ISSN 2278-5612

Role of Taxation in Formulation of Monetary Policy (Case study of Pakistan)

Mohammad Salih Memon
Assistant Professor Department of Business Administration*
saleh.memon@salu.edu.pk
Dr. Subhan Khatoon Gaad
Professor, Chairperson Department of Economics*
Sarmad Rahat
Lecturer Department of Economics*
*Shah Abdul Latif University Khairpur, Sindh, Pakistan

Abstract

Actually this is the problem of most of the countries to move or strengthen their economy by maintaining all necessary requirements in this light we worked out for the identification of the variables/reasons which can create the ways for more money available in the economy for utilizing it for growth and development, for that reason data was collected from the secondary sources like ministry of finance, state bank of Pakistan and applied linear regression to check the relationship, and concluded that model of the equation if perfect which clearly identifies that tax collections are highly and positively correlated with the monetary assets available in the country means when tax collection base is exactly planned or implemented no doubt collection will improve and this improvement will lead to more money available in the economy for the all reasons which leads the economic system towards growth and development.

Council for Innovative Research
Peer Review Research Publishing System
Journal: International Journal of Management & Information Technology
Vol. 10 No. 2
editorsijmit@gmail.com
www.ijmit.com/ojs

Introduction

Means by which governments are trying to finance their expenditure by imposing some charges on the citizens, and corporate entities of the country. A tax organism is based on top of some essential doctrine; they are:

Impartiality: this principle states so as to levy must be forced in accordance by the aptitude to forfeit rule. Impartiality has two different extents; flat and erect impartiality.

Progressivity: a levy structure be capable of progressive /regressive; income tax (direct tax) is generally progressive in character and VAT, Import duties, excise duty, and sales tax (indirect tax) can be minimized to certain extent through exemptions on basic consumption of commodities are generally regressive in character.

Straightforwardness: a levy structure have to be as easy as probable with the little levies and simple legislations; nevertheless some of the tax structures are intricate even with the huge figure of taxes forced for income considerations.

Efficiency: finally the levy structure has to be proficient; no one fiscal plan may be valuable if the tax structure is bungling and fraudulent.

Any type of initiative in designing of fine tax plan could be unsuccessful at the flap of tax management. Even though the tax plan can appropriately be put to reduce the saddle that tax structure entails on trade, this might completely be undermine by a deprived tax administration. And this is very much true in developing countries where administrative constraints such as, corruption, and weak institutions imposed substantial cost of business. A good policy imitative would make sure that the tax rates are reasonable and that tax is designed in a manner that it could be simple and easy to comply with, even while being so easy to administer by tax authorities.

Tax administration includes private sector and public sector activities, these includes the tax ministry, tax department, independent auditing, anti-corruption, and legislative over sight bodies, third parties to whom tax activities are out sourced, civil courts, tribunals, police and criminal justice system, tax practitioners, their associations, organizations, and tax payers associations.View is that the fiscal and monetary course of actions are not self-governing to each one and hunting only single policy exclusive of enchanting other policy in to the consideration, which may not produce the expected results. Furthermore the coordination of policy is to be propping up by concise institutional and outfitted preparations like “monetary and fiscal” coordinating committee/authority.

Here in Pakistan we do not have conception of such policy coordination previous to, the reforms of monetary division which was putted in just before practice in the previous decade of last century. From the time when than policy dexterity plank has been formed in the ‘Pakistan’.Both plans are affecting total demand. Routine fiscal additive and unrestricted monetary plan is generally outlook a principal policy tool for overall economic stabilization. But here are some circumstances, inside which monetary plan is not capable to encourage the overall economy, but unrestricted fiscal plan desirable to battle the situation. In the presence of downturn centralized banking authority reduces the interest rates; other than no any bank is able to reduce the interest rates lower the zero. But if interest rates fall to naught, as happened inside the U.S. throughout the dejection, and also inside Japan into latest years, monetary plan was fail to boost the economy auxiliary, so an optional fiscal plan would be required to enlarge the economy.

Literature Review

As (McLure, 2000) focuses on “control” in the light of requirement that sub national governments are able to influence the amount of revenue extensively at the periphery via their personal strategy choice. In the interest of maintaining precision, the appropriate way to manage is most likely by daunting tax rates. But governments on a few stages are probable to behave sensibly as well as in the favor of their populace; they are required to visage a tough budget restraint. They ought to be proficient to boost or shrink their expenditure in any episode of budget by enhancing or lessening their receipts in the means with the aim of they are accountable in public for the penalty of their decisions.

