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How Taxes and Inflation Will Affect Economic Growth in ASEAN Emerging Markets

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Abstract

Research aim : *The objective of this research is to examine the impact of tax revenue and inflation on the economic development of ASEAN emerging market nations from 2010 to 2023*

Design/Methode/Approach : *The analysis utilizes yearly secondary data acquired from diverse sources, including the World Bank, CEIC, and IMF. The chosen analytical technique is panel data regression, specifically the Random Effect Model (REM) approach, which was selected based on the Chow, Hausman, and Breusch-Pagan statistical tests.*

Research Finding : *The research findings suggest that tax income has a detrimental and statistically significant impact on economic development. The findings suggest that fiscal and monetary policies have distinct effects on the economic development of ASEAN developing nations. Considerable tax revenue has the capacity to impede economic development, but modest inflation may stimulate economic growth*

Theoretical contribution/Originality : *These findings enhance our knowledge of how macroeconomic factors affect economic growth in the ASEAN area.*

Practitionel/Policy implication : *The significance of government action in controlling economic growth through taxation and inflation is supported by this study. Macroeconomic uncertainty may result in lower tax collection. This includes uncertainty about spending, investing, and saving. Economic activity is subsequently impacted, necessitating careful analysis. In order to lessen the detrimental effects on economic growth, particularly those on tax revenue and inflation, lessons learned from this study can be used to future financial crises and economic shocks.*

Research limitation : *Due to inadequate data collection, this analysis eliminates the tax structure and is limited to looking at the tax revenue ratio. Future studies must clarify the tax systems of ASEAN countries in order to identify which taxes have a positive impact on economic growth and which have a negative one.*

Keywords : *Tax, inflation, economy growth, emerging market*

1. Introduction

Economic growth is a crucial indicator that reflects a country's progress. Global economists argue that the achievement of economic growth in developing countries remains an indicator for formulating subsequent development policies. Explaining economic growth is done by analysing the productivity generated each year. The indicator most frequently used for evaluating economic growth is the gross domestic product, or GDP [1]. GDP determines the total worth of goods and services generated inside a nation's boundaries over a specific time period [2].

Economic growth has continued unabated, as evidenced by the situation in the ASEAN region, especially in countries classified as emerging economies, such as Vietnam, Malaysia, Thailand, Indonesia and the Philippines. As a developing country, it will undoubtedly require significant economic growth. However, national economic development has continued as expected, albeit hampered by the deterioration of the global economy. As a result, the global financial crisis that occurred in 2008-2009, the global economic slowdown in 2017-2018, and the COVID-19 pandemic in 2020-2022 have all had significant negative impacts on global economic growth. Here is the economic growth of ASEAN emerging markets:

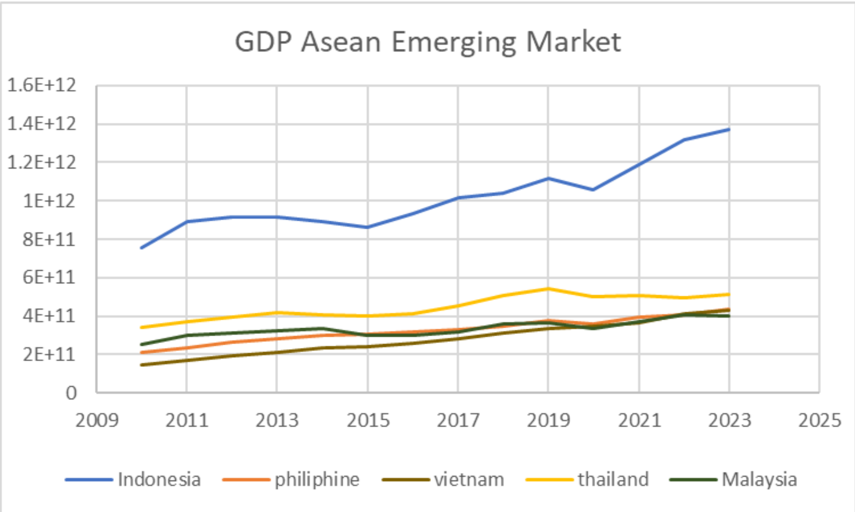

Figure 1
Economic growth of ASEAN emerging markets.
Source: World Bank (data processed by researchers)

