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Tax Structure and Economic Growth in Croatia: A VAR Approach

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One of the key contemporary debates deals with the relationship of tax structure and economic growth. Usually, the empirical research basis on panel data sample of group of countries (e.g. OECD countries or other groups of developed countries) (Arnold (2008); Arnold et al. (2011); Xing (2010); Acosta-Ormaechea and Yoo (2012)), while empirical literature considering an effect of tax structure in some specific country have been rather scant. Also, such research focusing on group of countries cannot provide more specific insight into country based interdependency between tax structure and growth. This paper tries to overcome this problem and analyses the relationship between tax structure and economic growth in the case of Croatia from 1991 to 2013, using a Vector Autoregression Model (VAR*)*.

The goal of this paper is to provide an analysis of the interdependency between tax structure and economic growth (GDP per capita) in Croatia during the period from 1991 to 2013 using a Vector Autoregression Model (VAR*)*.

The starting hypothesis is that all taxes have negative impact on economic growth in Croatia. Such assumption is in line with economic theory because theory predicts that all taxes create distortions which could have negative consequences for growth. Accordingly, the main aim of the paper is to investigate which types of taxes have the greatest negative impact on economic growth in Croatia, and which the lowest.

The analysis is focused on the tax structure not on their level. All regressions include the tax level expressed as a share of total tax revenues in GDP. Tax forms that are used in the model according to OECD classification of taxes are: personal income tax, social security contributions, corporate income tax, consumption taxes and property taxes. Also, the macroeconomic variables used in the model are: GDP per capita, the share of gross investment in GDP, population growth rate, gross enrollment rate in higher education institutions.

The results of the research proved that tax structure in Croatia in the observed period influence economic growth in a different way that it is the case for developed countries such as OECD countries for which the scientific research conducted so far. Also, based on the results it is possible to conclude that in the Republic of Croatia the exsiting tax structure should be modified in order to encourage economic growth.

Moreover, the results shows that tax policy in Croatia cannot be taken to extremes, and should be very carefully implemented because a large amount of other factors except tax policy such as monetary policy, corruption, efficiency of tax administration, transparency of government and Country-specific recommendations of the European Union can influence the results. Finally this paper discussed the reform path for the taxes according to the empirical results.

This paper represents the first research in the area of interdependence of the tax structure and economic growth for Croatia.

Keywords: tax structure, Croatia, VAR analysis, economic growth

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