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Impact of Tax Revenue Mobilization on Economic Growth in Ethiopia

Zeleke Addisu Gudeta *[1], Amsalu Bedimo Beyene [2], Lemessa Bayissa Gobena[3]

[1] Department of Public Financial Management and Accounting, Ethiopian Civil Service University, Addis Ababa, Ethiopia,
[2] School of Policy Studies, Ethiopian Civil Service University, Addis Ababa, Ethiopia,
[3] Department of Public Financial Management and Accounting, Ethiopian Civil Service University, Addis Ababa, Ethiopia,
Corresponding Author: zelekepfm2006@gmail.com

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Abstract

This study examines the impact of tax revenue mobilization on economic growth in Ethiopia. Annual time-series data from 1991 to 2024 were used to estimate the Auto Regressive Distributed lag (ARDL) model. The empirical results indicate that tax revenue, indirect taxes on goods and services, and trade taxes have a negative and statistically significant impact on the long-term economic growth in the country. The total tax revenue and tax types have shown statistically insignificant or no relationship in the short run. Furthermore, the agriculture sector and the institutional quality variables have also shown a weaker relationship with long-term growth. Hence, the study concludes that the weak relationship between tax revenue and economic growth in Ethiopia was mainly due to widespread informality, weak tax administration, a narrow tax base, and a low level of information technology to monitor economic transactions. This finding recommends that policymakers should aim to broaden the tax base, reduce exemptions/holidays, and digitalize the tax system to enhance tax revenue collection. Moreover, the government is recommended to restructure the economy, modernize the agriculture sector, and strengthen tax administration to minimize informality and mobilize more tax revenue for sustained economic growth.

Keywords: *tax revenue mobilization, economic growth, Ethiopia, ARDL*

1. INTRODUCTION

Taxation is a primary source of government revenue in almost all countries (Kessy & Sukartini, 2023). It's used for financing public goods that are crucial to sustainable economic growth (Gbato, 2017). The endogenous economic theory (Barro, 1990; Barro & Sala, 1992) posits that taxation plays a significant role in fostering the long-run growth rate. Arnold (2008) and Myles

(2009) have also realized that growth rate can be affected by tax policy through the effects of taxation on economic decisions and productive public expenditures. Some studies documented that reliance on tax revenue mobilization through taxation enhances governments' ability to design and implement policies responsive to country-specific development needs (Belinda et al., 2021; United Nations, 2015; World Bank, 2023). Moreover, according to public finance theories governments should have a good tax system that grows automatically with the economy, adjusted when required without any harm to sustainable economic growth (Musgrave & Musgrave, 1989).

However, tax revenue in developing countries remains insufficient to meet expanding public expenditure needs (Junquera-Varela et al., 2017; World Bank, 2023). Amutabi (2023) has also identified that the majority of developing countries have been struggling with high fiscal deficits, rising debt burdens, inadequate infrastructure, and dependence on primary commodities, which also challenge sustainable development. Hence, the international financial institutions have supported the structural reform and tax revenue mobilization programs in developing countries, including Ethiopia (Belinda et al., 2021). The transitional government of Ethiopia has also adopted economic liberalization reforms to stabilize its deteriorating economy and restructure the major sources of revenue, such as direct, indirect, and trade taxes, and modernize the tax administration through a series of fiscal reforms (Geda & Shimeles, 2005; Kassaw, 2023; Mascagni, 2014).

Replacing the 40-year-old, outdated Income Tax Proclamation 173/61, lowering the maximum tax rate from 89% to 35%, streamlining tax brackets, and broadening the tax base through withholding schemes on capital gains, interest, and lottery earnings were some of the issues resolved. Indirect taxation was reformed by replacing the sales tax with VAT and excise tax proclamations, while tariff changes modified both specific and ad valorem rates to encourage trade (Kinde & Alem, 2018). In parallel tax administration initiatives, revenue-collecting agencies were merging into a single autonomous body, which was later upgraded to the Ministry of Revenue. Additionally, the Integrated Tax Administration Systems (SIGTAS), biometric TIN, cash registers, and lately electronic taxation platforms were introduced to better modernize the tax system and revenue mobilization efforts in Ethiopia (Mascagni, 2014; MoF, 2020; Schreiber, 2018).

The Ethiopian economy has recorded a notable annual growth rate of 10.3% between 2004 and 2019. The tax revenue collection has shown an annual improvement at an average of 20% during the period (MoF, 2020, 2024). However, the tax-to-GDP ratio in Ethiopia has been gradually declining since 2015/16. It fell from 12.7% in 2015 to less than 6.1 % in 2024 and the reduction is also got in all major tax categories. Those lower performance outcomes are mostly because of the limited tax capacity, shallow tax base, high informality, and the pressures of globalization on domestic taxation (MoF, 2024). The tax-to-GDP ratio in Ethiopia remained significantly far below the IMF's recommended threshold of 15% (Hegab, 2025). Hence, the governments implemented a tax policy and administration reforms to mobilize adequate tax revenue for financing public services and sustain long-term growth (Junquera-Varela et al., 2017). The relationship between taxation and economic growth has become a global issue, and a number of empirical studies have been conducted to examine it for years.

However, findings have yielded mixed or contrasting conclusions (Gbato, 2017; Hakim et al., 2022; Tala, 2024). Some studies have shown that tax revenue and economic growth are positively correlated (Ajeigbe et al., 2024; Chika et al., 2022; Deresse, 2021; Kessy & Sukartini, 2023), while others discovered a conflicting results or that taxes have failed to mobilize adequate finance to support long-term economic development (Ayana et al., 2023; Victor. & Rapheal., 2024). Additional research also revealed no significant relationship between taxation and growth (Ahmed, 2023; Gbato, 2017), where taxation has failed to positively impact long term growth due to poor tax policy designed or implementation.