The chart shows that Indonesia consistently has the largest GDP compared to other countries, while Vietnam and the Philippines show relatively stable development. This pattern illustrates the economic dynamics in the ASEAN region, where emerging economies contribute significantly to regional economic stability. While there was an increase in GDP in some countries, this increase occurred in the context of global difficulties. The pace of growth can be influenced by policy choices through the impact of taxation on economic decisions and through productive public expenditure [3]. Taxation is the main source of government revenue in almost all countries. Taxation is also used to improve equity, security, and resource allocation, and accelerate economic growth [4]. Taxes are a crucial economic instrument. Taxes play a significant role in modern business, and its applicability is demonstrated by stability and predictability [5].

Taxes are financial or other levies imposed on taxpayers, both individuals and legal entities, by the state or its equivalent. Taxes are generally considered an important source of revenue to finance various government programmes [6]; [7]. All taxes must be founded on a legitimate legislation since, from a basic standpoint, they are mandatory payments made to the government by businesses and households [8].

The revenue generated to provide infrastructure affects the political, economic and social development of a country. Taxes are one way to generate the amount of revenue necessary to provide the necessary infrastructure. [6]. Compared to non-tax sources, taxes are the most favoured form of government revenue and have the highest contribution to total government revenue. [9]. While government revenue finances public expenditure and is essential for growth, taxes become harmful to the economy if not properly regulated. Commodity prices and individual incomes are affected by tax policies, which in turn affect individuals' saving, consumption, and investment behaviour. Changes in the consumption, saving, and investment habits of households and firms have an impact on the economy, which can be good or bad. Its role is linked to economic growth due to the dual effects of taxes on economic activity [10]. Taxation has positive effects, such as increasing income and wealth and maintaining price stability, but its negative effects, such as incentivising saving and investment, far outweigh the benefits.

According to conventional economic theory, taxation interferes with economic growth and causes distortions. [10]. Estimating the effect of taxes on economic growth has been the subject of numerous research. Taxation can influence economic decisions that impact growth rates in either a positive or negative way. The following studies outline how taxes contribute to economic growth [11]; [9]; [10]. While the negative effects in the study [6]; [12]; [7]. When considering a fundamental production function, it is clear that taxes can affect growth by affecting (1) physical capital, (2) human capital, and (3) total factor productivity. According to several studies, the taxes that hinder growth the most are those on personal and corporate income. Consumption, property, and environmental taxes are less harmful.

The goal of macroeconomic policy for the majority of nations in the globe today is to attain both price stability and sustainable economic growth. Price stability is emphasized in monetary policy conduct in part because of the goal of fostering sustained economic growth and boosting the value of the home currency [13]. Macroeconomic policy focuses on economic growth and inflation rate. Inflation is one of the many variables that can be considered as a determinant of economic growth. [14]. Inflation is a major concern for a nation's ability to maintain steady economic growth [15]. However, inflation has a complicated impact on economic expansion. As a measure of macroeconomic sustainability, inflation is one of the most significant markers of a nation's economic health [15]. One of the most crucial measures of a nation's economic health is inflation, which demonstrates the macroeconomic aspect of sustainability. Inflation affects the economy in both positive and negative ways, according to experts. Future investments and savings may be discouraged by inflation. Goods may become scarce if inflation is high enough because people may fear that prices may rise in the future. Uncertainty brought about by fluctuations in the inflation rate is one of the most important effects of inflation, since it can either raise or decrease consumer purchasing power [16].

