Causality Relationship between Tax Revenue and Gross Domestic Product in Sri Lanka

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ABSTRACT

This study aims to determine the impact of direct and indirect tax on gross domestic product in Sri Lanka from 1990 to 2019. Secondary data was collected from Central Bank annual reports for the above years related to Gross Domestic Product and tax revenue. Gross domestic product was considered as the dependent variable and total tax revenue was taken as the explanatory variable under two categories as direct and indirect tax in the study. The obtained data were analyzed using descriptive statistics, correlation, trend analysis, granger causality, simple and multiple regression model. The correlation analysis confirmed that 8.2% of positive correlation exists between total tax revenue and GDP growth rate, where as there is a 10.9% of negative correlation exists between direct tax and GDP growth rates. However, indirect tax and GDP growth rate have a 40.1% of positive correlation with each other. Results of unit root test indicated that all variables are stationary at 5% level of significance thus all the variables have short run relationship in the study. Further, causality results implied that direct tax, indirect tax and total tax and GDP growth rate do not have a bi-directional causality with each other. Hence, there is no long run relationship between them. Results of simple regression revealed that total tax revenue and indirect tax have a positive impact on GDP growth rate while direct tax negatively impacted on GDP growth rate. The findings of the study, may direct the policy makers to design the appropriate macroeconomic policies to stabilize the economy in Sri Lanka.

***Keywords*:** *Causality, direct and indirect tax revenue, Gross Domestic Product, simple and multiple regression*