The findings of the studies (Ahmed, 2023; Deresse, 2021; Hegab, 2025; Kassaw, 2023) have also offered various contradicting results in Ethiopia due to the difference in variables used, methodology applied (VECM ARDL & Stochastic Frontier Model) and time periods covered during the study. Therefore, unlike previous studies, this study has used an updated time series data from 1991 to 2024 on total tax revenue, tax types, and incorporated macroeconomic and institutional variables into the analysis, and provided better knowledge to the taxation literature. Moreover, by using the ARDL model, this study provides short- and long-term disaggregated impact analyses of tax components on Ethiopia's economic growth and contributes empirical evidence supportive of policy recommendations and future academic research.

This article is organized as follows: Section 2 provides a brief review of the literature on tax revenue mobilization and economic growth. Section 3 presents a methodology including the data, econometric model, and estimation procedures. Section 4 and 5 presented the results and discussion. Finally, the conclusion and recommendations were presented in Section 6.

2. LITERATURE REVIEW

2.1 The Theoretical Models

The neoclassical growth model (Feldstein, 1974; Prescott, 1997; Solow, 1956) argues that taxes affect growth indirectly mainly through saving, investment and leads to change in level of output. The model postulated that fiscal policies like taxation can have only output level effects or transitory effects. Therefore, the long-term effect on growth rate is driven mainly by the technological advancements. However, in later years, the neoclassical growth model was enhanced and broadened by the endogenous growth scholars (Barro, 1990; Barro & Sala, 1992; Lucas, 2008) and included taxation to examine the growth rate of the economy. These growth model confirmed that taxes have an impact on both the long-term growth rate and the stable level of output. Myles (2009) has also made an assessment to incorporate the impact of individual tax components into endogenous model and confirmed the dual effects of taxation on economic growth, where taxation can increase growth by indirectly financing productive public goods and generating positive externalities such as infrastructure, education, and healthcare. According to Bleaney et al. (2001), some taxes can also impede growth by distorting individual and firm behavior. Bleaney et al. (2001) and Myles (2009) have also emphasized that consumption taxes are less distortionary in the economy, and confirmed to enhance long-term growth more than direct income taxes.

The optimal taxation theory by Ramsey (1927) has also argued that the government must raise a required amount of tax revenue with minimum social cost in the economy. This theory also states that the optimal tax system should be designed to balance equity and efficiency while minimizing social losses and preserving incentives to work, save, and invest in the economy. In addition, Mirrlees (1971) has also posited that governments should use observable income information and design marginal rates based on elasticity and social preferences. The public finance theory also suggest that taxes should be used to finance core state functions, public goods (roads, schools, defense), and to maintain macroeconomic stability. Furthermore, governments should also ensure that a good tax systems increase automatically with the

economy, adjusted when necessary without harming the economic growth (Musgrave & Musgrave, 1989). However, developing countries do not raise adequate taxes to support the Sustainable Development Goals due to differences in economic structure and institutional constraints. The studies confirmed that these countries have mobilized a much lower tax-to-GDP ratio due to a high agriculture share of the economy, weak administrative capacity, and low compliance in the tax system (World bank 2023; Dordevic & Maftei, 2025; Musgrave & Musgrave, 1989). Therefore, Bird (2014) advised developing countries to strengthen their administration and build a capacity (to register, audit, and digitalize), and adjust and formalize the economic structure to improve the tax-GDP ratio, mobilize adequate tax revenue to support more stable and sustainable economic growth. Based on these theories and concepts, this study builds an empirical assessment and further examine the impact of taxation on economic growth in Ethiopia.

2.2 Empirical studies in developing countries, including Ethiopia

Many developing countries embarked on tax system reforms aimed at lowering tax rates, broadening the tax base, and enhancing tax administration to foster economic growth (Bird, 2008; Dom & Miller, 2018). Hence, the empirical studies and the findings on taxation and economic growth in developing countries are presented as follows.

Kessy and Sukartini (2023) employed pooled OLS for 21 African countries (including Ethiopia) and analyzed how taxation impacted economic growth over the period 2008-2018. The findings revealed that tax revenue and corporate tax rate positively influenced GDP. The personal income tax rate and taxes on income, profits, and capital gains had adverse effects. Overall, the study concluded that taxes are vital sources of revenue and economic growth in African economies. Focusing on Nigeria, Chika et al. (2022) have examined the influence of tax restructuring on the economy using the OLS regression technique and found that value-added tax (VAT), corporate income tax (CIT), and petroleum profit tax (PPT) exerted a substantial positive effect on economic growth. Whereas, a study by Victor and Rapheal (2024) found a negative relationship between the value-added tax (VAT) and Nigeria's economic growth during 2006-2023.

Ajeigbe et.al., (2024) have advised African economies to generate more tax revenues and promote their economic growth, after examining the impact of tax revenue and public expenditure on Sustainable Development Goals. The study used the GMM model for 45 developing countries from 2010 to 2020 and found a strong direct association between revenues

and other government income sources with economic growth. In the same way, studies in Sierra Leone (Ishmail, 2020) and Ethiopia (Deresse, 2021) have been shown that taxation is a vital source of finance to support long-term growth during the study period. However, Ayana et. al., (2023) employed GMM panel data for 43 Sub-Saharan African countries, including Ethiopia, and examined the interaction between government revenue and institutional quality and their effect on economic growth. The estimated result shows that government revenue harms economic growth during 2010-2022. The estimation result has also altered and tax revenue exhibited positive impact on economic growth when the interaction effect with institutional quality is considered. The findings indicate the need to strengthen revenue management and institutional quality to sustain economic growth in Africa, which is also theoretically supported and recommended by earlier studies (Bird, 2014; North, 1990; Acemoglue et.al., 2004).

