The Macroeconomic Effects of Tax Policy and Government Spending Changes in Turkey: Evidence from a VAR Model

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Abstract

During the pandemic conditions the importance of government expenditures and taxes has been increased considerably. In addition to that tax reforms have always been one of the hot topics in Turkey. Every government in Turkey has implemented some tax policy changes. Besides its fiscal purposes such as providing revenue to the state, taxes can also contribute to economic policy aims of the government. One of the debates that economists have long argued about is whether consumption or income should be taxed more. In other words, should the tax system be based preliminary on direct taxes or indirect taxes to stimulate the economic growth. Tax policy changes and government expenditures can effect macroeconomic indicators of a country significantly. Therefore, the effects of government spending, direct and indirect taxes on macroeconomic variables such as GDP, household consumption, private investment, inflation and net exports are examined utilizing quarterly data for the pre-pandemic period (1994Q1 – 2019Q4). Turkey has experienced many financial crises (1994, 1998, 2001, 2008) in the last decades indicating the macroeconomic environment is not stable. Hence employing nonlinear models as well as linear ones is much more appropriate for the case of Turkey. Accordingly, the interaction among government spending, taxes (under the distinction of direct and indirect taxes) and some selected macroeconomic variables over time has been investigated utilizing the linear vector autoregressive (VAR) and nonlinear VAR models.

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