6.

20 *Ibid*, at 7.

21 *Ibid.*

22 Robert G Lynch, 'Rethinking Growth Strategies How State and Local Taxes and Services Affect Economic Development', *Econ Policy Inst*, vii (2004), available at http://epi.3cdn.net/f82246f98a3e3421fd_o4m6iiklp.pdf accessed 24 November 2014.

23 *Ibid.*

24 *Taxation and Developing Countries: Training Notes*, EPS-PEAKS 13 (2013), available at www.odi.org/sites/odi.org.uk/files/odi-assets/events-documents/5045.pdf accessed 19 November 2016.

25 *Ibid*, at 14.

26 Lisa Kayaga, *Tax Policy Challenges Facing Developing Countries: A Case Study of Uganda* 1 (Queen's University 2007), available at www.collectionscanada.gc.ca/obj/s4/f2/dsk3/OKQ/TC-OKQ-850.pdf accessed 4 July 2017.

27 *Ibid*, at 13.

28 *Ibid*, at 13–14.

29 See n 17, at 2.

30 See n 24, at 9.

31 *Ibid.*

32 See n 26, at 26.

33 See n 24, at 14.

34 *Ibid*, at 9

35 *Ibid.*

36 *Ibid*, at 11.

37 *Ibid.*

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How can tax law stimulate economic growth and finance development?

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As introductory remarks, the concept of economic growth can be understood as an increase in a country's productive capacity, as measured by comparing gross national product (GNP) in a year with the GNP in the previous year.[1] It is one aspect of the process of economic development of a country. Financing development, in this context, can be understood to mean the provision of money to assist the process of economic development of a country. Coming to what tax law is meant, by and large, it can be defined as 'a body of rules under which a public authority has a claim on taxpayers, requiring them to transfer to the authority part of their income or property.'[2] On the other hand 'tax', be it, direct tax or indirect tax, can be defined as 'a fee charged or levied by a government on a product, income, or activity.'[3] A related concept, taxation is also legally defined as 'the process whereby charges are imposed on individuals or property by the legislative branch of the [government, be it federal or state], to raise funds for public purposes.'[4] Tax, though not the only source, is the main source of revenue of the government which has a pivotal value in financing development of a country. Accordingly, 'the main reason for taxation is to finance government expenditure and to redistribute wealth which translates to financing development of the country'.[5]

Though taxation plays a gigantic role in revenue mobilisation to escalate economic growth of a country, using tax as a source of financing development in less developed economies has been and is becoming a difficult issue. This is primarily due to various forms of tax resistance, like tax evasion, tax avoidance and corrupt practices like tax siphoning. These activities are considered as sabotaging the economy and are readily presented as reasons for the underdevelopment of [a] country. [6]

These various form of resistance of tax revenue mobilisation hinder the government from providing efficient, steadily expanding non-revenue yielding and essential public services. One tool for the government to halt such forms of tax resistance, could be through designing a well structured and simplified tax policy. Thus, among other things, promulgation of a very clear and unambiguous, simple and comprehensive tax law is an option for the government to arrest such different forms of tax resistance. Accordingly, it should be with the assumption of having clear, simple and comprehensive tax law that one can argue in the avowal of the role of tax law in stimulating economic growth and thereby financing development.

Having said this by way of introduction, this essay explores the link between economic growth and tax in its role of financing development. Over time, the roles of tax law in promoting economic growth and financing development have been exploited. Hence, in the course of this discussion, tax and taxation might be used interchangeably, simply because tax as a charge and taxation as a process of imposing the charge have the same ultimate goal and thereby can be understood as the same concepts for the purpose of this writing.

Accordingly, first, the discussion en routes for identifying the relationship of tax with economic growth and financing development. Then, the question of the role of tax law towards stimulating economic growth and financing development, particularly through halting various forms of tax resistance which are termites of the government treasury and evils of societal welfare will be thrashed out. Likewise, the role of tax law in attracting foreign investment (which is currently used as an instrument in most developing countries to enhance their economic growth), ensuring avoidance of double taxation and providing general guidelines/principles to ensure efficiency of tax administration have been considered. Finally, the essay wind up with concluding remarks.

Tax vis-à-vis economic growth and financing development

To begin with, 'the political, economic and social development of any country depends on the amount of revenue generated for the provisions of infrastructure in that given country.'[7] Consequently, one means of generating the amount of revenue for providing the needed infrastructure is through taxation. As it is divulged by Worlu, Christian N, Emeka Nkoro,[8] tax is the most important, the most beneficial, and the most sustainable source of finance for development. Thus, tax, as the main source of revenue to finance the development of a country, provides a government with the funding necessitated to build basic infrastructures upon which development of a country is based. In other words, it finances social and physical infrastructural needs of a country. It should be noted, however, that raising government revenue is not the only objective of taxation. Thus, these days, apart from the objective of raising the public revenue, a tax is levied to affect consumption, production and distribution with a view to ensuring the social welfare through the economic development of a country.[9] Thus, tax is also an important tool whereby it arranges or regulates the business environment thus it can create a conducive environment to conduct business, be it undertaken by corporations or sole proprietorships. Taxation provides a stable and predictable fiscal environment to promote economic growth and investment.[10] Indeed, taxation shapes the environment in which international trade and investment takes place.[11]

In general, as avowed by Jakir,[12] for stimulation of economic growth and financing development of a country, tax can be used as an important tool, among other things, in the following manner.

- Tax is the most important source of public revenue within which the revenue will be allocated on various productive sectors in the country with a view to increasing the overall growth of the country.
- The increase in the collection of tax increases the government revenue thereby it is safer for the government to avoid borrowings by increasing tax revenue.
- Taxation ensures the social welfare of the society by reducing inequalities in income and wealth. Thus, this in turn can encourage people to save and invest in productive sectors.
- Taxation also may be used to handle critical economic situations like depression and inflation. Hence, in case of depression, tax is set to increase the consumption and reduce the savings to increase the aggregate demand and vice versa. Thus, the tax policy may be used to strengthen incentives to savings and investment.
- Tax has a role in maintaining price stability, particularly in under developed countries, to ensure growth with stability.
- Tax is also used as a controlling mechanism to check inflation, consumption of liquor and luxury goods and to protect the local poor industries from uneven competition.

All in all, tax shapes the developmental activities undertaken by the government of a country and ensures the fair and equitable distribution of costs and benefits among society. Tax, besides its instrumentality as a main source of public revenue can be used as a device to reduce income and wealth in equality, stabilise the economy, discourage the consumption of dangerous products, protect domestic industries and products, attract investment and encourage export trade.

Moreover, taxation is the only effective weapon by which private consumption can be curbed and thus resources transferred to the state and used for developmental activities that helps to stimulate the economic growth and finance development for the benefit of society at large. Accordingly, using taxation as a tool, the economy can ensure sustainable development. Therefore, for the reasons stated above, tax/taxation has a role of stimulating economic growth and thereby finances development.

Tax law vis-à-vis economic growth and finance development

It might be hardly possible to show the direct link between tax law and economic growth. Hence, it is through identifying 'in a roundabout way' that one can show the linkage between tax law and economic growth and development financing. Accordingly, in this subtopic, the mechanics of tax law in stimulating economic growth and financing development, of course 'in a roundabout way', has been underlined in light of the role of tax law in arresting different forms of tax resistances, encouraging (particularly) foreign investment and providing a guidelines to ensure efficiency of tax administration. Thus, it is in the course of this discussion that the demeanors by which tax law stimulates economic growth and thereby finances development could be comprehended.

As it has been stated above, tax evasion, tax avoidance and tax siphoning have been identified as the main termites of the government treasury and evils of societal welfare in diverting the goal of taxation from financing development for the welfare of the general public to enriching individuals which in turn retards the economic growth of a country. So, to combat these different forms of tax resistance, we need to have, among other things, a comprehensive, properly designed, simplified and clearer tax law. Hence, clear, unambiguous, and well designed tax legislation can close loopholes for avoidance and prevent tax evasion so that there would be no room to evade or avoid taxes. Thus, taxes to be collected from each tax payer will be made properly without being evaded and avoided.

Moreover, the imposing and collection of taxes by the government from its subjects per se cannot fetch the intended economic growth and then finance development. Rather, it is when the taxes collected are devoted for the purpose of achieving the designed development projects to realise the social, political and economical needs of the public at large as well as the living standards of individuals. Hence, it is when the intended taxes are collected and allocated for the purpose of achieving the designed development projects that taxation can 'provide a stable flow of revenue to finance development priorities, such as strengthening physical infrastructure, and is interwoven with numerous other policy areas, from good governance and formalizing the economy, to spurring growth.'[13] In this regard the role of tax law in realising the allocation of taxes collected for the purpose of accomplishing the designed economic growth objectives is invaluable. Because, obviously, a well designed tax legislation which provides for ethical procedures to employees of tax authorities can avoid tax siphoning. It follows that the money collected from tax payers will be transferred to government treasury and thereby devoted to activities designed to ensure growth objectives which are the basis for the overall economic growth of a country. And it is in this line of attack that tax law finances development.

Generally speaking, tax law can assure the apt collection of tax (ie, without being evaded, avoided and drawn off) and thereby the economic growth of a country can be enthused and development will be financed for the money collected in the form of tax can be used to undertake developmental activities.

Tax law can also stimulate economic growth and finance development by means of encouraging investment. Besides different counter arguments, aptly regulated foreign investment is identified as beneficial to the host economy for it results in 'capital inflow, transfer of technology, creation of employment, transfer of managerial skills, building and upgrading of infrastructure.'[14] For foreign investment has these benefits, it is generally argued that it brings economic growth particularly for less developed countries. Consequently, currently, as a matter of fact, particularly developing countries are devising different mechanisms to attract foreign investment. Formulating favourable and stress-free legal environment is one of the apparatuses of magnetising foreign investment. Among other things, tax treatment in relation to foreign investment is viewed as a means to attract foreign investment.

Accordingly, particularly in developing countries, tax exemptions and reductions are used as a means to attract foreign investment in which exemption might be entitled depending on an area of investment and reduction might be made against the rate of import duties for capital goods. To realise such tax exemptions and reductions, a country should make changes to its tax policy. Thus, tax law enacted in such a way to attract foreign investment, at least indirectly, contributes for the stimulation of economic growth of a country and thereby it obliquely finances development. Along with tax exemption and tax reduction, avoidance of double taxation is also used as a means of attracting foreign investment. For the systematic imposition of two or more taxes on the same income, asset or financial transaction leaves the tax payer with a negative income and it affects the economic growth of a country. In this regard, tax law can 'serve the purpose of providing full protection to tax payers against double taxation and thus prevent the discouragement which double taxation may provide in the free flow of international trade and international investment.[15] Hence, tax law is essential to avoid double taxation in which tax payers will be encouraged to invest more for they are not made a victim of double taxation and thereby still tax law is very important in backing up the spur of the economic growth of a country thus it in some ways finances the overall economic development of a country.