On the other hand, Gbato (2017) has examined how taxation affected economic growth in 32 African countries, including Ethiopia, from 1980 to 2010. The results indicate no significant long-term relationship between variables. But the short-term results show that indirect and personal taxes had substantial adverse consequences on economic growth. Hence, the author has also claimed that taxation may be an ineffective policy tool for fostering growth in the area. Similar results have also been found in Ethiopia by Ahmed (2023). The ARDL result has no evidence of a causal long-run relationship between overall taxation, tax categories, and economic growth in Ethiopia from 1990 to 2021. Similarly, Hakim et al. (2022) investigated the impact of direct and indirect taxes on economic development across 137 countries between 2000 and 2020, of which about 1/3 were developed, and the rest were developing countries. Their research showed that direct and indirect taxes harmed economic development in developing countries. But the direct taxes were shown to have a strong positive relationship in developed countries, which indicates that tax structures in developing economies make no substantial contribution to growth.

Dladla and Khobai (2018) have also found that taxation had a negative and statistically significant impact on economic growth in South Africa by using ARDL method for data spanning from 1981 to 2016. Kazak et al. (2024) employed the adjusted OLS model and evaluated the tax curse hypothesis in Turkey over the differentiated effects of direct and indirect taxation using secondary data from 1998Q1 to 2023Q2. The study also indicates that direct taxes support the tax curse hypothesis, while indirect taxes show no significant effect.

Furthermore, the adverse impact of direct taxation is more pronounced in rapidly growing economies but diminishes over time. These studies have similar findings (Alfò et al., 2022; Arnold, 2008) where the traditional taxation and long-lasting growth relationships were empirically assessed and found that a reduction in personal and corporate income tax rates raises the GDP growth rate.

2.3 Gap in Empirical Studies

The above empirical studies showed an inconclusive relationship between taxation and economic growth (Gbato, 2017; Tala, 2024). The studies revealed that some countries recorded a positive relationship between taxation and economic progress (Ajeigbe et al., 2024; Chika et al., 2022; Deresse, 2021; Kessy & Sukartini, 2023), while others (Ayana et al., 2023; Victor & Rapheal, 2024) showed either a negative, mixed, or no link between the two variables. Some studies argue that variation in the findings was mainly due to the differences in institutions, economic development, and administrative capacity (Bird, 2014). Empirical findings have outcomes due to variation in the use of variables, time periods, and methodologies (such as OLS, ARDL, VECM, Stochastic Frontier Model, and GMM). In the same manner, the Ethiopian studies provided the contradicting findings. Some studies (Ahmed, 2023; Gbato, 2017) have found no meaningful relationship between taxation and economic growth, while Deresse (2021) found a positive association between the two variables. Hence, the findings indicate that the outcomes remain unclear. Therefore, this study has used updated taxation data (from 1991 to 2024) from reputable database sources and incorporated macroeconomic and institutional variables to provide more robust Ethiopian-related findings to the global taxation literature. By applying the ARDL framework and considering the short and long-term effects of taxes on economic growth, this study offers new empirical evidence supportive to policy formulation and provides insight for future academic research.

3. METHODOLOGY OF THE STUDY

3.1 Type and Sources of Data

This study examines the impact of tax revenue mobilization on growth in Ethiopia between 1991 and 2024 using an annualized series of data from secondary sources. This period was selected because of the political economy purpose of major tax policy reforms and the structural transformation of the Ethiopian economy from a command-based system to a market-oriented model during this time. The gross domestic product per capita (GDPPC), aggregate

tax revenue, represented by the tax-to-GDP ratio, and its disaggregated components (direct, indirect, and trade taxes) were the macroeconomic variables included in the analysis based on theories and prior studies (Bird, 2008; Gbato, 2017; Hakim et al., 2022; Leykun, 2022). Each variable is described in detail (Table 1) along with its corresponding data sources.

Annual GDP per capita (USD) is used as a dependent variable for economic growth, and data from the World Development Indicators (WDI) database (World Bank, 2025). GDP per capita is widely known as a crucial indicator of fiscal performance and the health of the economy. Total tax revenue and its disaggregated components, as listed in Table 1 below, are expressed as ratios to GDP, a conventional method in empirical literature that facilitates cross-country comparison and serves as a reliable measure of tax effort and performance. The tax revenue and its components data were obtained from the International Monetary Fund's government revenue dataset (IMF, 2024), which provides consistent, internationally comparable information.

The macroeconomic variables (the share of agricultural sector value added in the economy, and institutional quality as a governance variable were included as control variables to isolate the effect of tax variables on the dependent variable and to minimize bias in estimation. Data on the share of agriculture to GDP were secured from the World Bank Development Indicators (World Bank, 2025), and institutional quality data for Ethiopia were from the ICRG – QoG database (Coppedge et al., 2024; The PRS Group et al., 2025). Additionally, government reports, policy documents, and other published secondary sources were used to better understand the economic variables. The study has also used the natural log (Ln) in the econometric analysis to minimize skewness and reduce the variance of the economic variables (Damodaran, 2004).

3.2 Model Specification

The Autoregressive Distributed Lag (ARDL) model was used to examine how taxation has affected Ethiopia's economic growth. The ARDL was chosen due to its methodological advantages compared to earlier cointegration techniques (Pesaran & Shin, 1997). Pesaran and Shin argue that the ARDL is capable of handling variables with different integration orders, whether at the level, first order, or both. Because it successfully handles the endogeneity issues, the model is best at simplifying the long-run relationship, and it is well-suited to small samples. Lastly, it has an integrated system, where the error correction term (ECT) captures the speed of adjustment toward the long-run equilibrium after short-run disturbances. The integration

model is also important in retaining the long-run dynamics while reducing the chance of spurious regression that often results from time series data (Pesaran & Shin, 1997).