Under moderate inflationary conditions, an increase in prices may encourage firms to increase production, which in turn contributes to economic growth. On the other hand, excessive inflation can lower export competitiveness, raise production costs, and diminish people's purchasing power. In ASEAN emerging markets, inflation is often volatile and influenced by various global factors, such as commodity prices and monetary policies of developed countries. There is a relationship between interest rates and inflation. The real interest rate is calculated by reducing the nominal interest rate from the inflation rate. Real interest rates fall and nominal interest rates do not rise in tandem with inflation when the rate of inflation is high. Because businesses are hampered by rising interest rates, this implies that a rise in the nominal interest rate will result in a downturn in the economy and a rise in unemployment [17].

The Phillips Curve theory and the Quantity Theory of Money contribute to form our understanding of the connection between inflation and economic growth. In addition to incorporating information from relevant research literature, this thorough theoretical review includes a thorough analysis of the relationship between the variables [18]. The debate between monetarists and structuralists raises this issue. Inflation, according to structuralists, is required for economic growth, while monetarists contend that it is harmful [19]. Since capital and money may be exchanged for one another, an increase in inflation will lead to a rise in capital accumulation and quicker economic expansion [20]. On the contrary, [21] in the process of the new growth theory showed a non-linear relationship between economic growth and the inflation rate. They demonstrate how inflation, not its efficacy, stifles economic growth by reducing investment. Numerous experimental investigations have established a direct or indirect association between inflation and economic growth, despite the fact that this relationship is still up for question or is not entirely clear. The impact of inflation on a nation's economic growth can be either good or detrimental. Among other things, inflation promotes economic growth [14]. However, inflation's negative impact on economic expansion [16]; [22]; [22].

This research needs to be conducted for several important reasons relating to ASEAN economic conditions, the effects of monetary and fiscal policy, as well as the gaps in prior research. This article's research goal is to investigate how inflation and tax income affect economic growth in ASEAN emerging market nations. The emerging market ASEAN countries (Vietnam, Malaysia, Thailand, Indonesia and the Philippines) face complex economic challenges, including how tax policy and inflation affect their economic growth. Most previous studies have looked at the impact of taxes or inflation separately, but this study examines both together in the ASEAN context. Previous studies have focused on developed countries or other groups of developing countries, while specific studies on ASEAN emerging markets are limited. This study is essential because it can shed light on how inflation and taxation impact ASEAN's economic growth, particularly in light of the current global economic climate. Furthermore, policymakers can use the study's findings as a foundation to create more efficient strategy for overseeing the economies of ASEAN emerging market nations.

2. Method

The study's methodology is quantitative, and it makes use of secondary data in the form of yearly quantitative values spanning the years 2010–2023. Secondary data refers to information obtained from reports published by government agencies, which are available in various formats such as research papers, journals, and archives from institutional data organizations. Data sources were obtained from the Central Statistics Agency (BPS), World Bank, CEIC, IMF and various related data and internet data related to the research. The method used by the author to obtain data, the special approach is data collection through documentation. Documentation refers to data obtained from existing sources, including annual reports published by Statistics Indonesia, World Bank, CEIC, and IMF, as well as reference books and periodicals. This study uses panel data, specifically a combination of time series and cross-section data, from five ASEAN developing countries covering the years 2010 to 2023. The analytical tool used is eviews 12, which adopts several panel model approaches, including CEM (Common Effect Model), FEM (Fixed Effect Model), and REM (Random Effect Model). The optimal model was selected using Chow, Hausman, and Lagrange Multiplier tests.

3. Results and Discussion

Table 1. Model Selection

Fixed effect Test			
Effect Test	Statistic	d.f	Prob.
Cross-section F	67.048447	(4.63)	0.0000
Cross-section Chi-Square	116.169826	4	0.0000

The results of the Chow test indicate a chisquared probability value of 0.0000 and a cross-section F. The aforementioned findings show that H1 is accepted as the test result and H0 is rejected. The number less than 0.05 in the data shows that the fixed effects model outperforms the common effects model.

Table 2. Hausman Test

Hausman Test			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	2.321120	2	0.3133

The probability value for the random period is found to be 0.3133 using the Hausman test. Since the value is more than 0.05, it may be inferred from the data that H0 is accepted and H1 is rejected. Therefore, the Random Effect model is the best model to apply. The Hausman test indicates that Random Effect is a better fit than other models at this level. However, the following test is utilized to obtain more accurate results.

