

# The Relationship between Growth and Tax Revenues in Croatia

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**Abstract:** *In all countries, the main purpose of taxes is to finance public spending. However, according to Keynesian school, governments apply for the taxes not only for public funding, but also for achieving the objectives of fiscal policy. Recently, politicians have used the taxes as a tool to ensure the economic stability, equality in income distribution and economic growth. Among these objectives, economic growth refers to the net increase in national income. Traditional growth theories have failed to explain the growth using capital accumulation and labor. But, new endogenous growth theory investigates also the impact on growth of the public policy. Different taxes have different effects in the economy. If taxes examine as direct and indirect taxes, the first effect of indirect taxes on economy is related to resource allocation through the price mechanism. The first effect of direct taxes such as income and corporate tax is on saving and investment decisions of individuals. The rates on these taxes should be lower for decisions of economic agents. The high taxation of this earning has led to the badly affected of labor, capital and technology located among growth factors. As a result, entrepreneurship can be reduced; saving and investment decisions can be influenced negatively. On the other hand, the taxation of capital may also lead to balance of payment problems in country by leaving the country of capital. Investment and saving are the main tools of growth. Therefore, the use of taxes for providing economic growth is extremely important. The relationship between economic growth and taxes is discussed in many studies.*

*The share of total tax revenues to GDP in Croatia is 14.8% in 1991, 22.97% in 1996, 22.4% in 2000 and 18.6% in 2011. GDP growth rate is 5.2% in 1996, 3.75% in 2000 and -0.92% in 2011 respectively. In this study, the relationship between growth and tax revenues is analyzed by using Johansen Cointegration and Causality tests in Croatia between 1991-2011 periods. Johansen Cointegration test results reveal the existence of a positive and significant relation between growth and tax revenues. In the long term, the impact of taxes on growth is significant and positive. Granger causality test findings indicate that there is causality from growth to tax revenues in the 10% significance level.*

**Keywords:** *Tax Revenues, Growth, Croatia, Granger Causality Test, Johansen Cointegration*