Table 1. Type and Sources of Data

Nature of data	Description of Variables	Data Source	Expected sign
GDP per capita	GDP per capita in the year (GDPPC)	World Bank (WDI) database	-
Tax Revenue Mobilization	Total tax revenue as % of GDP in the year. (TR)	IMF- World Longitudinal Revenue Database	+ve
Direct Tax	Direct tax revenue as % of GDP in the year. (TR)		+ve
Indirect taxes on Goods and services	Indirect taxes on goods and services as % of GDP in the year. (IT)		+ve
Trade Taxes	Trade tax revenue as % of GDP in the year (TT)		+ve
Institutional Quality	The estimated value- shows quality of government in policy formulation and implementation (QoG)	ICRG _ QoG Database	+ve
Size of Agriculture in the Economy	% share of Agricultural value in the economy (Agri)	World bank Devel't indicators	+/-ve

Source: Table created by the author from the secondary data (2026)

Consequently, the subsequent equations were established to examine the impact of tax revenue mobilization on Economic growth in Ethiopia.

Model 1 (the Impact of total tax revenue on Economic growth)

$$\text{Ln\_GDPPC}_{(t)} = \partial_0 + \beta_i \text{LnTR}_{(t)} + \beta_i \text{LnMacVar}_{(t)} + \varepsilon_t \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (1)$$

Model 2 (The Impact of each tax type or disaggregated tax revenue on Economic growth)

$$\text{Ln\_GDPPC}_{(t)} = \partial_0 + \beta_1 \text{LnDT}_{(t)} + \beta_2 \text{LnIT}_{(t)} + \beta_3 \text{LnTT}_{(t)} + \beta_i \text{LnMacVar}_{(t)} + \varepsilon_t \ldots\ldots (2)$$

Where GDP per capita at time (t) = represented by $\text{Ln\_GDPPC}_{(t)}$ is the dependent variable, the total tax revenue at time (t) = $\text{Ln\_TR}_{t,}$ the direct income tax at time (t) = $\text{Ln\_DT}_{(t)}$, indirect tax on goods and services at time (t)= $\text{Ln\_IT}_{(t)}$ and trade taxes at time (t) = $\text{Ln\_TT}_{(t)}$ and the control variables : $\text{LnAgri}_{(t)}$ and $QoG_{(t)}$, were all considered as explanatory variables. The α represented the constant, β_I for the coefficient, i for period, and $\acute{\varepsilon}_t$ - the stochastic error term at time t.

The ARDL model enables the analysis of both the short and long-run relationships among variables and their dynamics, especially when there is a long-run co-integration relationship between the variables, and also the variables momentarily diverge from equilibrium. In such

instances, it estimates the speed of adjustment required to restore equilibrium. Thus, the model includes short-run dynamics, as demonstrated below for both tax revenue and its components.

$$\Delta \ln\_GDPPC_{(t)} = \beta_0 + \beta_1 \sum_{i=1}^{p} \Delta lnGDPPC_{t-1} + \beta_2 \sum_{i=1}^{qi} \Delta\, lnTR_t + \beta_3 \sum_{i=1}^{qi} \Delta\, lnAgri_t + \beta_4 \sum_{i=1}^{qi} \Delta\, QoG_t + \partial_{1i}\, LnGDPPC_{t-1} + \partial_{2i}\, LnTR_{t-1} + \partial_{3i}\, LnAgri_{t-1} + \partial_{4i}\, QoG_{t-1} + \varepsilon_t \dots\dots\dots\dots\dots\dots\dots\dots\dots (3)$$

$$\Delta ln\_GDPPC_{(t)} = \beta_0 + \beta_1 \sum_{i=1}^{p} \Delta LnGDPPC_{t-1} + \beta_2 \sum_{i=1}^{q2} \Delta LnDT_t + \beta_3 \sum_{i=1}^{q3} \Delta LnIT_t + \beta_4 \sum_{i=1}^{q4} \Delta LnTT_t + +\beta_5 \sum_{i=1}^{qi} \Delta\, lnAgri_t + \beta_6 \sum_{i=1}^{qi} \Delta\, QoG_t + \partial_{1i}\, LnGDPPC_{t-1} + \partial_{2i}\, LnDT_{t-1} + \partial_{3i}\, LnIT_{t-1} + \partial_{4i}\, LnTT_{t-1} + \partial_{5i}\, LnAgri_{t-1} + \partial_{6i}\, QoG_{t-1} + \varepsilon_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (4)$$

where β_0 is an intercept, i denotes the lag length, $\beta_1 - \beta_6$ for the coefficient of the short run, $\partial_{1i} - \partial_{6i}$, refers to the long-run coefficient of lagged value, Δ refers to the difference operator, and έ is the stochastic error term at time t.

The long-run impact of tax revenue mobilization on economic growth was estimated, after confirming the presence of cointegration and a long-run relationship among the variables, the error correction term, and the adjustment coefficient for tax revenue mobilization (Eq. 5) and for its components (Eq. 6), and incorporated into the ARDL model as follows:

$$\Delta \ln\_GDPPC_{(t)} = \partial_0 + \sum_{i=1}^{p} \partial_1\, \Delta Ln\_GDPPC_{t-1} + \sum_{i=1}^{qi} \partial_2\, \Delta\, Ln\_TR_{t-1} + \sum_{i=1}^{q5} \partial_5\, \Delta LnAgri_{t-1} + \sum_{i=1}^{q6} \partial_6\, \Delta QoG_{t-1} + \delta ECT_{t-1} + \varepsilon_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (5)$$

$$\Delta ln\_GDPPC_{(t)} = \partial_0 + \sum_{i=1}^{p} \partial_1\, \Delta Ln\_GDPPC_{t-1} + \sum_{i=1}^{q2} \partial_2\, \Delta Ln\_DT_{t-1} + \sum_{i=1}^{q3} \partial_3\, \Delta Ln\_IT_{t-1} + \sum_{i=1}^{q4} \partial_4\, \Delta Ln\_TT_{t-1} + \sum_{i=1}^{q5} \partial_5\, \Delta LnAgri_{t-1} + \sum_{i=1}^{q6} \partial_6\, \Delta QoG_{t-1} + \delta ECT_{t-1} + \varepsilon_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (6)$$

Here δ denotes the coefficient of the error adjustment term, also referred to as the speed of error adjustment, representing the previous year's percentage of last year’s disequilibrium that is adjusted annually.