Table 3. Test Hypothesis

Test Hypothesis			
	Cross-section	Time	Both
Breush-Pagan	179.2033	1.947819	181.1511
	(0.0000)	(0.1628)	(0.0000)
Honda	13.38668	-1.395643	8.478946
	(0.00000)	(0.9186)	(0.0000)
King-Wu	13.38668	-1.395643	11.02933
	(0.00000)	(0.9186)	(0.0000)
Standardized Honda	18.00415	-1.248963	6.864737

	Test Hypothesis		
	Cross-section	Time	Both
	(0.0000)	(0.8942)	(0.0000)
Standardized King-Wu	18.00415	-1.248963	11/06237
	(0.0000)	(0.8942)	(0.0000)
Gourieroux, et al.			179.2033
			(0.0000)

The p value, which is less than 0.05, is 0.0000 according to the results above. Therefore, using random effects is more appropriate. REM is the test that was selected. Additionally, normality and multicollinearity are the traditional assumption tests that are employed.

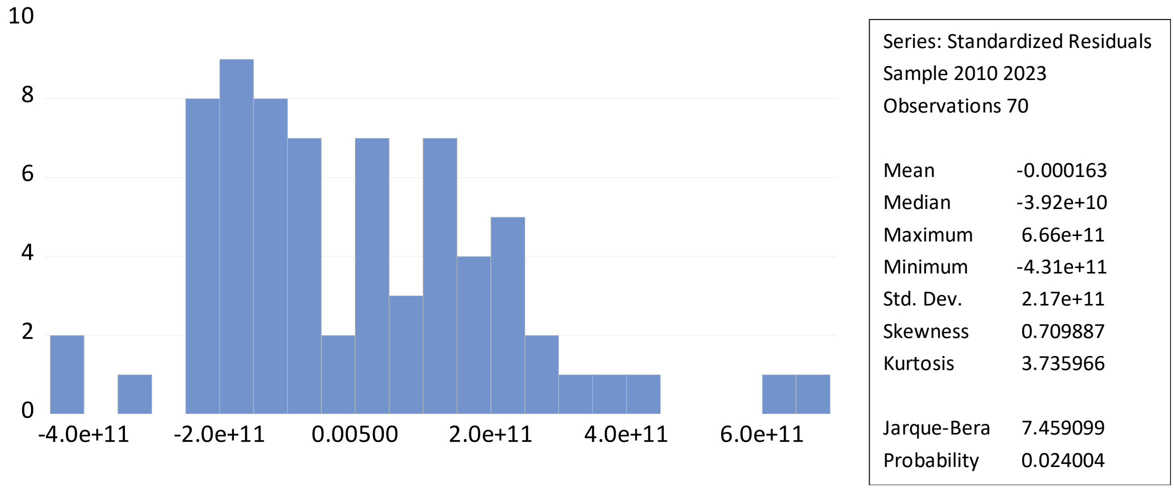

Figure 2. Classical Assumption Test

It is evident from the preceding histogram that the data is normal since the Jarque-Bera value is 7.459 and the probability value in the normality test is 0.02400> 0.0000.

Table 4. Multicollinearity test

	TAX	INF
TAX	1	0.3390014
INF	0.3390014	1

There is no multicollinearity issue as a variable, as demonstrated by the data provided below. This is determined by making sure the coefficient value, which is 0.339, is less than 0.10.