The other related idea is that tax law can stimulate economic growth and thereby finance the overall economic development of a country through providing guidelines/basic principles to ensure efficiency of tax administration for the assurance of tax compliance whereby the revenue of the country will be better financed. Tax law, though it may be broad, provides the principles of fairness and efficiency which should apply in the administration of taxation for the proper imposition and collection of taxes. Moreover, painstakingly designed tax law can provide clear, simple and user-friendly administrative systems and procedures. In other words, broadly speaking, such kinds of tax laws can somehow ensure accountability and good governance in areas of taxation. Accordingly, voluntary compliance will be promoted by an awareness of rights and expectations of a fair and efficient treatment with the inclusion of clear, simple and user-friendly administrative systems and procedures, for compliance is enhanced when it is easier for taxpayers to do so. Hence, meticulously promulgated tax law, in aptly defining taxpayers' rights and interest as well as penalties to be imposed against them for their failure to comply with their duties, can assure efficiency of tax administration towards promoting the development of a country for tax compliance better finances public revenue. Hence, still tax law is, crookedly, contributing to the economic growth of a country thus finances its development.

Conclusion

This essay has tried to bring into picture the indispensability of tax in raising revenue of a country and its functionality, among other things, in redistribution of income and wealth, discouraging the consumption of certain goods which are considered to be dangerous, stabilising the economy, protecting domestic industries and products, encouraging export trade and attracting investment. Moreover, the essay has also put forward different but interrelated technicalities of tax law in its contribution for the inspiration of the economic growth of a country and financing of development. Along with this, it has scrutinised how each of those technicalities can be used for the purpose of fostering economic growth and financing of development of a country.

Therefore, it is when we go through this analysis that we can discover the answer to the question of how can tax law stimulates economic growth and finance development. One thing that should be recalled here is that, since taxation is the primary source of revenue, which is required to finance public goods and services, it has a pervasive influence on economic decisions of individuals and businesses and on social equity. Thus, the tax system should achieve the appropriate level of revenue as efficiently and fairly as possible. And it is when there is a well designed tax law that makes the taxation system effective in raising revenue, efficient in its effects on economic decisions of households and businesses and equitable in its impact on different groups within the society. All things considered, it is through such transactions that tax law can stimulate economic growth and finance the development of a country.

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Notes

1 www.businessdictionary.com/definition/economic-growth.html accessed 7 December 2014.
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4 http://legal-dictionary.thefreedictionary.com/taxation accessed 7 December 2014.
5 See n 3 above.
6 *Ibid.*
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8 See n 3 above.
9 Jakir, 'Role of Tax in the Economic Development of a Country', (Economic and Growth Development, June 28, 2011), Available at http://jakir13.hubpages.com/hub/Role-of-Tax-in-the-Economic-Development-of-a-Country accessed 12 November 2014.
10 See n 3 above.
11 *Ibid.*
12 See n 9 above.
13 Ministerial meeting and expert roundtable of the NEPAD-OECD Africa Investment Initiative, *Taxation for Investment and Development: An overview of policy challenges in Africa,* (11-12 November 2009), www.oecd.org/investment/investmentfordevelopment/43966821.pdf accessed 10-11 November 2014.
14 M Sornarajah; *The International Law on Foreign Investment,* (2nd ed, Cambridge University Press 2004), p 47.
15 Sarbapriya Ray, 'A Close Look into Double Taxation Avoidance Agreements with India: Some Relevant Issues in International Taxation', (2011), Journal of International Affairs and Global Strategy, 2, www.iiste.org/Journals/index.php/IAGS/article/download/1064/984 accessed 22 December 2014.

How can tax law stimulate economic growth and finance development?

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Introduction

All governments, their divergent economic, social and political philosophies notwithstanding, need finance to subsist and function. To this end, they utilise an array of public revenue sources, which generally comprise of tax and non-tax sources. Nevertheless, taxes, which are levied via tax laws, take the lion's share in funding the undertakings of governments by 'accounting for 90 percent or more of their income'.[1]

The theme of this essay is that tax law can stimulate economic growth and finance development. As a prelude to this, the essay commences with explanations of the nature and purposes of taxation and tax law, the meaning of the concepts of economic growth and development, and the state's obligations with respect to taxation and development. Then, it expounds on how tax law can effectively stimulate economic growth and finance development. Lastly, it makes some concluding remarks and recommendations.

Tax and tax law: laying the foundation stones for growth and development

A tax may be defined as a 'charge, [usually] monetary, imposed by the government on persons, entities, transactions, or property to yield public revenue'.[2] A government 'may [also] raise or lower taxes to achieve social and economic objectives, or to achieve political popularity with certain groups'.[3]

Orthodoxly, in taxation, there is no give and take between a government and taxpayers and, as a result, the latter should expect no direct and equivalent benefit from the former in return for discharging their duty to pay taxes. This, however, is without losing sight of the government's responsibility (constitutional or otherwise) to utilise the tax revenues in the best public interest in view of the social contract it has with the people.

The power of taxation rests on necessity, and is an essential and inherent attribute of sovereignty, belonging as a matter of right to every independent state or government.[4] The need for compulsorily imposing taxes is, among other things, a corollary of the free rider problem associated with public or social goods and services.

To cover their expenses and achieve their other objectives, governments typically enact tax laws under which they oblige persons to contribute their fair share to society. Hence, tax law can be categorised as a branch of public law that 'covers the rules, policies and laws that oversee the tax process, which involves charges on estates, transactions, property, income, licenses and more by the government'.[5] The law of taxation can either be national, which mostly regulates domestic tax bases, or international, which addresses 'the law of conflict resolution that arises from the collision of national tax systems'.[6] A country's law of taxation is usually incorporated in its constitution, statutes, codes and treaties. By and large, tax law is designed to regulate the amount, timing and procedures of taxation as well as the powers and functions of tax administration bodies.

But what sort of tax law should a country have? Though each country is at liberty to pass a tax law which suits its own circumstances, countries are generally advised to give due consideration to certain invaluable principles in order to effectively promote economic growth and finance development. Adam Smith's four 'maxims of taxation', which are incorporated in *The Wealth of Nations*, are ranked at the forefront of such principles. Accordingly, applying his maxims, a tax law should be crafted in a manner which: (a) obliges taxpayers to pay taxes in proportion to their respective abilities (equality); (b) plainly specifies the amount of tax which each taxpayer must pay, and the time and manners of payment to avoid arbitrariness (certainty); (c) levies every tax at a time or in a manner convenient for the contributor to pay it (convenience); and (d) makes the costs of tax administration inexpensive so as not to make the tax collection process a futile exercise (economy).

Over the passage of time, other principles have been identified. Thus, a tax law should be passed (a) on different sources rather than concentrating on a single source, taking into account a country's capability to administer them (diversity); (b) which allows authorities to revise a tax structure both with respect to its coverage and rates to suit changing requirements of an economy (flexibility and elasticity); (c) which can yield enough revenue for the treasury and a government should have no need to resort to deficit financing (productivity); and (d) that creates an uncomplicated tax system (simplicity).[7] Also, a tax system must include accountable tax administration institutions and officials, as well as transparent taxation processes to ensure the proper execution of tax laws and to foster the economic growth and development of a country.

Economic growth and development: meaning and states' legal obligations

Economic growth and development are correlated but are not the same. Economic growth can be described as the 'increase in the total amount of production and wealth in an economy'.[8] Development shows us how growth impacts society by increasing the standard of life.[9] This means the growth of an economy, though indispensable for development, does not necessarily bring about development since 'history offers a number of examples where economic growth was not followed by similar progress in human development'.[10] Instead, growth was achieved at the cost of greater inequity, higher unemployment, weakened democracy, loss of cultural identity, or overconsumption of resources needed by future generations.[11] Therefore, development goes far beyond a rise in the capacity of an economy, and is about accessibility to shelter, education, health facilities and jobs for the people (amelioration of living conditions) and, generally, the proper respect and enforcement of all human rights.

These days, development is no longer considered to be an issue of exclusively domestic concern, as demonstrated by the emphasis given to the right to development by the scores of international human rights documents (particularly as of 1945). For example, the United Nations Charter obliges both the UN itself and all its Members to promote and take actions to achieve 'higher standards of living, full employment, and conditions of economic and social progress and development'.[12] In addition, article 22 of the Universal Declaration of Human Rights (UDHR) provides for everyone's right to social security and entitlement to the realisation of the economic, social and cultural rights indispensable for his dignity and the free development of his personality. Likewise, under article 2(1) of the International Covenant on Economic, Social and Cultural Rights (ICESCR), states have pledged to take steps, to the maximum of their available resources, for the progressive full realisation of the rights it recognises, particularly by adopting legislative measures.

More specifically, Paragraph 2 of the Preamble of the United Nations Declaration on the Right to Development (UNDRD) further describes development as a 'comprehensive economic, social, cultural and political process, which aims at the constant improvement of the well-being of the entire population and of all individuals on the basis of their active, free and meaningful participation in development and in the fair distribution of benefits resulting therefrom'. In other words, development is not only about respecting, fulfilling and promoting economic, social and cultural rights, but also about respecting, fulfilling and promoting their civil, political and third generation counterparts on account of their indivisibility and interdependence. The Sustainable Development Goals, which are a continuation of the Millennium Development Goals, are also germane to economic growth and development, as they encapsulate numerous targets relating to development and growth such as promoting sustained, inclusive and sustainable economic growth.

In all the aforementioned and in other instruments, states are duty-bound to take various actions in order to translate human rights into reality. Since the enforcement of these rights is inconceivable without adequate financial resources, states pass and execute tax laws.

Tax law's efficacy in stimulating economic growth and financing development

Tax law can efficaciously stimulate economic growth and finance development in multifaceted ways. Most importantly, it may be the primary means by which a country may collect revenue to invest in education, which, in the words of Nelson Mandela, 'is the most powerful weapon which [we] can use to change the world'. This helps a country to have greater human capital, which can solve problems and innovate new technologies, thereby positively stimulating its economic growth and increasing its people's living standards. Moreover, law of taxation can support the development of a country by enabling its government to deliver other crucial social services, such as healthcare facilities, social welfare and housing. This is because, without these basic necessities, people will not have the capacity and willingness to productively work to foster the progress of their country.

The role that tax law plays in the establishment and functioning of essential state organs (such as courts, defenses and the police) is also of paramount importance for development and economic growth of a nation. This is due to the fact that economic growth and development are difficult, if not impossible, to attain unless there are institutions that can watch over the peace and stability of a country (internally and externally) and enforce human rights in general.

In addition to using tax law for generation of revenue to invest in human capital and to fund vital state bodies, tax law can provide for the funds necessary to establish and operate public enterprises in those industries where the private sector is unable or unwilling to invest (for example, in infrastructure and highly capital-intensive industries). The formation of such enterprises creates employment opportunities, and generally results in improved infrastructure and less costly goods and services for people and further revenues for governments, all of which are important to stimulate economic growth and finance development.