Based on the outlined methodological procedures, variable selection, and analytical approach, the econometric analysis was conducted using the ARDL model in EViews. Before conducting the main testing, several diagnostic tests, including the Breusch-Godfrey LM, the Breusch-Pagan-Godfrey, and the Augmented Dickey-Fuller (ADF), were executed to test for stationarity, serial correlation, and heteroscedasticity tests as proposed by (Engle & Granger, 1987; Pesaran & Shin, 1997). Additionally, the multivariate normality test (Jarque-Bera test) & the model stability test results were evaluated against the CUSUM and CUSUMSQ values. Consequently, the estimated descriptive and regression results generated from E-views are presented in the next section using narratives, tables, and graphs.

4. RESULTS AND DISCUSSION

4.1 Descriptive Analysis:

The descriptive figure below shows that GDP per capita had registered a continuous increase after 2003/04, reaching a maximum of 1134 USD in 2024. The lowest score (109 USD) was recorded immediately after the Ethiopian- Eritrean war (from 1997 to 2001). The Ministry of Finance and international studies have also confirmed that the Ethiopian economy has recorded a notable annual growth rate of 10.3% between 2004 and 2019 (Belinda et al., 2021; Hegab, 2025; MoF, 2024; MOF, 2021). These same studies have also shown that tax revenue collection has improved annually, the lowest per capita was also recorded due to the Ethiopian-Eritrean war (from 1997 to 2002/03) as reported by Mascagni (2014). However, despite the nominal tax collection increments, the tax-to-GDP ratio has been gradually declining since 2015.

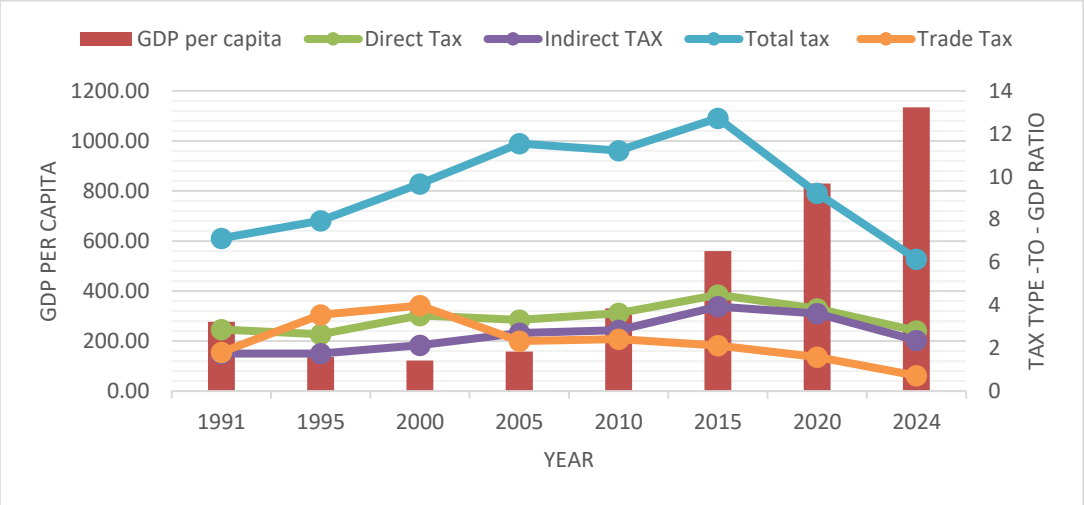


Fig 1: The Relationship between GDP per capita and Tax-to-GDP ratio
Source: Own computation, EViews output 2026

Tax revenue-to-GDP ratio fell from 12.7% in 2015 to less than 6.1% in 2024, and the reduction was also seen across all major tax categories (Hegab, 2025; MoF, 2024). Both direct taxes and indirect taxes on goods and services have exhibited a consistent upward trend, with direct taxes registering the highest mean value of 3.43% of GDP, compared to 2.68% for indirect domestic taxes and 2.46 % for trade taxes. By contrast, trade taxes have declined since 2002/03, decreasing from 4.93 % in 2001/02 to 0.72% in 2024 (see Figure 1).

The Agricultural sector value added, which is also used as a tax base in the economy, has declined from the highest 62.3% in to 31% (see Table 2), which is still higher than the average of Sub-Saharan African countries. It has also been documented that the agriculture sector has constituted more than 64% employed labour force in Ethiopia (MoF, 2024). In addition, the institutional quality index in Ethiopia has an average score value of 0.45 during the study period, signifying a relatively weak or below-average governance structure, weak enforcement, and high corruption compared to the global experience (The PRS Group et al., 2025).

