Macroeconomic Policy: Evidences from Growth Laffer Curve for Sri Lanka

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Abstract: Public economic policies are vital for the provision of efficient public services, in which optimal taxation system to promote economic growth in Sri Lanka. The research question intends to identify the optimal taxation policies and government size for promoting economic growth. Rationale for the research is to provide pragmatic evidences on the economy to investigate the different macroeconomic indicators with empirical models, while supporting to build up tax systems that generate optimal tax revenues through Laffer curve estimation. An empirical approach is used to estimate the Laffer curves with Instrumental Variable Generalized Method of Moments (IV-GMM) in factors affecting optimal taxation. The results expose a strong correlation of the tax revenue, and GDP with respect to tax rate for the Laffer curves, includes significant covariates such as tax rate, tax^2, tax^3, lag (tax), young dependency ratio, total factor productivity, exchange rate, foreign direct investment, and openness. The U-test shows that extreme points are at 17.36 and 17.93 of the tax rate implying U-shape for Laffer and growth Laffer curves respectively. The implications of the study are to deliberate on the macroeconomic determinants of the optimal taxation for reform the tax systems. Finally, the paper guides policymakers to reform tax systems with empirical evidences on impacts of public economic policies to improve optimal taxation for the economic growth in Sri Lanka.

Keywords: Taxation, Laffer Curve, Economic Size, Economic Growth, IV-Generalized Methods of Moments

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