Also, during business cycle fluctuations, a country may use its tax law as a reaction to counter the resultant economic problems and to stimulate economic growth. For instance, in times of recession, which involve 'decline in economic activity within an economy, usually characterized by higher unemployment and less investment in new plants and equipment',[13] a 'government might lower tax rates to try to fuel economic growth'.[14]

Other means by which tax law stimulates economic growth and finance development include narrowing the gap between the rich and the poor, and enabling a government to serve as a lender. A government can bridge the gap between the rich and the poor by 'imposing a heavier tax burden [such as the progressive Ethiopian income tax law] on one group in order to fund services for another'.[15]

Furthermore, a country's tax law can make a government a source of finance (lender) for many investments. This is particularly important in developing countries where finance is less accessible to the poor. If money is made available by a government, individuals will be in a better position to use their entrepreneurial expertise to venture into businesses, which will create jobs, result in greater tax revenue and ultimately foster a country's economic growth and development.

Tax law can also deter the production and use of some methods or goods which harm public health and the environment. Imposing environmental taxes on polluters can stimulate the economic growth of a country, since it discourages them not to damage the environment and contemporaneously compels them to adopt state-of-the-art and environmentally-friendly equipment as well as production or service-rendering systems. These techniques of businesses reduce the rapid depletion of natural resources and bring about efficiency in production, which contributes to an increase in economic capacity and sustainable development. Besides, the law of taxation may be a tool for discouraging the making, importation and consumption of certain products which are perilous to public health and well-being (mainly tobacco products). By imposing high excise (sin) taxes on manufacturers or importers, a country can protect the health of its productive population and help its economy to grow. It is worth noting that, in recognition of the significance that tax law has in reducing the demand for tobacco, article 6 of the World Health Organization Framework Convention on Tobacco Control (FCTC) obligates states to take tax measures on tobacco products. In this regard, the 2002 Ethiopian Excise Tax Proclamation, in its Preamble, states that 'it is believed that imposing [excise] tax on goods that are hazardous to health and which are cause(s) to social problems will reduce the consumption thereof'. Accordingly, it imposes 20 per cent and 75 per cent excise tax rates on tobacco leaf and tobacco products respectively.

Viewed from another vantage point, a tax law of a country, by granting tax exemptions in certain fields of activities, may stimulate its economic growth and development. This is to say that sometimes intentionally forgoing the collection of taxes, in the forms of exemption from taxes, results in long-term advantages for a country. Typical cases in point are the income tax and customs duty exemptions given in Ethiopia to investors by the Investment Incentives and Investment Areas Reserved for Domestic Investors Council of Ministers Regulation No 270/2012. Such incentives encourage investors to make investments with high expectations of profit, thereby creating job opportunities, transferring technologies and skills, becoming sources of tax revenues and fostering the economic growth of a country. Further, by targeting tax exemptions towards investments in disadvantaged sections of a country, a government can attract more investments to these areas to prevent or reduce regional economic disparities and attain more balanced national economic growth and development in its country. For example, with the intention of promoting investments in some parts of the country, the Ethiopian government grants additional tax incentives to investors that invest in the areas, as per Regulation No 270/2012.

Similarly, a country's economic growth may be stimulated by providing for tax exemptions of non-commercial entities (such as non-governmental organisations) in its tax law to create a propitious environment for their establishment and operation. Such organisations can help a government to resolve societal problems, thereby freeing up tax revenues the government otherwise would have had to spend on such problems and enabling the government to reallocate its funds to other productive activities.

Finally, international tax law is also capable of promoting economic growth of countries by avoiding or minimising the adverse impacts of repetitive taxations of the same subject matters and, in this manner, encouraging international trade and investment. For instance, Ethiopia signed treaties with some countries to avoid double taxation and to promote foreign investments.

Conclusion

As explained in this essay, tax law can serve as an instrument to effectively stimulate a country's economic growth and finance development in several ways. But, to realise these goals, a tax law should be enacted mainly in accordance with the basic principles of taxation. Therefore, as the Persian adage 'a stone thrown at the right time is better than gold given at the wrong time' advises us, any country that wishes to achieve economic growth and development should first embark on revising its tax laws and signing treaties regarding taxation pursuant to these principles. Then, it should set up institutions and employ officials who are accountable and have transparent working systems to deal with the administration of tax laws. Finally, it is recommended that other stakeholders (such as the World Bank and the International Monetary Fund) also contribute to the endeavours of countries in enacting, implementing and improving their tax laws.

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Notes

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How can tax law stimulate economic growth and finance development?

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Introduction

Government is the major player in a country's economic life, and governmental actions are the roadmap for the proper functioning of the economy. The degree of governmental involvement in an economy varies depending on the economic doctrine a state follows, and may fall anywhere on the spectrum from a laissez-faire approach to a strict, centralised management approach. Regardless of the economic doctrine employed in a country, one notion that always persists is the need for the government to formulate and execute strategies aimed at setting the economy on the right course. Among others, fiscal policies are one such set of strategies where the government uses instruments of taxation, spending and borrowing to manage and stimulate the economy.[1] More specifically, the fiscal policy of taxation refers to governmental assessment upon 'property value, transactions, [the] estates of the deceased, licenses granting a right and/or income, and duties on imports from foreign countries.'[2] It also includes revenues collected from individuals for the services of the state.[3] This essay will present methods by which tax law can be used to narrow income inequality, mobilise domestic resources and build physical and social infrastructure.

Narrowing income inequality

A developed economy may be characterised as an economy that offers an environment where there is reduced inequality between the people. In order to stimulate economic growth and development, the income gap between the rich and the poor has to be minimised and people at the bottom of the income hierarchy must, at least, be capable of affording everyday needs, including food, water, clothing, shelter, and reasonable educational and health services. Tax law can be deployed to narrow income inequality. Through the collection of taxes from its more affluent citizens, governments generate the revenue to assist the poor to ensure that their most basic needs are met; such assistance may include income transfers, social welfare programmes, skills training programmes, free healthcare, free primary education and the like. When such programmes aimed at narrowing the gap between rich and poor are well planned, well organised, and well executed, there is a high possibility that such programmes will contribute to the overall economic growth of the state.

To further encourage economic growth, such assistance programmes must aim to curb dependency and foster productivity. Such programmes can be effective when priority to participate is given to those who are more likely to significantly contribute to society in return for the assistance they receive (eg, allowance for student tuition fees, aiding a subsistence farmer to get fertilizers and pesticides for his once-a-year yield, vocational training to homeless people etc).

Mobilisation of domestic resources

As Brautigam says, 'the failure of a state to raise revenues successfully may effectively restrict its ability to develop'.[4] Poverty is one of the results of maladministration of national wealth and resources, and a state that efficiently utilises its resources is more likely to see reductions in poverty and remarkable improvements in the living standards of its citizens and well-being of its economy. One method by which governments can stimulate economic growth and development is by setting revenue requirements. By promulgating tax laws which target certain businesses and individuals and designing the laws in a manner that further enables the government to levy more taxes on sectors or entities which have a high rate of noncompliance or from which the government has failed to obtain substantial revenues, governments are able to generate increased revenue. This also allows governments to avoid unfairly increasing the taxation of those who are compliant, which is beneficial in that increased taxation of those compliant taxpayers can weaken their morale and effectively encourage noncompliance.

A noticeable challenge in developing countries is the inadequacy of the tax administration agencies or authorities. There is widespread corruption and weak administration of revenue collected, and tax laws can remedy such problems by providing checks and balances in the taxation process, and thus embracing accountability and transforming the revenue administration body into a robust institution equipped with the expertise and resources to detect and fix any acts of misconduct (both within and outside the institution, and including tax evasion, tax non-compliance and money laundering). These laws can also be implemented in a manner which results in the lowest possible cost (ie, efficient) for the collection and disbursement of taxes, and it should also be inexpensive to comply with tax laws. The more simple and efficient the tax system is, the 'cheaper' it becomes.[5]

Tax deductions, which are offered so that taxpayers pay proportional amounts to their abilities, should be calculated as accurately as possible.[6] In addition, tax law should aim to encourage businesses and entities that are conducting research and development in the fields of science, technology and information and other sectors which can be hubs for creative minds and sources of immense progress in the regional and international arena by offering such entities tax incentives and, if necessary, exemptions. In return, the entities will have increased profits available to be redirected to further their researches and studies. Such incentives and exemptions not only helps the entities they target, but they also encourage other businesses to become involved in research and development in their area of specialisation, be it agriculture, education, health, service business, manufacturing, IT, etc. Companies and businesses that primarily focus on exporting products should get special attention from the government via tax incentives because, through exporting domestic products to the international market, hard currencies can make their way to the exporting country, which in return adds to the foreign reserve and increases the country's trading capabilities.

Building physical and social infrastructure

As the UN has noted, 'Government revenue has substantial effect in relieving poverty and improving physical and social infrastructure'.[7] Physical infrastructure is essential to economic development, and is even sometimes described as its source. Public utilities and facilities, such as power plants, highway roads, airports, seaports, dams, universities, hospitals and recreational centers, are crucial for development. At the same time, such utilities and facilities require significant revenues to fund construction.

Because of the expense associated with the construction of such utilities and facilities, it is often impractical for private financing to cover all costs and the responsibility for the development and construction of such facilities falls on the government. In order for the government to meet the demands relating to infrastructure, it must rely on public funding and, more specifically, taxation. Simply speaking, taxation of individuals, businesses, financial transactions, imports and sales, when cumulated, enable the government to build the necessary infrastructure for its citizens to use. In other words, the people are the primary beneficiaries of these facilities, and thus the principle of reciprocity is being realised. The taxpayers' morale is also boosted by the immediate benefits they enjoy.

With respect to social infrastructure, where expenditures are made for improving human capital in terms of both quantity and quality, economic growth occurs. An influx of capable professionals can result in increased robustness in sectors that were previously stagnant, and can ultimately create more jobs by expanding the existing industries and thus revitalise the economy.

In cases where local capital is insufficient to stimulate an industry, foreign investment may come into the picture. In the ever more globalized world, foreign investment can contribute a remarkable amount to the gross domestic product of a country, particularly a lesser-developed country. The tax policies of the host nation are one factor that draws investors to its doorstep, and a tax system that is crafted to be conducive to investors and their business operations will facilitate the utilisation of the host nation's economy and foster the nation's economic potential.

Conclusion

In conclusion, as Todaro and Smith say, 'Development is a multi-dimensional process involving changes in social structures, popular attitudes, and national institutions, as well as the acceleration of economic growth, the reduction of inequality, and the eradication of poverty.'[8] These changes may be realised through the interplay of various actors, of which one is the government. Through taxation, governments can manage their countries' economies. Tax law plays an invaluable role in stimulating economic growth and financing the development of nations, particularly in the reduction of inequality, mobilisation of local resources, and creation of physical infrastructures and social capital.

