

# Tax revenue, total expense, gross domestic production and budget deficit: a study...

[Economics](#)



## **Abstract**

The main aim of this study is to find out relationship among tax revenue, total expense, gross domestic production and budget deficit of Sri Lanka. Budget deficit is a vital problem in Sri Lanka. This study covers 26 years from 1990 to 2015. This research mainly covers three independent variables such as tax revenue, total expense and gross domestic production. Budget deficit is dependent variable of this research. This study mainly focuses descriptive and inferential statistics to analyze research data, answer the research questions, reach research objectives and test hypothesis.

SPSS used in this study for statistical analysis. Further graphical, descriptive, correlation and regression analysis performed in this study. Secondary data used in this study. Correlation analysis confirmed that there is positive significant relationship among direct tax revenue, indirect tax revenue, capital expense, recurrent expense, gross domestic production and budget deficit of Sri Lanka from 1990 to 2015. Regression analysis confirmed that 98.9% of gross domestic production depends on capital expense, recurrent expense, direct tax and indirect tax of the Sri Lanka.

Capital expense has significant impact on the gross domestic production of the country. 99.4% of budget deficit depends on capital expense, recurrent expense, direct tax and indirect tax of Sri Lanka. Further it can be stated that indirect tax revenue has significant impact on the budget deficit and also recurrent expense has significant impact on the budget deficit of the country.

## **Introduction**

Every country is trying to maintain sustainable development for their best present and future. Economy is one of the key elements of sustainable development. Tax revenue, total expense, gross domestic production and budget deficit/ surplus are the key indicators of economy in every country. Budget deficit is one of the major problem for every country. Especially continuous budget deficit is very serious problem for many countries. Budget deficit is continuing in Sri Lanka which is not good for the developing countries. Lymer and Oats (2009) stated that taxation is a key economic tool for well managing country's income; taxation has played a significant role in developed countries.

Fiscal policy is very important for every country. It should be amended according to the economic conditions and expectations of the country. Generally numbers of tax policy changes are often occurring in every budget to increase tax revenue and try to reduce budget deficit in every country. Tax policy changes mean that abolish some existing tax policy in the tax system. These changes may withdraw old tax from taxation; add new tax to taxation, increase tax percentage, decrease tax percentage and etc. Tax policy changes will differ from country to country according to their economic position.

## **Tax Revenue (TR)**

Government total revenue could be divided as tax revenue and non-tax revenue. Tax revenue is one of the major revenue of government revenue. According to central bank report (2016), more than 86% of government revenue comes from tax revenue in Sri Lanka. Direct tax revenue and <https://assignbuster.com/tax-revenue-total-expense-gross-domestic-production-and-budget-deficit-a-study-in-sri-lanka/>

indirect tax revenue are major two revenues under tax revenue of every country. According to central bank report (2016), it can be found that more than 80% revenue of Sri Lanka has been generated by indirect taxes.

According to Lymer and Oats (2009), they defined tax is a compulsory levy which is imposed on income, business, expenditure or capital assets by government and other tax authority. Here income tax payers does not receive any specific return as directly however they are receiving some advantages as indirectly which are freehealth, education, national security, infrastructure facilities, livelihood assistances and others. Here charges, tolls and other levies does not consider as tax payments. Those are paid to obtain a specific service from the government. Tax collection is much important for every country to their effective and efficient economic operation. Singh (1999), Shanmugam (2003) ; Lymer and Oats (2009) pointed that generate revenues for public expenditure is one of the major objective of tax collection in every country.

### **Total Expense (TE)**

Government total expense can be divided into two major parts such as total recurrent expense and total capital expense. Sri Lankan government total current expense's includes the following major expenses salaries and wages, other goods and services, interest payments and current transfers and subsidies. Capital expense includes acquisition of real assets and capital transfers. According to central bank report (2016), it can be seen that government spending in Sri Lanka increased to 1, 015, 106. 70 LKR Million from 985, 815 LKR Million in 2016. An average expense of Sri Lanka is 151, 449. 44 LKR Million from 1950 until 2016. Sri Lanka reached 1, 015, 106. 70 <https://assignbuster.com/tax-revenue-total-expense-gross-domestic-production-and-budget-deficit-a-study-in-sri-lanka/>

LKR Million in 2016 which is high level government expense in Sri Lanka and Sri Lanka had 440 LKR Million expense in 1950 which is very low level government expense in Sri Lankan history.

### **Gross Domestic Production (GDP)**

Gross Domestic Production (GDP) Gross domestic production is the total economic production of the country which consist three major sector such as agriculture, industrial and service sector. Gross domestic production, direct tax revenue, indirect tax revenue and government expense have interrelation among them. Economic growth of the country is calculated based on the present and past year gross domestic production of the country. According to annual report of central bank (2016), Sri Lankan economy has grown by 4.4 % in real terms even though it had several international and national economic challenges.

