THE IMPACT OF PERSONAL INCOME TAX ON ECONOMIC GROWTH IN CENTRAL ASIAN AND CAUCASIAN COUNTRIES: A COMPARATIVE ANALYSIS

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Abstract: *This thesis examines the impact of personal income tax (PIT) on economic growth, fiscal stability, and income distribution in five Central Asian countries - Kazakhstan, Uzbekistan, Turkmenistan, Kyrgyzstan, and Tajikistan and three Caucasian countries - Armenia, Georgia, and Azerbaijan. By analyzing specific data over the past decade, this study highlights the nuanced ways in which different PIT policies influence economic outcomes. The thesis concludes with policy recommendations aimed at optimizing PIT structures to support sustainable growth and equity in these regions.*

Keywords: *Personal income tax, individuals, income, tax rates, GDP.*

1. Introduction

Central Asia and the Caucasus are regions characterized by diverse economic structures, ranging from resource-rich economies to those heavily reliant on agriculture and remittances. Personal income tax (PIT) is a critical fiscal tool that can significantly influence economic performance, government revenue, and social equity. This thesis provides a detailed, data-driven analysis of the impact of PIT on economic growth in the five Central Asian countries and three Caucasian countries, offering insights into the effectiveness of various tax policies implemented over the past decade.

2. Economic overview and PIT structures

Kazakhstan, the largest economy in Central Asia, operates with a flat PIT rate of 10%, among the lowest in the region. The PIT-to-GDP ratio has hovered around 3-4% over the last decade. Kazakhstan's economy, which grew at an average rate of 4-5% annually, is heavily dependent on oil and gas exports. The low PIT rate is intended to encourage investment and consumption, though it limits the government's ability to leverage tax policy for income redistribution. Income inequality remains an issue, particularly between urban and rural areas.

Uzbekistan has undergone significant tax reforms, particularly in 2019 when the PIT rate was reduced from a progressive system with rates up to 23% to a flat rate of 12%. This reform aimed to simplify the tax system, improve compliance, and stimulate economic growth. The PIT-to-GDP ratio has been around 4-5%, with GDP growth averaging 5-6% per year. The reform has spurred economic activity, especially in the industrial and services sectors, though challenges like income inequality, particularly in rural areas, remain.

Turkmenistan, with its closed and state-controlled economy, maintains a flat PIT rate of 10%. The country's PIT-to-GDP ratio is relatively low, around 2-3%, reflecting its heavy reliance on natural gas exports rather than tax revenues. GDP growth has been highly volatile, averaging around 3-4% annually but subject to significant fluctuations due to external factors such as energy prices. The flat tax system has had little impact on income distribution, with inequality remaining high.

Kyrgyzstan employs a flat PIT rate of 10%, with a PIT-to-GDP ratio of around

4-5%. The economy is less developed compared to its neighbors, with GDP growth averaging 3-4% per year. The reliance on remittances from abroad and a large informal sector has limited the effectiveness of PIT as a tool for economic development. Despite the low tax rate, compliance remains a challenge, and income inequality is pronounced, particularly between urban and rural populations.

Tajikistan also uses a flat PIT rate of 13%. The PIT-to-GDP ratio is about 3-4%, with GDP growth averaging 5-6% annually, driven largely by remittances and foreign aid. The tax system is relatively underdeveloped, and the flat PIT rate has not significantly impacted income distribution. Poverty remains widespread, and the economy is highly vulnerable to external shocks, particularly in the labor and remittance markets.

Armenia transitioned from a progressive PIT system with rates up to 23% to a flat 23% rate in 2020. The PIT-to-GDP ratio is relatively high at around 6-7%, with GDP growth averaging 3-4% annually. The shift to a flat tax was intended to simplify tax administration and stimulate economic growth, but it has raised concerns about increasing income inequality. The economy is small and vulnerable to external pressures, particularly from geopolitical tensions.

Georgia's progressive PIT system, with rates ranging from 2% to 20%, has remained stable over the last decade. The PIT-to-GDP ratio has been steady at 5-6%, and the country has achieved average GDP growth of 4-5% annually. The progressive tax system has helped reduce income inequality, supported by a favorable business environment that has attracted foreign investment. However, challenges remain in addressing poverty, especially in rural regions.

Azerbaijan, which is heavily reliant on oil exports, switched from a progressive PIT system to a flat 14% rate in 2019. The PIT-to-GDP ratio has been low, around 2-3%, reflecting the country’s reliance on oil revenues rather than income taxes. GDP growth has averaged 2-3% annually, though this growth is highly volatile due to fluctuations in global oil prices. The flat tax was aimed at improving tax administration and economic efficiency but has had a limited impact on broader economic diversification and income equality.

3. Comparative analysis of economic impact

The relationship between PIT and GDP growth varies significantly across these countries. In Kazakhstan, Uzbekistan, and Turkmenistan, low PIT rates have supported higher consumption and investment, leading to steady economic growth. However, in Azerbaijan and Armenia, the effectiveness of PIT in driving growth has been less pronounced, with these economies being more influenced by external factors like oil prices and geopolitical dynamics. Georgia's progressive tax system has successfully balanced growth with income redistribution.

The contribution of PIT to government revenue is markedly different across these countries. In resource-rich Kazakhstan and Azerbaijan, PIT plays a minor role in government revenue, which is primarily derived from natural resources. In contrast, Armenia and Georgia rely more heavily on PIT for funding public services, making their tax policy critical for fiscal stability. Uzbekistan’s recent reforms have improved revenue collection, demonstrating how tax policy can be adjusted to balance growth with fiscal health.

Income distribution and tax equity are closely linked to the structure of PIT systems. Georgia and Armenia’s progressive tax policies have been more effective in reducing income inequality than the flat tax systems in Kazakhstan and Azerbaijan. However, Armenia’s recent shift to a flat tax has sparked concerns about widening income disparities. In Uzbekistan and Kyrgyzstan, lower PIT rates have fueled economic growth but have not fully addressed the issue of income inequality, particularly in less developed areas.

4. Policy recommendations

To promote sustainable growth and reduce income disparities, Central Asian and Caucasian countries should consider adjusting their PIT rates. Countries like Kazakhstan and Uzbekistan could benefit from introducing higher tax brackets for top earners, thereby enhancing the government’s ability to address income inequality without stifling economic growth.

Improving tax compliance is essential for increasing government revenue and ensuring fiscal stability. Investments in digital tax infrastructure and public education campaigns could help countries like Armenia, Kyrgyzstan, and Tajikistan improve tax compliance and broaden the tax base.

The large informal sectors in Kyrgyzstan, Tajikistan, and Uzbekistan undermine the effectiveness of PIT systems. Policymakers should focus on formalizing these sectors by providing incentives for small businesses to enter the formal economy, such as tax breaks or simplified registration processes.

For resource-dependent economies like Kazakhstan, Azerbaijan, and Turkmenistan, diversifying revenue sources beyond natural resources and PIT is crucial. Expanding the tax base to include emerging sectors such as technology and services can reduce vulnerability to external shocks and contribute to more stable economic growth.

5. Conclusion

The impact of personal income tax on economic growth in Central Asia and the Caucasus is shaped by each country’s unique economic structure, fiscal policy, and external dependencies. While PIT is an important tool for revenue generation and economic management, its effectiveness varies across the region. By optimizing PIT rates, improving tax compliance, and addressing informal economies, these countries can enhance their economic resilience and promote more equitable growth.

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