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How can tax law stimulate economic growth and finance development?

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Introduction

This essay is a work to identify how tax law can stimulate economic growth and finance development. It will first describe the concepts of tax law and economic growth, and establish how the former affects the latter. It will then focus on how to finance development, with a particular focus on how tax law may be used to aid in such an effort.

Economic growth can be defined as an increase in the capacity of an economy to produce goods and services, comparing one period of time to another[1] and including both smaller scale goods and services (ie, the rural farmer with a small farm) and larger scale industrial companies.[2] Countries aim to increase the production of goods and services to encourage economic growth and ensure that their citizens are safe and have access to food, healthcare and education.

Tax law is often a method employed by governments to encourage economic growth. Defined, a 'tax' means a charge imposed by the government on people, businesses and various activities and possessions (such as income, property, purchased goods or inheritances), the revenues of which are used by the government to fund itself and its programmes.[3] Tax law can be further understood as those rules and policies that govern the taxation process (or the process by which the government imposes such charges on estates, transactions, property, income and licenses).[4] In most countries, if not all, a law must be enacted which provides authority for a tax to be charged or collected before the tax may be imposed.[5] While tax laws should not be the same in every country due to differences in natural resources, geographical locations and other factors, every country should have a tax system that stimulates economic growth.[6] Lesser- developed countries face the challenge of raising sufficient revenues, and in most cases rely on taxation as the main source of revenue.[7] Bearing this in mind, heavy taxation may deplete the disposable income of taxpayers and ultimately decrease the ability of the taxpayers to put money back into the economy, so there is a need for governments to strike a balance between generating the amount of revenue needed to provide basic services and the need to keep taxes low to encourage production. While taxation often has an effect on, among others, the distribution of income, the stabilisation of the economy and the implementation of government policies,[8] and while it can be difficult to accomplish one objective without affecting others, this essay focuses exclusively on how governments use taxation to bring about economic growth.

The question of how tax law stimulates economic growth can be looked at from two angles: 1) how the law can levy or provide for taxes that stimulate economic growth; and 2) how the law can avoid irregularities in the taxation process. In considering the question from the first angle, it is generally preferable for governments to enact tax laws that favour production and increase the tax base,[9] thereby increasing the amount of revenues generated by increasing the size of the pool generating such revenues, rather than enact laws that increase the rate of taxation.[10] Tax law can stimulate economic growth by giving tax incentives to foreign and local investments and thus encouraging investment. Charging a low tax on costs of production, for example, will attract foreign investment and increase production, thereby leading to economic growth; however, because it can be harmful to the economy for foreign businesses to operate in the country only while they are benefitting from the low taxes, governments should consider providing incentives to firms that have operated in the country for some time or can show a commitment to staying in the country. Tax law can further stimulate economic growth by reducing the taxes levied on land, thereby encouraging investors to purchase the land and establish factories and businesses on such land, which will ultimately result in increased goods production.

Following that same logic, governments can increase goods production by reducing the taxes imposed on labourers or offering incentives for labourers to work together, and by offering tax exemptions to labourers based on meeting certain threshold production quantities. Tax law can also stimulate economic growth by giving tax exemptions to entrepreneurs who open or establish businesses that provide crucial services, such as education, healthcare, insurance, etc.

Looking at the question from the angle of how the avoidance of irregularities in tax law can stimulate economic growth, it can be argued that tax law is a significant driver in economic growth if it is not affected by political or selfish motives. In some countries, taxes are levied based more on political motivations, and in such circumstances, taxation yields no or few results towards economic growth. For example, economic growth is minimal where politicians reduce or abolish some taxes to gain votes, or impose heavy taxes on businesses owned or operated by their political opponents. Tax law must be enacted in a manner that insulates it from political influence. In addition, some governments collect taxes in an unregulated fashion, which can discourage production and disincentivise local and foreign investment. Therefore, tax law should be detailed enough to hold those who are imposing taxes in such a manner liable, and to punish tax defaulters. Because tax revenues are so vital to economic growth, tax laws should also be well drafted to ensure that there are no loopholes, which result in tax avoidances and lost revenues.

With respect to implementation, tax law can be more effectively implemented where there is ease of tax collection, such as multiple tax collection centres, the ability to calculate and pay taxes online, or automated tax billing machines. By creating efficiency in tax collection, governments can generate increased revenues, and ultimately be able to apply those revenues towards the development of infrastructure.

Economic growth and finance development go hand in hand because where there is finance development, there is an increased likelihood of economic growth.[11] A strong tax system can do both. Finance development can be defined as a process that improves the quantity, quality and efficiency of financial intermediary services.[12] It includes access to banks, developed financial markets, microfinance markets and all savings institutions. To stimulate finance development, tax law should create a fertile ground for financial intermediaries to be established and succeed; one way in which this can be done is if tax laws offer a reduction of taxes on interest rates such that people can more easily obtain loans. Tax laws should also give exemptions to microfinance institutions so that such institutions can be established and provide greater access to savings and loans, and finance development more generally. In addition, and as described above, tax laws should be adopted that govern the taxation of financial markets in a way that avoids irregularities involved in the sales and functioning of the markets. Where there is transparency in all transactions, individuals feel more secure and are more likely to invest their money freely, which favours finance development. To stimulate financial development, tax law should impose equivalent charges on foreign banks and local banks in order to encourage foreign banks to open branches in the country, ultimately leading to the expansion of the financial sector and financial development. Last but not least, tax law should also impose taxes, to the extent that such imposition does not result in double taxation, on national banks, and particularly those national banks that carry out activities in other countries. This may discourage national banks from investing abroad, but it will ensure that such banks are servicing those in need of financial services in their home countries.

Conclusion

In conclusion, while economic growth is needed to break the vicious cycle of poverty, it cannot occur without increased production, increased investments and finance development, all of which come into existence through effective governmental policies on taxation. When tax laws are well drafted and enforced, such laws create an environment in which economic growth is stimulated.

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How can tax law stimulate economic growth and finance development?

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Economic growth refers to responses that increase income and output. From this point of view, economic growth shows the relationship between inputs and output; that is, a return. It is a sustained increase in per capita national output or net national product over a long period of time. Economic growth can be determined by four important determinants, namely, human resources, national resources, capital formation and technological development.[1] If this is how economic growth is viewed, then how can tax law pave the way for the attainment of this goal?

Countries create tax policies in order to, among other things, expand revenue sources and enhance economic growth. Ethiopia's economic policy framework commits government to address apparent market failures.[2] Tax law is the pillar instrument in realising this policy, in that it provides tax incentives, including import duty exemptions, and tax holidays. Tax laws express the objectives of tax policies. Such expressions usually are to be found in legislative preambles. Sometimes, clear policy objectives are found in the substantive articles of the legislation. Notable in this regard are Ethiopian tax proclamations that clearly stipulate their aim in their preamble. But, it does not mean that it fails to include it on its substantive articles.

Finance development, on the other hand, is related to what the financial system of the country looks like; that is, revenue and expenditure of a country. In this regard, tax law also plays a huge role. The following section is devoted to how tax law stimulates both by looking at certain measurements.

Investment

The economic growth of a country is mainly dependent on the level of investment that country has.[3] Investors may be domestic or may come from outside. Tax law has a stimulating effect on the investment rate, provided it fulfils the basic principles of taxation; that is, equity, certainty, simplicity, clarity, fairness and having a low rate with a broad base.

The main purpose of taxation is to expand a state's avenues of revenue. The political, economic and social development of any country depends on the amount of revenue generated for the provision of infrastructure in that given country.[4] A tax system offers itself as one of the most effective means of mobilising a nation's internal resources, and it lends itself to creating an environment conducive to the promotion of economic growth.[5] Some may ask what this has to do with economic growth and finance development. A government is there to provide public goods that are hard for private actors of a market to provide, watch for externality, protect the economy from monopoly abuse, and regulate market failure in general. In order to look after such things, the government needs revenue, and tax is the main source. By constructing infrastructures, the government creates a fertile field for investors, who are the main actors of economic growth. It is easy to imagine how hard economic development would be without infrastructure. By setting out how taxes are to be levied, tax law stimulates economic growth and finance development.

Tax law provides incentives for certain investments and promotes tax policies that are favourable to the operation of market forces. Investors, especially foreign investors, look at the tax rate and available tax incentives of a given legal system before they decide to invest in a country. If one looks at Ethiopia, a country following the scheduler system of taxation, it has incorporated 'foreign tax credit principle, loss carry forward principle and deductible assets, bad debts, etc. of a business' in order to attract investment.[6]

What kind of tax law achieves this?

Tax incentives

Tax laws that provide incentives encourage investment, which is the main machinery of economic growth. Incentives exploit and develop the immense nature of resources of the country in return for the development of the domestic market through the growth of production, productivity and service.

With this regard, Ethiopian tax laws follow customs duty payment exemption on capital goods and construction materials, and on spare parts whose value is not greater than 15 per cent of the imported capital goods' total value.[7] Besides, it has room for income tax exemption of two to seven years for manufacturing or agro processing and agricultural investments.[8]

Tax rates

Economic growth can be encouraged by lowering tax rates. Coming up with lower tax rates has the effect of attracting or stimulating domestic investors and attracting foreign ones. With capital becoming increasingly mobile, national corporate tax rates have an increasing influence on where multinational companies locate their operations, locate their jobs and report their income. If a country's laws are conducive to investment, it stimulates economic growth by creating productivity, employment opportunity and boosting wages. This has to do with how a country's tax law sets the tax rate. The moment a country sets a higher tax rate, it discourages investment. This shows how tax law contributes to economic growth because economic growth is directly related to investment. As to tax rates, since Ethiopia has come up with different forms of taxes, we can say that it imposes moderate tax rates compared to other countries. In order to encourage investment, it comes up with a 30 per cent flat rate for business, 15 per cent in the form of VAT.

The tax rate also affects finance development. It is a fact that finance development is dependent on the financial system of a state. Finance develops if the amount of saving increases. The saving rate has a direct relationship with the tax rate. If a higher tax rate is imposed on the interest gained from a deposit, then people become reluctant to save. If the case is reversed, however, people tend to save more; and in that case, finance develops.

Tax base

Tax rate reduction, though having a positive effect on investment, reduces revenues. To offset such a trade-off, countries can and should pay for a significant rate reduction in the corporate tax by broadening the corporate tax base to eliminate tax breaks and preferences. To raise revenue, Ethiopia came up with immense types of taxes. VAT, income tax, TOT and tariffs are notable in this regard.

As I mentioned in the introduction, tax law has a dual role of stimulating economic growth and finance development. A country cannot grow economically by sacrificing finance. In order to expand investment, countries reduce their tax rate. However, it results in decrease of revenue. To strike the balance between the two, good tax law broadens the tax base. By doing so, the state also looks after the finance system.