Compliance of levy is a main dilemma for most of the tax system as well as it is not a simple chore to pursue the tax payers to meet the terms by means of tax necessities still tax rules are not ever clear-cut (James & Alley, 2004).

The connotation of tax conformity is clear in a variety of ways; (Andreoni, Erard, & Feinstein, 1998) asserted that tax fulfillment be supposed to as tax payer’s eagerness to comply with the tax rules in sort to acquire economic system at symmetry throughout the country.

(Kirchler, 2007) professed a simple description within which tax fulfillment is distinct as more unbiased word to define tax payer’s willingness to pay-off their taxes.

Tax fulfillment is exposure of the every one income and expenditure of the levy by satisfying the necessities of laws, convention, and verdict of judiciary (Alm, 1991).

Furthermore the tax compliance is divided in to two main perspectives, fulfillment in language of direction and fulfillment in the form of carrying out tax income (Chow, 2004) and (Harris, 1989).

Various writers have highlighted tax fulfillment from separate perception, (Allingham & Sandmo, 1972) defined tax fulfillment as a problem of coverage real income, as well as claim that tax fulfillment behavior was affected by the circumstances in which tax payer is deciding under uncertainty, (Clotfelter, 1983) that tax payers would have the benefit of tax stash because of reporting less profits.

In distinction with the tax obedience, tax non fulfillment is as well professed as the letdown of tax payers to testimony the accurate revenue, claiming inference and reimbursement of genuine quantity of tax billed to the concerned power at the instant (Kirchler, 2007).

Approaches to Tax Compliance

Tax Compliance	First Approach	Second Approach
Concept of:	Tax gap 100% compliance less actual Revenue	Voluntary willingness to act in accordance with the sprit as well as letter of tax law.
Definition	Narrower	Wider
Tax Compliance	Economic rationality	Behavioral co-operation
Exemplified by:	Trade off: 1. Expected benefit of evading. 2. Risk of detection and application of penalties. 3. Maximize personal income and wealth	Individuals are not simply independent, selfish utility maximisers. They interact according to differing attitudes, beliefs, norms, and roles. Success depend on co-operation
Issues of:	Efficiency in resource allocation	Equity, fairness, and incidence.
Taxpayer seen as	Selfish calculator of pecuniary gains and losses	“good citizen”
Can be termed the:	Economic approach	Behavioral approach

Researchers of monetary measures are of the opinion that monetary plan got bigger impact on economic activities as unexpected change within reserves of currency affect output and growth, for promotion of economic growth centralized banking authority must increase the reserves of money. But they are of the opinion that enhancement in the spending from government side would crowed out private segment plus that can offset and short term benefit of expansionary fiscal plan. On the next hand the idea of liquidity trap which is just a situation in which the interest rate (real) cannot be decreased by monetary establishment was best commenced by Keynesian. Than liquidity ambush means an enhancement within money supply cannot gear up the economic growth for the reason that the descending anxiety of investment owning to the tactlessness of interest charge to money supply. John Maynard Keynes proposes the fiscal plan by increasing overall demand in array to restrict unemployment rate and dipping it for controlling the inflation.

Monetary and fiscal policy both got influential role for the macroeconomic stabilization into the developing countries, other than somehow magnitude of this plan has been a Sevier dispute among the Keynesian and the monetarist. The monetarists are of the opinion that fiscal plan to a certain extent than the monetary plan got bigger pressure on economic motion. While many other researchers suggested the efficiencies in other economies as policy, that have pressure on economic activities (Ajisafe & Folorunsho, 2002).

The term fiscal plan is coupled with the usage of tax plus public expenses to affect the altitude of economic activity. The execution of the fiscal plan is directed from side to side budget of the government. Than simply we can say that budget is other than a sketch for managing the government segment. The mainly imperative characteristic of community budget is its usage as a means in running of overall economy (Omitogun & Ayinla, 2007).

Fiscal plan is concerned with the actions of government into expenditure plus imposing taxes with the view that it will influence macroeconomic variables in a desired direction. This is concerned with the sustainability in economic growth, will be the reason for creating high employment and decreasing the inflation as well (MicrosoftCorporation, 2004).

Thus the intention of fiscal plan is to stabilize the economy. Enhancement in governmental spending or decrease in taxes will lead to drag the economy out of slump; while reduction in expenditure or enhancement in tax rates will slow down the curve (Dornbusch & Fischer, 1990).

