

**EFFECTS OF TAXATION ON ECONOMIC GROWTH  
(UGANDA'S EXPERIENCE: 1987-2005)**

**BY**

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## **Abstract**

The development of endogenous growth theory has opened an avenue through which the effects of taxation on economic growth can be explored. Explicit modeling of the individual decisions that contribute to growth allows the analysis of tax incidence and the prediction of growth effects. This dissertation, titled “Effects of Taxation on Economic Growth (Uganda’s Experience: 1987-2005)”, reviews the theoretical and empirical evidence to assess how taxation affects the rate of economic growth in Uganda. The main objective of the study was to establish the effects of taxation on economic growth. Specific objectives included examining the long run effects of direct taxes on the rate of growth of GDP, examining the long run effects of indirect taxes on the rate of growth of GDP and estimating the empirical relationship between distortionary taxation and the rate of growth of the economy.

Major tax reforms implemented in Uganda since early 1990s aimed at addressing fiscal challenges facing the country. Reforms were directed towards improving administrative efficiency and to ensure better taxpayer compliance.

Studies on taxation and growth may find negative growth effects resulting from taxation, but it is more difficult to measure the potential benefits of the spending financed by the revenue collected. A combined impact of distortionary taxes and beneficial government expenditure can be used to assess the growth effects on an economy. In the methodology for this study, labour, capital, government consumption and revenue from the different tax components were used as the explanatory variables against GDP as the explained variable. Estimates of this study only reflect the cost of a combined tax and expenditure system and ignore effects caused by political decisions, corruption and other redistribution policies.

The results show that a 1% change in direct taxes would increase economic growth by 0.86% while a percent change in indirect taxes would negatively impact economic growth by decreasing it by 0.53%. It was also found out that a 1% change in private investment would increase economic growth by 0.63% while the same change in public investment would decrease economic growth by 0.14%; though these results were not statistically significant. A 1% increase in the labour force would lead the economy to a 0.36% growth, holding other factors constant while a 1% change in government consumption decreases economic growth by 0.02% but again both effects were not found to be statistically significant. A regression with both direct and indirect taxes combined however showed that a percentage change in total tax revenue would reduce economic growth by 0.12% but this time the results were statistically insignificant.

It is recommended that the government hedges the correlation between budget revenues and commodity prices to combat the negative effect of indirect taxes on economic growth. An improvement in international tax cooperation is also necessary to combat tax evasion and other harmful tax practices. Finally, fiscal relations among central and local governments need to be reformed to bring expenditure responsibilities at each level of government more into line with the financial resources