Principles of tax law

Tax law not only sets incentives to stimulate economic growth, but also comes up with principles to regulate the market; that is, to bring about a healthy market. Good tax law plays a paramount role in attracting investors to stimulate economic growth by assuring certainty, simplicity and equity, as well as by reducing cost of compliance and administration, controlling tax avoidance and evasion, protecting against double taxation and controlling inflation.

Tax law stimulates economic growth and finance development if, and only if, it cares about the rules of efficiency and equity. Through efficiency, tax law allocates resources and distributes wealth throughout a nation. When we examine equity, we see how an equitably founded tax system plays a role in distributing income across individuals. An equal distribution of the power to levy tax has a paramount role in stimulating economic growth and finance development. This means that a country grows economically; and it has to have distributed resources. Tax law stimulates this because the government levies tax from the wealthiest section to build infrastructure in the less developed area. By doing this, investors would like to expand their investment in those areas. Enhancing tax equity has an enormous impact on economic growth. The cost of the operation of tax law also influences economic growth, as well as finance development.

Though it is hard to find consensus on how equitable a tax system is, the Ethiopian tax system tries to be fair, coming up with the principles of horizontal and vertical equity. One example of this is the income tax proclamation. By following progressive taxation, Ethiopian income tax tries to levy more on the richest in order to redistribute resources.

Cost affects investment, which is the backbone of economic growth. Investors do not want to incur costs for compliance, understanding tax laws, accessing them and dealing with the institutions collecting the tax. Tax laws attract investors if they are legislated in such a way that they are easy to understand and available at low cost or easy access for free on websites. By doing so, tax law stimulates economic growth and finance development. For that matter, minimising administrative costs, as well as having transparent tax administration laws, stimulates economic growth and finance development. A tax system brings high revenue for a government if it is productive in developing finance.

However, the Ethiopian tax system has certain pitfalls in minimising the cost of taxation. It is hard to access tax laws, which makes it difficult for an average taxpayer to make sense of their obligations under the various tax laws in force. Because tax laws are uncoordinated, most tax laws repeat certain provisions as if they were not already provided for in other tax laws.[9] In addition, administrative costs of taxation are high in Ethiopia, since there are different tax rates for many segments. Therefore, Ethiopia must come up with an efficient tax system no matter how it evolves over time.

Fair tax laws stimulate economic growth. The fairness of a tax law is dependent on the tax rate. Tax law discourages investment if it lets many small businesses pay higher tax rates than big businesses, and when companies face the highest tax rate. A complex tax system diverts productive resources into wasteful lobbying and tax avoidance schemes.[10] In order to stimulate economic growth and finance development, tax law has to stay away from economic decisions; rather, it has to be neutral. Growth-oriented tax systems seek not only to minimise the distortions of market signals by the tax system, but also to create as few obstacles as possible to investment, innovation, entrepreneurship and other drivers of economic growth.

Principles of double taxation, tax avoidance and evasion, and curbing inflation

The way tax laws regulate investors has a direct effect on economic growth. For instance, if a country's tax law avoids double taxes, it stimulates economic growth. This is because investments run away from states where double tax exists, and double tax forces companies to shift workers and research overseas just to try to compete on a level playing field against foreign competitors.

Countries create tax laws that exempt certain investment from being taxed twice in order to stimulate economic growth. Countries follow a more territorial system of taxation to stimulate economic growth and finance development by letting companies invest everywhere and reinvest in their homeland without being taxed twice. If tax law is not framed in such a way that it prevents tax avoidance and tax evasion, then it negatively affects the finance development of a state. A country that has a well-crafted tax law that closes loopholes, which invites tax payers to avoid their tax burden, stimulates finance development.

At times, Ethiopian income tax has envisioned foreign tax credit under article 7, rules of relationship and thin capitalisation, and transfer pricing principles, in order to encourage investment on the one hand and boost finance on the other, as a way of closing the door to tax avoidance. Besides, Ethiopia fills her gap for holding investors by entering into double taxation treaties with other countries. Last but not least, each tax proclamation of Ethiopia come up with has provisions for tax evasions.

Tax law is the main instrument for curbing inflation, stimulating economic growth and finance development. Market instability is one area of market failure in which the intervention of government is highly sought. Perfect market and economic health means full employment, steady economic growth and a market free from inflation. The diseases of the market are price instability, inflation and a lack of economic growth that, in return, results in higher rates of unemployment.

Labour force and saving

Growth in the labour force and savings are important contributors to economic growth and finance development. Labour is an input that affects output. The structure of tax laws affects labour. For instance, imposing a higher tax rate on income taxes discourages employees from working, meaning if a labour force does not get a return for its work, it tends to prefer leisure over labour. If a labour force supply is not encouraged, then development is hindered. So, the way tax laws are designed affects the supply of labour force. Employees look for lower tax rates, which rewards them higher income.

Saving is also the main machinery of economic growth and finance development. The finance system of a country determines the level of growth of a country. If that is so, countries design their tax laws in such a way that it enhances saving. For instance, the introduction of Value Added Tax (VAT) is mainly believed to bring about high rates of saving because it does not tax capital, only consumption. This means that, if a country's tax law favours investment over consumption, saving increases – and an increase in saving stimulates economic growth and finance development. In this regard, Ethiopia promulgated income tax law with relatively lower tax rates to relax employees and increased flat rate VAT to encourage saving.

Conclusion

Tax laws are legal instruments by which the concepts and principles of taxation are materialised. Tax laws set how governments levy tax on businesses, properties and incomes of people. This creates collection of revenue. A state collects revenue in order to prevent market failure. The market fails to provide public goods that have a non-rivalry nature when there is economic instability. The market is also non-equitable. Governments create tax laws in order to alleviate this. By imposing tax on citizens, governments raise their revenue so it can provide for the development of infrastructure that stimulates investors and equitably distribute wealth.

Tax law also curbs inflation, which in turn stimulates finance development. Tax laws are not only meant for the increment of state revenue; rather they are aimed at stimulation of economic growth as well as finance development. The main base of economic growth is investment. Tax law has a paramount effect on this, by providing incentives in certain areas and exempting certain areas of investment so that investors are attracted. Even the structure of tax laws – that is, the tax rate, the tax base as well as certain concepts like tax avoidance, tax evasion provisions and the very nature of the law itself – has a direct relationship with investment. For instance, companies run away from a country that sets high corporate tax rates. The neutrality of tax laws, such as its simplicity, low cost and easy compliance, also has the power to affect investment – and that ultimately affects economic growth. Simply put, tax laws favour market operations when they are simple, easy to access and transparent. Incentives attract foreign investors and encourage domestic ones**.** Thus, true investment, which is the base for economic growth, is mainly dependent on tax law.

Tax law acts as a catalyst of finance development and economic growth by creating avenues for revenue collection, by curbing artificial surpluses of money in a market, by encouraging the labour force through a low tax rate, and by giving incentives for investments. Generally, tax law has a stimulating effect on economic growth and finance development if it is composed of these basic principles. In this way, it provides incentives for investors and creates an environment conducive to the market to operate. Among other things, it enhances saving and investment by coming up with different types of taxes like VAT, broadening tax bases to raise revenues, and reducing tax rates. Ethiopia's tax system is pro-investment but the country has homework to do in fulfilling the simplicity and reducing the cost of compliance in order to fully attain its goal.

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How can tax law stimulate economic growth and finance development?

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Tax is the most important, sustainable and predictable source of public finance for all countries. It is for this reason that the impact of tax law on economic growth and the development of a nation has been excessively debated among economists and international development agencies. This essay therefore seeks to show ways in which tax law can stimulate economic growth and reduce poverty. It argues that poverty reduction can effectively be achieved if a country raises enough revenue to provide for the needs of its own citizens. In this regard, tax law is the key priority for economic growth and poverty reduction. A transparent and simple tax system enhances compliance on the part of taxpayers. This will result in more tax collection that can be invested in more potentially productive sectors. The essay concludes by demonstrating how investing in these productive sectors best addresses the plight of the poor.

Tax law refers to the legislation that regulates the process of government collecting money (ie, tax) from its citizens and/or businesses. Tax law is the 'body of rules under which the public authority has a claim on taxpayers requiring them to transfer to the public authority part of their income or their property'. For example, in Zambia, tax legislation includes The Value Added Tax Act Chapter 331, The Income Tax Act

Chapter 323, and The Mine and Minerals Development Act Chapter 213, just to mention a few.

Tax law, therefore, is the law that outlines who must pay taxes and the rate at which they can be taxed. Tax law also addresses situations that may arise in the course of collecting and paying these dues, such as qualifying for exemptions or seeking remedy for non-payment. One of the main things that tax law usually does is establish a government's authority to collect these funds through a particular agency, such as the Zambia Revenue Authority. Once this has been done, it puts in place a process that determines how tax will be collected. Tax law is therefore needed to ensure that tax is taken in a just and fair manner.

Tax laws are an important tool used to stimulate economic growth. Economists agree that economic growth is the increased production of an economy. It is defined as an increase in the value of goods and services produced by every sector of the economy. The aim of economic growth is to 'raise the standard of living of people as measures the total output of goods and services which an average person in the community will have for consumption and investment'.[2] The most widely used measure of economic growth is the real rate of growth in a country's total output of goods and services, commonly known as the gross domestic product (GDP) of the country.

In terms of development, tax revenue entails money needed to improve the quality of human life. It also implies reducing poverty and enhancing individual economic opportunities. And, to a greater extent, this would include better education, improved health and nutrition, conservation of natural resources, a cleaner environment and a richer cultural life.

Poverty is defined as 'pronounced deprivation in wellbeing',[3] and wellbeing as 'a capability to function in society'.[4] Poverty arises when people lack key capabilities, and so have inadequate income or education, or poor health, and many others. Poverty is therefore said to have various dimensions which include income poverty, education poverty, security poverty and many others.

Before considering the issue further, it should be emphasised that taxes differ from other sources of revenue in that they are compulsory levies and are unrequited. That is to say, taxes are not paid in exchange for some specific thing, such as the issue of public debt. Notwithstanding the fact that tax is a compulsory levy, economies across the world depend on resources collected from taxes to finance government activities. No government can be sustained without mechanisms for generating domestic revenue. Taxes are therefore a major way for countries to raise revenue to meet the social and developmental needs of the people.

The authority to collect taxes is derived from tax law. Taxes play a critical role in encouraging economic growth and reducing poverty in a number of ways. First, the starting point is that the tax law of a given country must be comprehensible to the taxpayer. The tax system that commands the trust of taxpayers must not only be as simple as possible, but also certain both to the taxpayer and to the administrator in order to be generally understood by the public.[5]

This will enhance transparency in tax administration and reduce conflict between taxpayers who disagree with interpretations and applications made by revenue authorities. Tax law of that nature minimises the risk of tax avoidance, creates a level playing field in which all in the sector can compete fairly, and ensures that the right person is taxed at the right time.[6] This will result in high tax payment compliance, and hence more tax revenue for the government.