Table 2: Summary of Descriptive Statistics

	Mean	Maximum	Minimum	Std. Dev.	Observations
GDPPC	406.25	1134	109.59	315.2	34
TR	9.72	12.73	5.32	2.09	34
DT	3.43	4.62	1.89	0.70	34
IT	2.68	5.01	1.28	0.88	34
TT	2.46	4.93	0.72	1.05	34
Agri	42.68	62.28	31.22	7.57	34
QoG	0.45	0.55	0.09	0.09	34

Source: Author's Computation (2026)

4.2 Multicollinearity and Correlation Test

The correlation test (see Table 3) confirms that the economic growth is positively correlated with all the regressors and control variables, except for the Agricultural, total and trade tax revenue % share of GDP. The time series data and dynamic models with lagged values violate the OLS the assumption of no autocorrelation in errors and undermine exogeneity and may lead to biased results. But these types of relationships do not necessarily lead to serious problems in dynamic models because the model have built-in specifications to adjust such type of autocorrelation and endogeneity issues (Damodaran, 2004; Wooldridge, 2013). Additionally, the variable selection in such dynamic models also depends on strong theoretical reasoning or practical rationale (Becker et al., 2015; Damodaran, 2004). In addition to the

correlation, the variance Inflation factor (VIF) test was also evaluated to provide more reliable and unbiased results. The variance Inflation factor (VIF) measure of variables indicates that all variables, included in the model, have exhibited a value of less than 10, which indicates that there is no severe multicollinearity problem in the model (Damodaran, 2004) . Therefore, the correlation coefficients and VIF (see Table 4) results confirm that the variables are valid and can be retained to capture reliable results.

Table 3: Correlation Coefficients of Variables

Variables	GDPPC	TR	DT	IT	TT	AGRI	QoG
GDPPC	1.000						

TR	-0.134						
	0.451						
DT	0.255	0.797	1.000				
	0.146	0.000	-----				
IT	0.569	0.612	0.731	1.0000			
	0.000	0.000	0.000	-----			
TT	-0.732	0.302	0.167	-0.336	1.000		
	0.000	0.083	0.346	0.051	-----		
AGRI	-0.662	-0.553	-0.724	-0.747	0.244	1.000	
	0.000	0.000	0.000	0.000	0.165	-----	
QOG	0.388	0.543	0.559	0.531	0.065	-0.807	1.000
	0.023	0.000	0.001	0.000	0.716	0.000	-----

Source: Author's Computation (2026)

Table 4: Variance Inflation Factor (VIF)

Variables	Centered VIF	
	Model 1	Model 2
TR	1.499	
DT		5.280
IT		4.164
TT		2.849
AGRI	3.028	7.411
QOG	2.980	3.958

Source: Author's Computation (2026)

4.3 Stationarity Test

The unit root test was conducted as a pretest to identify whether the time series data is stationary or spurious. The presence of a unit root in the data means that the time series data is not stationary, which also means no constant variance or no constant autocovariance for each given

lag in the ARDL estimation. So, the stationarity tests were conducted, t-tests were computed, and compared against standard critical values to avoid spurious regression or reject the null value. Hence, the ADF result in Table 3 shows that all variables are stationary at the first-order difference I (1). Because no variables are integrated at the second order, the ARDL approach can be appropriately applied.

Table 5: The stationarity test results

Name of Variables	Value at Level I (0)		Value at Level I (1)		Stationary
	T-Value	P-Value	T-Value	P-Value	
LnGDPPC	-0.07	0.944	-3.470	0.015	Integrate at 1st difference
LnTR	-1.341	0.598	-5.283	0.000	Integrate at 1st difference
LnDT	-3.170	0.03	-	-	Integrate at the level
LnIT	-1.525	0.508	-6.524	0.000	Integrate at 1st difference
LnTT	-0.984	0.747	-6.212	0.000	Integrate at 1st difference
LnAgri	-1.610	0.466	-4.729	0.000	Integrate at 1st difference
QoG	-11.72	0.000	-	-	Integrate at the level

Note: the Schwarz Information criterion (SIC). I (0) indicates integration of order 0 or at the level, while I (1) indicates integration of order 1 or after first differencing.

Source: Author's Computation (2026)

4.4 Bounds Test for Co-integration:

Within the ARDL framework, the cointegration relationship is examined using the bounds testing approach. The purpose of this test is to evaluate whether the long-run relationship is absent (null) or not. Hence, Table 6 indicates that the F-statistic exceeds the upper bound of the critical values at all conventional significance levels. Consequently, the evidence leads to rejection of the null hypothesis, confirming that the regressor variables jointly have a cointegration relationship with the dependent variable and also the presence of the equilibrium condition in the long run. The regression results also exhibited that more than 70% of the variations in the dependent variable were explained by the independent variables.

The optimal lag length selection process was also performed using the Schwarz Bayesian information criterion (SBC). The Schwarz information criterion has an important advantage in dynamic ARDL models, penalizing complexities with the minimum information values. Hence, the ARDL with leg length of (1,0,1,0) and (1,0,0,0,1,0) were selected for model 1 and model 2 using the Schwarz information criteria (BIC) at minimum value at (-2.115268 and -1.824121), respectively.

Table 6: The bound test results:

F- Bound Test	Null Hypothesis: No levels of relationship			
	Model 1		Model 2	
Significance level	I (0)	I(I)	I (0)	I(I)
10%	2.37	3.2	2.26	3.35
5%	2.79	3.67	2.62	3.79
1%	3.65	4.66	3.41	4.68
F- statistics	7.37		4.75	
K	3		5	

Note: The Schwarz Information criteria (SIC), Model 1: No constant & no trend; Model 2: Unrestricted constant & no trend specification are used for estimation.

Source: Author's Computation (2026)

4.5 The Long-Run Estimates and Short-Run Adjustments

The ARDL model is useful for identifying both long and short-run relationships and dynamics between variables. The bound test confirmed the presence of a joint cointegration relationship between the dependent and independent variables as indicated by the F-statistic (see Table 6). Therefore, after securing a long-run cointegration relationship and selecting the optimal lag length, it would be better to proceed to the regression results, which show that the error correction term is –0.455 and significant at the 1% level, indicating that 45.5% of past years' disequilibrium is corrected annually.