Fiscal policy is concerned with the governmental expenditure, levy, and have a loan to affect the economic activities and growth of overall demand, output and employment as well. Fiscal policy highlights the management of government to the economic system through exploitation of its income and expenditure patterns for achievement of its desired goals related to the growth of economy (Medee & Nembee, 2011).

When magnitude of financial structure is short as compare to the magnitude of fiscal deficit, centralized banking authority do not have any choice except to magnetize the fiscal deficit. In other countries where there is superficial financial system, monetary plan is the back elevation of the coin of fiscal plan, in addition to that can participatepersistent role. In the countries whose income is low, security markets are under developed and centralized banking authority do not withheld most of the tangible securities, and they do not have instruments to control the monetary system, but they constitute one of the factor that intrude the dominancy of fiscal measures, country's economic plan is good as its fiscal plan, as well as sovereignty of centralized banking authority may not bring an independent monetary policy (Oyejide, 2003).

Monetary policy instruments (direct and indirect) are deliberately used as monetary policy on the behalf of monetary establishment, such as centralized banking authority in array to achieve macroeconomic stability. Monetary plan is device for accomplishing the monetary and price stability. Monetary plan is nothing than a program or plan of actions undertaking by monetary establishment, to manage and normalize the flow of money by means of the public and credit with the view of achieving predetermined macroeconomic goals (Dwivedi, 2005).

According to (Ogunjimi, 1997) monetary policy depending on formal efforts of government's to manage the flow of money and economy in array to achieve economic objectives. And three categories of monetary judgment can be made regarding:

1. The quantity of money in motion,
2. Intensity of interest charge, and
3. The function of banking system and credit market

Collectively these procedures are intended to adjust importance, supply plus cost of cash in the economy, by keeping in view the intensity of economic motion. Excess monetary supply willpower result the surplus demand of households, prices will shoot up and equilibrium of payment will worsen. The challenges of policy administration are completely on monetary establishment which are committed to its control effectively.

Since the time economic growth is considered as most important goal of economic policies (Fadare, 2010). According to (Khosravi & Karimi, 2010) estimated that economic growth is most important concerned with labor and capital. The materialization of endogenous escalation theories has expectant many researchers to inquire the position of additional factors in defining the economic growth observable fact (Bogdanov, 2010).

More of the empirical studies are for the impact of fiscal policy on economic growth. A central belief of those is that fiscal plan is generally linked through growth; it states that suitable fiscal actions in a particular situation can be utilized for stimulation of economic growth as well as development (Khosravi & Karimi, 2010).

Methodology

Data was collected from the ministry of finance government of Pakistan and State Bank of Pakistan for the period of 2000-01 to 2009-10 and linear regression was applied to check the interrelationship between taxation and monetary policy for which diagnostic tests are formed:

$$MA = \alpha + TC\beta + \mu$$

Results and Discussions

		Monetary Assets	Tax Collection
Pearson Correlation	Monetary Assets	1.000	.971
	Tax Collection	.971	1.000
Sig. (1-tailed)	Monetary Assets	..	.000
	Tax Collection	.000	..
N	Monetary Assets	10	10
	Tax Collection	10	10

According to the results Monetary Assets and Tax Collections are highly correlated to each other and significant by (1-tailed) test.

Model	R	R Square	Adjusted R Square	Std. Error of Estimate	Change Statistics R Square Change	F Change	Sig. F Change
1	.971	.942	.935	377182.858	.942	130.736	.000

Explanatory power of the regression equation can easily be judged by looking at the value of R-Square and we can say that model is fit at the .000 level of significance.

Model	Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
1. (Constant)	130798.949	308951.609		.423	.683
Tax Collection	3.932	.344	**.971**	**11.434**	**.000**

As the value of beta is concernedwe can predict by looking at the results that degree of association of Tax Collection is very much high and positive with Monetary Assets.

Conclusion

Keeping an eye on the results it can easily be concluded that model of the equation if perfect which clearly identifies that tax collections are highly and positively correlated with the monetary assets available in the country means when tax collection base is exactly planned or implemented no doubt collection will improve and this improvement will lead to more money available in the economy for the all reasons which leads the economic system towards growth and development.

Limitations

This study is limited on the basis of time horizon and geographic/economic restrictions in the way that researcher only selected data from 2000-01 to 2009-10 (ten Years), geographically/economically means the results of research is only applicable in the economic system of Pakistan, the researcher will not be responsible of results if applied anywhere else.

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