There are number of factors are impact on the gross domestic production of the country. Unfavorable weather conditions of Sri Lanka adversely impacted economic activities especially it was seriously affected agriculture sector of Sri Lanka in last year. Service sector of Sri Lanka has increased by 4.2% of GDP in 2016. Expansion in financial service, insurance, telecommunications, transportation and whole sale and retail trade is the major reason for this greatest achievement in service sector of Sri Lanka. Industry sector also has grown by 6.7 % in Sri Lanka. Industry sector has contributed 26.8 % to the gross domestic production of Sri Lanka in 2016.

### **Budget Deficit (BD)**

Generally government budget includes revenue, expense, budget surplus/ deficit and financing/ investment for one year period. Tax revenue is major source in revenue as well as recurrent expenses and capital expenses are major recurrent expenses. Budget deficit means that government total revenue less than its total expense. Budget deficit is one of the major problem for every country in the current world. Sri Lanka has budget deficit in every year although it is differ from year to year but the current budget position is not good level.

There are number of reason for the budget deficit of the country but it can be confirmed that government revenue and expense are the key variables in the budget deficit of any country. Especially Sri Lanka is providing many services as totally free as well as with minimum payment such as free education, samurdhy, electricity, postal, transport, free health, free try foods, etc... above reasons and inefficiency in tax collection, tax evasion, inefficient tax policy, pastcivil warand resettlement could be seen as reasons for facing budget deficit in Sri Lanka. According to the central bank report (2016), it can be seen that budget deficit of Sri Lanka was 5. 40 percentage of gross domestic production in 2016.

### **Empirical Review**

According to best of researcher knowledge and availability of information, researcher was unable to find any research on this particular research topic.

The following empirical evidence found by the researcher which is more related with this study. Muriithi (2013) pointed that all taxes have

disincentive impact such as taxes adversely impact of investment on human,  
<https://assignbuster.com/tax-revenue-total-expense-gross-domestic-production-and-budget-deficit-a-study-in-sri-lanka/>

physical capital and innovation or creativity of the country. This research main objective was to reveal association between economic growth of Kenya and government revenue of Kenya.

Results of this study concluded that adverse association between import duty and economic growth of the country which means that if any increase in import duty that reduce economic growth of Kenya and vice versa. This study results reveal that any increase in excise duty which reduce slowly rate of economic growth of the country. Major findings of this study were existing income tax policy leads to increase in the tax revenue of the country in every year and income tax had direct association with economic growth. That means if any increase in the income tax that will directly associate with economic growth of the country. Further this study found that there is positive impact of increase in value added tax on the rate of economic growth of Kenya. Researcher concluded that economic growth of Kenya has been increased in over the past years.

According to Chaudhry and Munir (2010), tax collection was one of the significant economic issues for the economic development of the country. Results of this study reveal that determinants of tax efforts significantly depend on openness, broad money, external debt, foreign aid and political stability. Agriculture, manufacturing and service sector share turn out to be insignificant. This study concluded that openness, money supply and political stability are boosting variables to increase level of taxation.

Gacanja (2012) did a study to find association between economic growth and tax revenues. Based on the results of this study, researcher stated that there

<https://assignbuster.com/tax-revenue-total-expense-gross-domestic-production-and-budget-deficit-a-study-in-sri-lanka/>

was positive association between economic growth and tax revenue of Kenya. This study covered income tax, import duties, excise duties and value added tax as tax variables. Tax variables were positively impact on gross domestic production of the country. Value added tax had high impact on GDP and import duties had low level of impact on GDP. According to the results of this study, researcher suggested that government should desist from concentrating on increasing tax revenues by increasing tax levels but instead employ a tax structure that enhances the tax base thus improving economic growth rate.

James (2003) found that there was a positive and statistically significant relationship between the share of government expenditure in gross domestic product and the share of net disbursement of overseas development assistance. Further findings reveal that foreign aid leads to tax relief and there was a strong indication for usage of foreign aid for recurrent expenditure of the country. Worlu and Emeka (2012) examined about impact of tax revenue on the economic growth of Nigeria from 1980 to 2007.

They found that tax revenue stimulates economic growth through infrastructural development. Further major findings of this study highlighted tax revenue impacts on economic growth in Nigeria. Eric and Jonathan (1996) noted tax reforms are sometimes touted as having strong macroeconomic growth effects. They used three approaches to find the impact of a major tax reform 5 percentage point cut in marginal tax rates on long term growth rates in this study. The first approach was to examine the historical record of the United States' economy to evaluate whether tax cuts



have been associated with economic growth. The second was to consider the evidence on taxation and growth for a large sample of countries. Final approach was micro level studies of labor supply, investment demand, and productivity growth. Results of this study suggested modest effects, on the