Table 5. Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	28.46941	0.208405	10.88952	0.0000
TAX	-0.130141	0.015759	-7.442155	0.0000
INF	0.021520	0.016750	2.405238	0.0189

Weighted Statistics			
Root MSE	2.15E+11	R-Squared	0.452620
Mean dependent var	4.82E+11	Adjusted R-squared	0.436281
S.D dependent var	2.93E+11	S.E. of regression	2.20E+11
Akaike info criterion	55.11155	Sum squared resid	3.24E+24
Schwarz criterion	55.20792	Log likelihood	-1925.904
Hannan-Quinn criter.	55.14983	F-statistic	27.70065
Durbin-Watson stat	0.220508	Prob(F-statistic)	0.000000

The findings of the panel data regression demonstrate that the probability value of the tax variable is 0.0000 <0.05. Therefore, it may be said that h1 is accepted and ho is rejected, indicating that throughout the 2010–2023 timeframe, the tax variable significantly affects economic growth in ASEAN rising nations. The panel data's inflation variable has a probability value of 0.0189 <t, according to regression analysis. In light of this, it can be concluded that h1 is accepted and ho is rejected, suggesting that the tax variable significantly affects economic growth in ASEAN emerging states from 2010 to 2023. The likelihood value of the f-statistic is 0.000000, which is below the significance level of 0.05, based on the panel data regression results. Individually or in combination, taxes and inflation have a substantial influence on the dependent variable, economic growth.

The effect of taxes on economic growth

The results of the regression test of the tax variable show a negative effect which is at -7.442 which indicates that there is a decrease in economic growth by 7.44% if the tax has increased by 1%. And the results show that taxes have an effect on economic growth. This research is in line with [23] The tax's research has a detrimental impact on economic expansion. The primary goal of fiscal policy is economic growth, and taxes are the primary financial tool utilized to accomplish this goal [24]. High taxation can reduce individual purchasing power and business profitability, thereby discouraging consumption and investment, which are the main drivers of economic development.

Research from the G7 nations, where taxes have a detrimental effect on GDP, also supports this theory. It has been suggested that a higher tax burden will negatively affect income since there will be fewer incentives for innovation and development thus inhibiting economic growth and reducing GDP. Developing countries are more vulnerable to large tax increases on both personal and business income. While taxes serve as an important means of generating state revenue, if not utilised effectively, excessive tax revenues can hinder economic progress, especially in developing countries.

One of the primary economic instruments that the government employs to control the macroeconomy and raise funds for the budget in order to stimulate the economy, reducing poverty, and creating social justice is taxation. [25]. A high income tax rate lowers incentives to save and invest, has a negative impact on the labor supply, and discourages investment in the development of human capital. High taxes frequently influence households' decisions, leading them to save more and spend less since they increase taxes on disposable income [7]. As a result, households frequently participate in less productive economic activities, switch from high-tax activities to lower-tax ones, or eventually decide to steer clear of any economic activity together. The government constantly seeks to raise tax income in order to fund expenditure initiatives, according to public choice theory. Simultaneously, the government decides how to restrict economic activity using the funds it receives from taxes. Government expenditure can therefore significantly boost economic expansion. Consequently, economic growth is stronger when government revenue is higher [25]. Higher taxes restrict activities that boost productivity and discourage investment and labor involvement in productive industries and hours worked, according to research findings demonstrating that tax revenue has a detrimental impact on economic growth [7].

Research from the G7 countries that shows taxes having a negative effect on GDP also supports this theory, explaining that more taxes will have a negative effect on income due to the lack of incentives to develop and innovate, thereby hindering economic growth and reducing GDP. Developing countries are more vulnerable to large tax increases on both personal and business income. While taxes serve as an important means of generating state revenue, if not utilised effectively, excessive tax revenues can hinder economic progress, especially in developing countries. Therefore, the government can obtain funds through taxes to improve economic operations, which will result in economic growth. The Laffer curve theory, which merely states that any change in tax rates has an economic impact on output, employment, and jobs, is supported by the research findings. As a result, the tax base offers incentives to promote more activity. The findings demonstrate that the whole economy is significantly impacted by the variable tax collections from value-added tax, petroleum tax, and corporate tax. Therefore, any change in any of the variables will have a direct impact on GDP. The endogenous growth theory, which contends that internal rather than external causes drive economic growth, is also supported by this study. One of the internal elements is taxes, which are produced internally through the labor of human resources. This argument is supported by the study's findings, which demonstrate that tax income significantly affects economic growth [23].