Second, tax law can stimulate economic growth and reduce poverty by being clear on the criteria used to grant tax incentives necessary to attract business that otherwise would have located elsewhere. This safeguard prevents governments from offering excessive incentive packages to investors. Commentators in this field have concluded that excessive tax incentives are essentially unnecessary expenditures that deplete government revenue sources.[7] They erode the level of government services, such as infrastructure improvement and education. Therefore, tax law stimulates growth if tax legislation enables the government to capture a greater share of revenues.

However, the law should only allow the granting of tax incentives necessary to attract both local and foreign investment. Investments in businesses or the mining industry that generate employment for the locals are important for poverty reduction in the long-term. The employable workforce, once employed, would not only expand the revenue source of the government but also gain income that will improve their living standards. For example, the income may enable them to educate their children, access basic health services and many other services.

Another way in which tax law can stimulate economic growth and reduce poverty is by promoting accountability of governments for the revenue they raise and promoting public transparency in the taxes paid by enterprises. This is very important because the effect of tax on welfare depends on what the government does with the revenue. This will ensure that taxes are spent on socially valuable programmes which are important for poverty reduction.

Tax law may provide safeguards that ensure taxes be spent on sectors that both maximise growth stimulation and best address the plight of the poor, such as infrastructure development, education, tourism, agriculture and health. This approach links growth and poverty reduction because it allows everyone to share the benefits of growth. For instance, the government can use taxes to empower the people in poorest areas by providing functioning feeder roads, power and simple irrigation facilities. A functioning infrastructure like railways, roads, energy and telecommunication is also important for reducing poverty. 'This is true from both the perspective of enhancing economic growth through improved international competitiveness… and from the perspective of linking poor rural areas to urban markets and social amenities.'[8]

In the modern world, education is widely recognised as a very powerful tool for poverty reduction. Building more school infrastructure, and training and employing qualified teachers are the primary requirements for quality education. Quality education equips the people with necessary skills. Education develops the people's consciousness and creativity. For example, it is a well-established fact that, at a basic level, mothers with basic education are better equipped to avoid aspects of poverty through practices such as improved hygiene and child nutrition. At higher levels, access to education in a growing economy with rising job opportunities can uplift many from poverty.[9] In developing countries like Zambia, it is educated people who acquire high paid jobs, and live in comfortable residences.

Progress in governance and technology, and contribution to a knowledge economy, are among the benefits of education.[10] Further, gains in productivity, specialisation and better job attainment can also contribute to economic growth as private benefits of education. In addition, public benefits come from research and development, the ability to attract foreign direct investment (FDI) and better governance through a well-educated electorate and leadership body.

Similarly, taxes can also be used to expand tourism investment in order to reduce poverty. For example, it can be used to develop areas with highest poverty incidence but with tourist potential in order encourage investment inflows in those areas. Improved infrastructure will lead to higher investment and increased visitors in the country. This creates jobs and enhances the livelihood of the local people in addition to generating more tax revenue for the country.[11]

Furthermore, taxes can be used to provide basic healthcare, which involves basic drugs and disease prevention against common ailments like malaria, diarrhoea and others, which tend to afflict the poor more. This will reduce the number of deaths of many breadwinners and parents. Consequently, there will be a reduced number of orphans and street children.[12] Besides, research has shown that healthy people perform well at schools, and work productively, thus increasing the real growth of the economy. Moreover, countries that have low risk of infections attract tourism.

Another way in which tax law can promote economic growth is by strengthening the social security of the country. Social protection and economic development are mutually reinforcing.[13] If a tax system is fair and certain, it enables employers to pay their social security contribution to the social security scheme on time and without difficulties. A classic example of the social scheme in Zambia is the National Pension Scheme Authority (NAPSA). When employees' social security is guaranteed, they are more likely to become productive. Employees will be able to give their best at work because they know that, should they get sick, injured or die, their social security is protected. High productivity leads to more profit for the company, good labour income for the employees, and high tax contribution to the government. Another economic benefit of high productivity is the consequential economic expansion of the company. This entails more job creation.

Furthermore, tax law can stimulate economic growth and poverty reduction by reducing marginal tax rates. New economic analysis and evidence from optimal tax theorists indicates that national governments fared better by taxing a medium share of a rapidly growing economy as opposed to trying to extract a large share of a stagnant economy.[14] Ireland, India, Russia and East Asia are a few of the economies that began expanding impressively after their governments sharply reduced marginal tax rates.[15] Higher taxes can discourage the investment rate, or the net growth in the capital stock via high statutory tax rates on corporate and individual income, high effective capital gains tax rates, and low depreciation allowances.[16]

America has experienced three periods of very strong economic growth in this century: the 1920s, the 1960s and the 1980s.[17] Each of these growth spurts coincided with a period of reductions in marginal tax rates.[18] For example, following the Kennedy tax cuts in the early 1960s, the economy grew by nearly five per cent per year.[19] In the seven years following the 1981 Reagan tax cuts, the economy grew by nearly four per cent per year, while real federal revenues rose by 26 per cent.[20]

In Zambia, high internal taxes and charges are among major constraints in the production and export of various commodities.[21] A stagnating agricultural sector is responsible for reduced inflow of investment resources, and reduced competitiveness due to policy constraints.[22] Thus, reducing the marginal tax rate in the agricultural sector will make agriculture one of the key components driving economic growth and poverty reduction in Zambia. This requires increasing the efficiency, competitiveness and sustainability of production while ensuring food security and increased income.

Lastly, at the international level, tax law can also play an important role in stimulating economic growth and poverty reduction. For example, the formation of Custom Unions and Free Trade Areas such as COMESA allows contracting states to impose a duty tax fee on agreed-upon goods and services. This facilitates more circulation of goods and services. It also acts as an incentive to investors and encourages local people to engage in business. This will lead to job creation, and more people to pay taxes such as Pay As You Earn (PAYE) and Value Added Tax (VAT). When more tax is paid, it increases the revenue of the state. More revenue can be used in road and bridge construction, hospitals, schools and colleges. Building apartments can alleviate the shortage of shelters in the country. More road construction will enhance economic trade. For example, business traders will be able to transport their products without delay, leading to easy accessibility of goods and services by the consumer.

In all the circumstances, tax law can stimulate economic growth and reduce poverty by being comprehensible. Enhancing transparency in tax administration encourages compliance by ensuring accountability of governments for the revenue they raise. Promoting public transparency in the taxes paid provides safeguards that ensure taxes are spent on sectors that both maximise growth stimulation and best address the plight of the poor; strengthen the social security of the country; reduce marginal tax rates; and can be used to facilitate more circulation of goods and services in international markets, which acts as an incentive to investors and local people to engage in business. This will lead to job creations and to more people paying tax that can be used in other productive activities.

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How can tax law stimulate economic growth and finance development?

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A tax is a monetary charge imposed by the government on persons, entities, transactions or property to yield public revenue. The term embraces all government impositions on the person, property, privileges, occupations and enjoyment of the people and includes duties, imposts and excises.[1] Taxes are levied by the state by virtue of its sovereignty for the support of government and all public needs.[2]

Tax Law is a body of law concerned with taxation.[3] Economic growth is the quantitative change or expansion in a country's economy. Economic growth is conventionally measured as the percentage increase in Gross Domestic Product (GDP) or Gross National Product (GNP) during one year.[4] Development is the process by which someone or something grows or changes and becomes more advanced.[5]

A government collects taxes in order to provide efficient and steadily expanding non-revenue yielding services such as infrastructure, education, health, communications systems, etc. Tax is the nexus between the state and its citizens. Tax revenues are the lifeblood of the social contract.[6] Tax is the most sustainable source of finance for development. Tax revenue in Africa is worth ten times the value of foreign aid. The long-term goal of poor countries must be to replace foreign aid dependency with tax self-reliance.[7] Governments that have influenced their economic development through revenue from tax include, among others, those of Canada, the Netherlands, the United Kingdom and the United States.[8]

Tax Law can stimulate economic growth and financial development by creating tax incentives. A tax incentive is a reduction made by the government in the amount of tax that a particular group of people or type of organisation has to pay or a change in the tax system that benefits those people.[9] The most efficient forms of tax incentives are special economic zones (SEZ) and tax holidays.

A SEZ is a geographical region that has economic and other laws that are more free-market-oriented than a country's typical laws. 'Nationwide' laws may be suspended inside a special economic zone. In China, SEZs were founded under Deng Xiaoping in the early 1980s. The most successful SEZ in China, Shenzhen, developed from a small village into a city with a population over 10 million within 20 years. Following the Chinese example, SEZs have been established in several countries, like Brazil, Cambodia, India, North Korea, Pakistan, the Philippines, Poland and South Korea.[10] A tax holiday is a period when people or companies do not have to pay any tax or not as much tax as usual on goods, services or profits.[11]

Tax incentives attract investments. With the global market having cutthroat competition, foreign investors and multi-national corporations are drawn to countries where they can have a competitive edge over their competitors. Tax incentives are bait for the commercial entities. 'You catch more flies with honey than vinegar.' However, governments must offer tax incentives in critical sectors of the economy that have a positive ripple effect on the rest of the economy. There must be transparency when awarding tax incentives. They must be based on economic considerations as opposed to political ones. For example, Uganda's Finance Minister Maria Kiwanuka has said, 'We are no longer giving tax incentives to individuals. We shall only be giving tax incentives to specific sectors where we believe it is applicable, for instance, in medical equipment.'[12] Despite Uganda's narrow tax base, the government has been generously administering tax exemptions to individuals and companies and this has had a negative impact on domestic revenue collections since many people or taxable items have been exempted from paying tax.[13]

Tax law can encourage industrialisation. This is through a policy termed as protectionism. The government can impose low export taxes on the local industries manufacturing for the international market so that the exports compete favourably on the international market. The government can impose high import taxes that will make the locally manufactured goods more competitive locally than the imported ones. Imposition of high import tariffs curtails dumping. This is the practice of selling goods in another country so cheaply that companies in that country cannot compete fairly.[14] Protectionism is today despised world over with numerous international trade agreements against it. However, it is through this policy that the developed countries climbed the economic ladder to its apex. The developing world, in my opinion, should therefore consider it as well.

Though Britain entered the 'game' of industrialisation first, it still relied on protectionist policies until major industrial sectors were established. During the sixteenth century, Henry VII aimed to support the domestic processing of wool, which accounted for roughly half of English industry in that time, through taxing exports of raw wool. The US, which is regarded as the model type of political as well as economic liberalism, was in fact 'the mother country and bastion of modern protectionism'. After independence, the US issued high tariffs and taxes under the guidance of George Washington. The US performed most successfully during years of high protectionism. In the 1920s, it had the highest tariffs on manufactured imports with 37 per cent after Spain.[15]

Tax law can stabilise the monetary currency in countries. It can be used to control inflation and deflation. Inflation is a continual increase in the price of goods and services.[16] Deflation is a decrease in the amount of available money or credit in an economy that causes prices to go down.[17] Governments increase the rate of direct taxes in order to curb inflation. This reduces the purchasing power of the people, hence stabilising the currency. In the incidence of deflation, the converse can be done by the government. Direct taxes are decreased so that the purchasing power of the population is increased. This uplifts the country from deflation. A stable currency maintains the purchasing power of the population, ensures that the fiscal and monetary plans of the government are achieved and instils investor confidence in the country, hence stimulating economic growth and financing development.