The long-run regression result (Table 7) demonstrated that overall tax revenue, indirect taxes from goods and services, and trade taxes were statistically negative and significant at the 1% level. But the direct income taxes were found to be positive and insignificant in the long-term periods. This clearly indicates that tax revenue mobilization has a cumulative, significant long-run impact on economic growth in Ethiopia. The total tax revenue has exhibited a regression coefficient of -0.98, which indicates that a 1 % change in tax revenue has a -0.98 % declining effect on economic growth during the period. The negative relation with the long-term growth is the same across all tax types in the study, except for direct income taxes in the long-term periods. The negative sign implies that the tax revenue collected doesn't meet the expected revenue mobilization and sustained growth objectives in the country.

The short-run regression results (Table 7) indicate that immediate changes in taxation have not impacted economic growth during the short-run period. This indicates that the changes in tax revenue don't have an immediate, significant impact. However, the regression results have also

confirmed that the long-run impacts on economic performance are exhibited due to the delayed effects. The short-run effects of changes in taxation have been offset by the immediate effect of tax base changes for direct income and commodity taxes, with tax revenue losses from rate reductions, exemptions, and constrained by weak administrative and institutional factors in the economy.

Table 7: The long-run regression results

Variables	Model 1		Model 2	
	Coefficients	P-Value	Coefficients	P-Value
LnTR	-0.98	0.000**		
LnDT			0.01	0.96
LnIT			-0.67	0.001***
LnTT			-0.22	0.004***
LnAgri	0.44	0.355	1.03	0.21
QoG	-1.35	0.65	-2.34	0.12
The short-run regression result				
D(LnAgri)	0.96	0.000***	1.03	0.000***
CointEq (-1)	-0.455	0.000***	-0.383	0.000***
R^2	0.74		0.72	
Adjusted R^2	0.73		0.70	
Durbin Watson	2.13		2.01	

*Note: The Schwarz Information criteria (SIC), Model 1: No constant & no trend; Model 2: Unrestricted constant & no trend specification are used for estimation. P-Value *** denotes 1%, ** 5%, & * 10%.*

Source: Author's Computation (2026)

Hence, the overall regression results (Table 7) indicate that changes in total tax revenue and tax types have not impacted economic growth during the short-run period. This indicates that the changes in taxation revenue don't have an immediate, significant impact. The taxation literature in developing countries, particularly in Africa (Kande, 2026; Kebede et al., 2025; Lawa et al., 2025) have also confirmed that taxation has no and/or an insignificant immediate impact on economic growth. The short-run effects of changes in taxation have been offset by the immediate effect of tax base changes for direct income and commodity taxes, with tax revenue losses from rate reductions, exemptions, and constrained by weak administrative and institutional factors in the economy (Hegab, 2025; Nair et al., 2025). However, the regression results have also confirmed that taxation has significant long-run impacts on economic performance, which are exhibited due to the delayed effects.

Indirect tax revenue from goods and services, and trade taxes have demonstrated statistically negative and significant regression coefficients at the 1% level in the long run. According to studies in developing countries, indirect taxes (VAT & Excise taxes) have a similar negative effect on long-run growth by means of increasing the cost of consumption and production, increasing inequalities, and indirectly affecting economic growth (Babu et al., 2020; Mpofu, 2022). The trade taxes were inversely related to long-term growth, which indicates a clear picture that Ethiopian tax collection capacity from international transactions has been hampered by erratic trade transactions and limited administrative capacity. This was also consistent with earlier study (Hakim et al. 2022), which showed that tariff rates have a reverse association with imports and purchasing power in the economy. Empirical study in developing countries (Gnangnon, 2023) has also shown an adverse link between trade taxes and economic growth due to the economic structure and prevalence of shadow economies. Moreover, similar studies in Ethiopia (Hegab, 2025; Nair et al., 2025) also confirms that high informality in the economy and low institutional capacity have limited the trade tax revenue collection from economic transactions.

The findings (in Table 7) demonstrated that total tax revenue has negatively impacted the economic growth in Ethiopia. This clearly indicates that tax revenue mobilization has a cumulative, significant long-run impact on economic growth in Ethiopia. The prior empirical evidence also displays that the Ethiopian tax system has encountered numerous challenges in generating sufficient tax revenue to support economic development in Ethiopia (Ahmed, 2023; Hegab, 2025; Kassaw, 2023). Specifically, Leykun (2022) has clearly stated that the Ethiopian economy is under-taxed, with a large tax gap and low tax effort, mainly due to policy choices and enforcement mechanisms. Some studies in developing countries (Hakim et al., 2022), Sub-Saharan Africa (Gbato, 2017), and South Africa (Dladla & Khobai, 2018) discovered comparable findings that taxation has exhibited a weaker or no impact on long-term growth. The other group of studies in Nigeria and Gambia (Touray & Jahaveh, 2024; Lawa et al., 2025) have also exhibited the same negative relation with economic growth, indicating that taxation is not used for long-term productive investments.

Similarly, findings on direct income taxes have also had a positive, but statistically insignificant impact on long-term economic growth, like other countries in developing countries. The authors have highlighted that this weak relation was due to the low tax-to-GDP ratio, which is below the threshold to stimulate economic growth (Kubaje et al., 2025; OECD/AUC/ATAF,

2025). A study conducted in Sub-Saharan African countries also found a similar insignificant finding between income tax and economic growth (Gbato, 2017). Ethiopian studies exhibited that direct taxes (personal and corporate) have a weaker link with economic transactions. This was attributed to structural and administrative inefficiencies that constrained adequate tax revenue to finance sustained economic growth (Hegab, 2025; Nair et al., 2025).