Additionally, this finding has very significant policy implications. A comprehensive tax strategy that addresses all significant facets of the tax system and yields quantifiable outcomes is required to raise tax revenue. We contend that the tax system should prioritize transparency, efficiency, and ease of execution, delaying the more challenging aspects until the outcomes are evident. Through training, the government should focus on enhancing management capability. This entails guaranteeing taxpayer compliance and expanding tax collection duties. The deployment of anti-transfer pricing solutions, stringent tax refund management, and e-commerce operations should all be subject to more stringent government checks and inspections in order to prevent the loss of tax income. Since all parties involved should have online access to data on tax collection and associated expenses, transparency is essential.

The effect of Inflation on economic growth

According to the inflation variable's regression test results, which stand at 2.405, economic growth will rise by 1% for every 2.4% increase in inflation. According to study, a nation's economic growth is significantly impacted by inflation. This supports Philips' contention that by lowering the unemployment rate, rising inflation promotes economic growth.Increases in the cost of consumable goods and services over time are referred to as inflation. Economists are eager to learn more about the relationship between economic growth and inflation. The reason for this is because monetary policy conduct is thought to have a big influence on long-term economic growth [26]. Economic growth and its correlation with inflation have been the subject of intense scrutiny. Almost all economic players, including producers, investors, and consumers, are impacted by high inflation rates when making decisions because they are unclear about the projected outcomes of their choices. On the other hand, growth and productivity are suppressed when inflation peaks [27].

This finding has significant policy consequences. Efforts to reduce inflation to very low or zero levels are likely to have a negative impact on economic growth, contrary to the policy recommendations of international lending institutions. [19]. However, efforts to promote faster economic growth may cause the economy to overheat and destabilise inflation. Therefore, these economies are at a tipping point. In order to accelerate economic growth, they require inflation, but the growth rate must be in line with a steady inflation rate rather than outpacing it. However, too fast growth can accelerate the inflation rate and bring them to the brink of collapse, as found by [28].

The economic growth of a nation is greatly impacted by any change in the general level of prices. The economic engagement of citizens will rise with the implementation of an efficient inflation control strategy. Because inflation enhances the demand for goods and services, it promotes economic growth by driving up prices. Businesses may be encouraged to boost output as a result, which could lead to more job openings. In emerging market countries, rising prices may encourage producers to increase production to meet greater demand, thereby increasing output. In addition, moderate inflation can also accelerate consumption and investment, as people and businesses seek to capitalise on purchasing power before prices rise further, keeping inflation under control.

The results of the study support and are in line with [29]; [30]; [31]. This favorable association only happens when inflation falls below the government-established threshold. This finding suggests that the government should make sure inflation stays below the threshold. The study's overall conclusions indicate that it's critical to keep inflation at a modest level. The findings demonstrate the potential of inflation to stimulate economic expansion. People will trust money since its value can be preserved while inflation is minimal, and prices will stabilize. They will be encouraged to make investments in the real sector as a result. Therefore, the government should keep inflation moderate and steady. This can be done by implementing an inflation targeting policy, which should regularly assess the inflation target established in prior years. Thus, the economy can be driven by inflation.

4. Conclusion

The results of the investigation into the connection between tax revenue, inflation, and economic growth allow for the following deductions: During the 2010–2023 era, 1) the tax revenue variable has a negative effect on the economic growth of ASEAN emerging markets, and 2) the inflation variable has a positive effect on the same period. Among the recommendations from this study are: 1) Development of a more adaptive tax policy, which requires a reduction in the tax burden on key sectors that contribute to economic development, such as small and medium enterprises, and industries that stimulate exports. 2) Managed inflation, Effective implementation of monetary and fiscal policies, including interest rate regulation and commodity price monitoring, is needed to prevent excessive inflation that can damage purchasing power and economic stability. 3) To give a more comprehensive picture of the region's economic progress, more research is required to confirm other significant factors such political stability, labor quality, and foreign direct investment (FDI).

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