Tax law can widen and deepen the tax base. The tax base is the set of economic activities and assets that is taxed. Any attempt to broaden the tax net needs to take into account whether the extra revenues outweigh the collection costs. The priority targets should be those benefiting from tax preferences, those misusing transfer pricing to shift profits, and the extractive industry. Many countries have successfully enlarged their tax bases. Tunisia has increased its own at a yearly average of 3.5 per cent; South Africa has more than doubled it, as has Egypt in the last five years.[18] Tax law enables governments to be creative and capture taxes from nascent areas of the economy. In Uganda, the government has decided to tax international remittances from Ugandans living abroad and also tax cash transfers by mobile phones and other money transfer operators.[19]

Uganda's informal sector, like that of most sub-Saharan African countries, is largely composed of numerous unregistered and unregulated small and medium-sized enterprises. A recent report by *The Monitor* quotes data from the nation's Statistics Bureau, which notes that the sector currently makes up about 43 per cent of Uganda's total economy. Uganda's Revenue Authority has revealed that it continues to face difficulties in taxing businesses operating in the informal sector.[20] I believe tax law can save the day. The government can enact tax laws that will compel the informal sector to pay taxes, for example, the government can make a law that sets an ultimatum for the registration of all the informal businesses for tax payment purposes or it could enact heavy penalties for tax defaulters engaged in the informal sector.

Tax law can be harmonised among countries to promote collective simultaneous development, especially where the countries are in a federation or regional bloc. This is through an agreement on a unified tax framework by the countries and establishing a minimum and maximum limit for taxes. A unified tax regime will reduce the temptation for firms operating across different countries to evade taxes. The most fundamental impact of the harmonisation is that it eases cross border trade in the private sector. This will result in increased movement of goods and services within the countries, increased investment, enhanced employment opportunities, etc.

The East African Community (EAC) partner states will have a harmonised tax system by April 2015. Kenyan Cabinet Secretary in the Ministry of East African Affairs, Commerce and Tourism Phyllis Kandie told a media briefing in Nairobi that negotiations are currently ongoing at the ministerial level:

> 'We shall begin by harmonising the Value Added Tax (VAT) and the Excise Taxes. Tanzania, Uganda and Rwanda have a VAT rate of 18 per cent while Kenya's is 16 per cent. The economic bloc has different levels of taxation across the same industries. What is important is that we have agreed as a region on the need for uniform tax systems across the five partner states. Tax harmonisation will make cross border trade easier for the private sector. Our aim is to ensure that intra-EAC trade reaches the level of other trading blocs such as the European Union.'[21]

Countries lose colossal amounts of money, which could have been directed to enhancing economic growth and financing development, through tax evasion. Tax evasion is using illegal means to avoid paying taxes.[22] Tax law can be enacted to recover money that the government loses through evasion. Tax law can deter tax evasion by imposing a heavy penalty such as a sanction. In India and other South Asian countries, tax evasion is endemic, starving the government of revenue and retarding the pace of economic growth and social development. This has spawned a shadow economy, with a large number of tax payers hiding wealth. India's Finance Ministry estimates that the off-the-books economy totals about 40 per cent of the country's GDP. In a bid to recover money hidden abroad, the government has renewed efforts to revise its tax treaties with at least 25 countries, and renegotiate agreements with 51 others.[23] In China, tax evasion attracts the Death Penalty.[24] Countries in need of tax revenue for economic growth and development can borrow a leaf from the above countries and enact similar tax laws.

In conclusion, taxes are a significant instrument which every government utilises in order to fulfil its obligations to its people. The mandate to impose and collect taxes, and also administer sanctions pertaining to taxes, is conferred by tax law. The relevance of tax law cannot therefore be overemphasised. In matters pertaining to tax and tax law, governments must always address their minds to the wise counsel of Jean-Baptiste Colbert, Minister of Finance under King Louis XIV of France, who stated that 'The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing.'

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How can tax law stimulate economic growth and finance development?

Taxation is essential for sustainable development because it supports the basic function of a sustainable state and sets the context for economic growth. Taxation charges on estates, transactions, property, income and licenses are all intended to boost the economy of the country, consequently leading to good tax regulatory mechanisms, and promoting good governance and accountability by the government for the prosperity of the nation. Taxation therefore lies at the administrative heart of any government, and acts as a catalyst for public demands with regard to a government's responsiveness and accountability.

Taxes usually provide the guidelines on how the budget of any country will look. Before the budget is read, changes usually involve taxes. The economy of any country thrives on how much it gets on the taxes it imposes on its citizens. So, usually when the budget is read, it highlights areas in the economy that will need improvement, and the only way this can be achieved is if the collection of taxes is done in a good and fair way. With such a system in place, the economy of the country stands a chance of development, because all areas likely to lead to development of the country will be taxed equally.

Tax law can also lead to economic development through good tax policies. Tax law in itself cannot achieve development, but the policies implemented by any state through which taxes can be collected will be the basis for development. For instance, charging fair taxes could be one way of encouraging citizens to even pay the taxes, investing in economic activities other than agriculture because, most times, the difficulty of raising good taxes comes from the fact that the tax base itself is not enough. Agricultural activities do not act as good tax resources, therefore you find that, instead of growing and expanding the tax base, the country will instead deteriorate. Therefore, one way of ensuring the economic growth of a country is if economic activities other than agriculture are considered in this way. They will be taxed proportionately, leading to development.

Taxes are necessary to fund the legitimate operations of government. The core functions of government, such as providing for the common defense and upholding the rule of law, cost money, and taxes exist to raise revenues to fund these legitimate activities. A good tax system, for instance, can help citizens themselves hold the state accountable for how the tax payer's money is spent.[1] Transparency in how taxes are collected and spent is a good system if we are to consider that a state is democratic and cares for its citizens.[2]

Taxes for any development and the progress of a country play a role in proper resource allocation. For instance, tax revenues may be used to encourage development activities in the less developed areas of the country, because the imposition of tax will necessitate the proper allocation of resources. Taxes thereby ensure that areas that were not or are not given enough attention as far as development is concerned are considered, and increase the overall growth of the country.[3]

Another way taxes can increase economic development is by creating a system where rigging of tax or tax avoidance is prevented, because paying taxes in essence is not a bad thing. However, once people start avoiding them or show an unwillingness to pay taxes, then most likely this will affect the activities of the country and the plans of the government for its citizens. So, if tax avoidance or tax evasion are to be dealt with and avoided whichever way possible, then maybe a sustainable economic growth and development can be realised.

Taxing income more than once is unfair and detrimental to some countries' economies. Double taxation like capital gains taxes, dividends taxes – all of which apply to income that has already been taxed – is unfair. Several countries have gone on to sign double taxation agreements to tackle this problem, such as countries in the east African community including Burundi, Kenya, Rwanda, Tanzania and Uganda.[4] It is only Burundi that does not have a tax treaty with any country, and Rwanda has already signed the double taxation treaty and even ratified it.[5] The remaining east African countries are hesitant because they are scared of the implications of the treaty. Still, the fact that they have the double taxation treaty arrangements with other countries is proof enough that, in case this treaty is implemented, the economies of these countries might boost.

For a country like Rwanda, given its history of the 1994 genocide, taxes have played a tremendous role in the development of the country. In fact, Rwanda's goals are embedded in its vision 2020, which seeks to transform Rwanda from a low income, agriculture-based economy to a knowledge-based, service-oriented economy by levying appropriate taxes. Rwanda is set to achieve the goals it initially set out, because the only way these goals will be achieved is if the citizens themselves pay taxes.

When the taxes are high in a given country, this not only discourages investment but incentives are very minimal. Consequently, you find that, instead of a country moving forward, it is restrained, because what would be the point of investing in a country that makes the working conditions unbearable, instead of making profits? The investor is just making losses. This is where good tax policies play a role, because they can be used to handle critical and economy-threatening situations like depression or inflation.

A key reason why people do not pay taxes is that they do not see any corresponding improvements in public services that directly affect their lives. The urban population does not relate to better roads in rural areas. The rich do not even use public infrastructure such as public schools and public transportation as much as the poor do. This, in turn, discourages people to pay taxes, because they do not see their money's worth. So, the need for accountability for taxpayer's money can play a tremendous role in the development and economic growth of a country.

Taxes are good for the economic development of a country, because not only do they increase investments, but they are also used as a control mechanism to check inflation and the consumption of certain harmful products that may not be favourable to the development of the country. The entry of certain products in a given state may not be prohibited, but their consumption may be checked through taxing of such products. In this way, inflation and uneven competitions that imports pose to the local industries, are all curbed, and the economy can ensure sustainable development.

Another way to boost finance will involve tax incentives and exemptions for promoting local investment and stimulating economic growth through native entrepreneurship and investment; and expansion of trade and investment opportunities within a regional agreement, through creating large investment areas and enlarged markets, which are vital for regional integration. These are very crucial in the avoidance of differences in tax systems. Consequently, creating regional integration will enable a states' members to comply with the legal remits and regional agreed policies in their own capacity and competence.[6]

Another way taxes can increase development is if qualified and well-trained staff are employed, because the accountability, the recording and collecting processes all require people with the skills to do so. When tax officials are not paid well, or if there are no well-established tax systems they can use, like mail or telephones, to make their work easier, then how shall the collection and ability to keep accounts be possible because of these bad working conditions?

You find that people will be taxed more, and yet this would not have been the case if only proper channels through which taxes can be collected were established. So, having well-monitored, properly working systems through which taxes are collected is one way economic development and the fostering of economic activities can be assured.

In conclusion, all of the above factors explain how tax law in itself is not the cause of economic growth and development. Rather, the policies presented in a tax system of any country are what can either lead to prosperity or detrainment in terms of development depending on the tax policies a country chooses. In order to address these factors, policymakers will have to think outside the box to ensure that the majority of the population that is currently not paying tax is brought into the tax net. If any country is to achieve equity, efficiency and growth in its tax system, it is important that the policies they will adopt to achieve these goals be done in a humane way without hurting the livelihood of the poor.

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How can tax law stimulate economic growth and finance development?

Introduction

Most of the world's economies – if not all – have spared little effort in encouraging their economic growth and development. Governments engage various actions to that end. The economic growth of any country, and its development, were proven to be the result of not only economic factors but also non-economic factors. Among the non-economic factors of economic growth and development are attractive legal and institutional frameworks. With regard to the legal framework, tax law is one of the areas of law that draws much attention with regard to the contribution of an attractive legal framework to economic growth and development. The fact that tax law can stimulate economic growth and finance development is subject to little dispute; however, the extent to which – and how – tax law can stimulate economic growth and finance development needs to be ascertained. Hence, this essay will answer the question by first providing a general understanding on tax law and taxation, economic growth and development. Second, it will endeavour to explain how tax law can stimulate economic growth and finance development.

Tax law

Taxation is not recent – and it is even argued that the history of taxation is not dissociable with the evolution of the state itself. Therefore, in all states, various laws were –

and are being – enacted to regulate all issues relating to taxation. One cannot think of what is meant by tax law without first defining what a tax is and what its main objectives are. Scholars have endeavoured to define the concept of 'tax'. MM Akanbi in his work *The Law of Taxation* defined tax as 'a compulsory contribution to the support of government levied on persons property, income, commodities, transactions, etc., now at a fixed rate proportionate to the amount on which the contributions is levied'. According to Ray A Sommerfeld, a tax is a non-penal but compulsory transfer from the private sector to public sector levied without any receipt of a specific benefit. Thus, from these scholarly definitions, a tax can be understood as a compulsory levy without direct consideration that is 'determined by legislative authority'.

The imposition of taxes by states seeks to achieve certain objectives, which are ultimately the functions of the taxes. Professor Richard A Musgrave in his work *The Theory of Public Finance* stated three major objectives of taxation: allocation of resources, redistribution of income and stabilisation of the economy. Although Musgrave found these to be the major objectives of taxation, 'the primary function of a tax system is to raise revenue for the government for its public expenditure'. However, the other functions of taxes cannot be neglected as they are of paramount importance for the economic growth and development of any country. For instance, taxes can be used for social goals by redistributing national income. They are also used for stimulating investment and allocating resources, as Musgrave rightly put it.

Considering that taxes are significant for the survival of any country, all issues relating to taxation have to be provided for by relevant laws. This position is strongly backed by Yoseph Edrey, who argued that 'any tax in a democracy may be levied only by an act of the legislature', which renders it very important and necessary to have rules and regulations regulating taxes and taxation systems, hence, tax law.

Thus, tax law can be defined simply as a body of rules dealing with charging, assessment and collection of taxes. Charging and assessment provisions make up substantive tax law, while collection and other administrative provisions make up procedural tax law. It is worth noting that these rules (and their implementing regulations) should be drafted so they ensure the three major objectives of taxation, namely, financial, economic and social objectives. It is important to note that, for a tax system to achieve the aforementioned objective, it has to adhere to some principles, as suggested by the famous liberal economist Adam Smith in his work *An Inquiry Into the Nature and Causes of the Wealth of Nations,* where he opined that a tax has to be certain and not arbitrary, considerate of the convenience for the contributor, efficient, fair and equitable as well. For other economists, principles of neutrality and fluctuation have to be upheld, so the tax system can change easily according to the economic system's needs. Thus, there is a little doubt that all these canons have to be reflected in the tax code of any country, in order to ensure that fiscal and non-fiscal functions of taxes are achieved.

Economic growth and development

These two concepts can be heard from speeches of various politicians and other personalities of today's world. They are also read in publications of international bodies like the U nited Nations Development Programme, World Bank and International Monetary Fund, which have drawn the attention of many scholars. What do these concepts really mean? How do they relate to each other? And what are major factors for attaining either?

Before 1960, economic development was identified with economic growth. However, in 1960s, this idea was criticized and it was pointed out that developing countries continued to experience poor living conditions among their population despite there being impressive growth figures in the period following World War II. This leads to the argument that development needs something beyond economic growth alone. As noted by Professor Tim Jackson, countries are 'far from raising the living standard for those who most needed it… growth let much of the world's population down'. Thus, despite the fact that there exists a two-way relationship between growth and development, these concepts are different and the existence of growth does not necessarily lead to development.

Economic growth as defined by Alina P Haller as 'an increase of the national income per capita'. From this definition, as noted by Professor Kuznets, economic growth is mainly a quantitative concept. This means that economic growth refers only to the increase in quantity of goods and service produced and is measured by Gross Domestic Product (GDP) per capita and other measures of aggregate income. For a country to attain a good level of economic growth, certain factors to stimulate it must exist, such as investment, existence of natural resources, innovations, advanced technologies, developed infrastructures and a large and skilled working population (human capital). Good legal and institutional frameworks must also exist to stimulate and accommodate the preceding factors.

Unlike economic growth, development is far more complex than simply economic growth or the quantitative accumulation of national wealth. Tatyana P Soubotina and Katherine A Sheram in their work *Beyond Economic Growth: Meeting the Challenges of Global Development* stress:

> 'Development is also the qualitative transformation of a whole society, a shift to new ways of thinking, and, correspondingly, new relations and new methods of production. Moreover, as you will probably agree, transformation only qualifies as development if it benefits most people, improves their *quality of life* (emphasis added) and gives them more control over their destinies. This comprehensive process of change has to involve most of the population and cannot be limited to modernization at the top or in the capital city.'

There exist various indicators of development beyond increased GDP per capita, such as good living standards, high life expectancy, income equality, high rate of literacy and reliance on advanced technologies, to mention a few. This indicates that economic growth does not necessarily go hand in hand with development; and this idea has been confirmed by the Overseas Development Institute, which noted that several countries have witnessed soaring economic growth, but limited progress in social indicators such as health and education. Although economic growth differs from development, a two-way relationship exists between them. On the one hand, economic growth provides the resources that permit sustained improvements in development, whereas improvements in the quality of the labor force – which is inextricable to development – are an important contributor to economic growth.

Tax law: a stimulus to economic growth and a financing to development

While investment, progress of production technologies and developed international trade influence economic growth, good living standards among the population of a country and income equality, which are key indicators of development, do not occur automatically, but rather, they need to be encouraged. The law in general, and tax law in particular, plays a significant role in stimulating economic growth and financing development, which then have ripple effects on growth and development. The contribution of tax law is not controversial; its importance is recognised by the fact that tax reforms made through tax legislation have been justified by various politicians in their campaigns with the ultimate goal of achieving economic growth and development. But, how can tax law really stimulate economic growth and finance development?

To begin with economic growth, it is important to consider that the role of tax law in some instances can be obscured by the effects of other influential factors like natural resources and human capital. First, through tax law, a government can provide tax incentives to attract direct foreign investment and local investment – a strategy that is not unknown, as it was emphasised by Yair Listokin in his article 'Equity, Efficiency, and Stability: The Importance of Macroeconomics for Evaluating Income Tax Policy', where he argues that tax codes are full of incentives for businesses to invest in capital equipment or new employees. Thus, the role of tax law in this area is plausible. For instance, the tax credit on investment, introduced by the Revenue Act of 1962 in the United States, led to 10.2 per cent of all amounts invested in manufacturing equipment in 1963. Hence, there is no doubt that such a tax incentive is a potent stimulus to investment, and ultimately for economic growth. In various countries, tax holidays have been granted for attracting businesses to invest in areas where investments are relatively low or in domains that are critical to economic growth. For instance, in Egypt, under the law no 8, a five-year tax holiday is awarded for priority sectors in the Old Valley, for example, in infrastructure, manufacturing and venture capital projects. In the instant case, there is little doubt that such incentives can profoundly stimulate economic growth, and it is through tax law these incentives are granted and their efficiency is ensured. In addition, governments use their tax codes to grant incentives for research and development (R&D), which will lead to innovations and technological progress, the influenceof which on economic growth cannot be neglected. This argument is also shared with Ansa Johanson et al in *Tax and Economic Growth,* where they allude that tax incentives for R&D can lead to tax-induced innovative activities in highly R&D intensive industries which may eventually translate into a persistent acceleration of productivity, and therefore lead to economic growth. Moreover, tax law can stimulate economic growth by granting tax incentives for higher education, and this would lead to improvement of human capital which is one of the determining factors for economic growth. For instance, in the US, individuals can exclude certain qualified education expenses from their taxable income under Section 162 of the Internal Revenue Code. Thus, this encourages people to advance their education and increases the national productive workforce, which in return leads to an increase of GDP, and ultimately, economic growth.

Last but not least, the clarity of tax law and the simplicity of tax procedure is necessary for tax compliance, which is necessary for the increase in national revenues. In this regard, it is argued that better administration of existing tax legislation may increase revenue by 30 per cent or more in many countries in Sub-Saharan Africa. These revenues are ultimately used by the government to develop infrastructures like power plants and roads that would ultimately positively influence economic growth.

With regard to development, tax law plays a very critical role in this area. First, tax law can be used to fill the gap between the poor and the rich. While it is a well-known fact that income inequality – which deepens the gap between the poor and the rich – constitutes a serious threat to development, tax laws can be used to curtail this gap between the poor and the rich. This was noted by Reuven S Avi-Yonahin in his article 'The Three Goals of Taxation', where he suggests that taxation can have a redistributive function aimed at reducing the unequal distribution of income and wealth that results from the normal operation of a market-based economy. Thus, tax laws can curtail income inequality by providing for rates that are high enough for people with higher earnings along with exemptions on lower income. A similar argument was noted by W Elliott Brownlee in his pamphlet *Historical Perspective on U.S. Tax Policy toward the Rich,* where he argues that taxing the rich is required for redistribution of income.

In effect, as put by Alex Cobham, who argued that income redistribution can allow a given society to achieve human development gains by lifting its poorest members out of poverty, it is understandable that by curtailing the gap between the poor and the rich, tax law can lead to good standards of living, which is a key indicator of development. Moreover, tax law can finance development, to the extent that tax legislation ensures the efficient collection of resources needed to finance public expenditure on facilities that are vital to development, for example, hospitals, schools, potable water, etc.

Last but not least, it is also important to note that tax law can be used to curb the problem of unemployment – which certainly constitutes a hindrance to development – by granting tax incentives for businesses that employ a certain number of domestic employees, which would eventually lead to the increase of household income and indeed improve their standards of living.

Conclusion

The topic under discussion has drawn the attention of various scholars and politicians. John F Kennedy was famously quoted arguing that 'We must start now to provide additional stimulus to the modernization of American industrial plants… I shall propose to the Congress a new tax incentive for businesses to expand their normal investment in plant and equipment.' Thus, as is apparent, tax law plays a critical role in stimulating economic growth and financing development. However, this role should be understood in the sense that tax law has ripple effects on growth by stimulating factors that directly affect growth like investment, innovation and technologies. This is achieved through, among other things, tax incentives provided in tax legislation. The role that tax law plays in financing development is also critical – tax legislation is being used to curtail the gap between the poor and the rich and to ensure the efficient collection of revenues that contribute to public expenditure in activities that seem to be critical to development. But, it is worth noting that governments have to strike while the iron is hot: they must revisit their tax codes in order to ensure that their tax laws are drafted in a way that meaningfully stimulates economic growth and finance development, because the role of tax law is not automatic.

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