The Agricultural sector variables included in the study as control variable has exhibited positive and significant results in the short run. The regression result showed that a one % change in the agricultural sector will result in a 0.96% increment in economic growth during this period. This signifies that agriculture, which is the main economic sector and the largest employer of the labour force, also serves as a major source of exports and output productivity in the country. However, the estimation result revealed a statistically weaker impact on economic growth in the long run. The positive effects were due to the sector's larger share in the economy, including exports, mechanization, and output productivity in the country (Hailu, 2024; Rahman & Jannat, 2025). However, the long run has no strong impact, because the sector's low-value products, low productivity, and subsistence farming have a weaker impact on long-term growth. Maiga (2024) has also found the same positive association between the agricultural sector and GDP growth in five African countries. But he has also observed that the impact is not strong, due to inadequate technology, mechanization, and an underdeveloped market (Sassi, 2026).

Furthermore, the institutional quality variable was also included in the model to capture a governance effects such as tax policy design, administration and implementation capacity. The institutional theories argue that strong institutions enhance tax revenue collection capacity and support long-term economic growth (Acemoglu et al., 2004; North, 1990). But, in this study, the change in institutional quality has no statistically significant impact on economic growth in the short-run periods, indicating that institutions in Ethiopia need capacity and will be improved gradually. However, the insignificant result persists over the long run. The weaker long-run link between these variables and economic growth was attributed to weaker administrative and structural constraints in the Ethiopian economy (Hegab, 2025; MoF, 2024), which is also a similar finding to other studies in developing countries (Kebede, 2017; Olalekan & Mbaya, 2023). A similar study was conducted to evaluate the effect of institutions using GMM in African countries and found that institutional quality has no long-lasting effect on economic growth in Africa. They also pointed out that the reason for underperformance in most

African countries was due to the low institutional quality to stimulate financial development (Ekeocha et al., 2023).

4.6 The Diagnostic Tests

In this section, the post-estimation tests were conducted to check the robustness and stability of the results. These tests included the autocorrelation test, the normality test, the heteroskedasticity test, and the Ramsey and CUSUM plot tests. The estimated results show no evidence of serial correlation based on the Breusch-Godfrey serial LM test and no heteroscedasticity problems based on the Breusch-Pagan test.

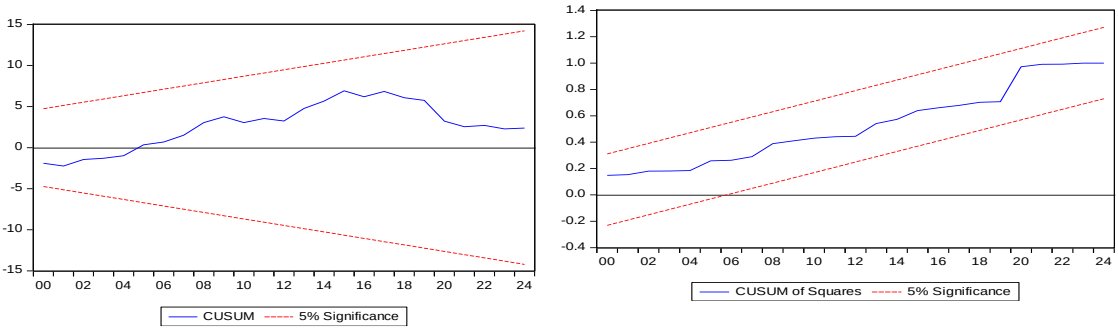
Table 8: Diagnostic tests of the model

Diagnostic tests	**F-statistics**	**P-value**	**F-statistics**	**P -value**
	Model 1		Model 2	
Normality Test	2.570	0.276	0.748	0.688
Serial Correlations	0.189	0.829	0.887	0.439
Heteroscedasticity	0.069	0.976	1.934	0.124
Ramsey Test	0.389	0.538	3.928	0.071
CuSum & Cusum Square	Stable		Stable	

Source: Author's Computation (2026)

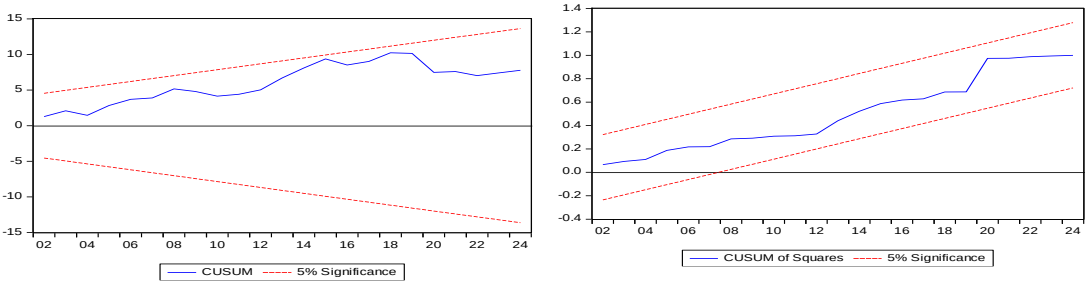
The Ramsey (RESET test) and Jarque-Bera normality tests also confirm that the residuals are normally distributed and that the model is well specified, rejecting the null hypothesis at p-values exceeding 5% significance level. Table 8 presents the estimated values of each test with the F-statistics and p-Values. Therefore, the overall estimated ARDL model, which was tested against a series of diagnostic tests to ensure the validity, reliability, and robustness of findings, confirmed that the estimations show no evidence of serial correlation & no heteroscedasticity problems. Furthermore, the Ramsey and Jarque-Bera tests also confirmed that the residuals are normally distributed and that the model is well specified, all attained by the decision of not rejecting the null hypothesis at p-values exceeding 5% significance level. The CUSUM and CUSUMSQ (see Figures 2 & 3) statistical tests were also used to evaluate model stability within the 5% confidence bound and confirmed the stability of the estimated short and long-run coefficients. Therefore, all test results confirm that the estimation is reliable and have validated the findings for interpretation and policy recommendation.

Figure 2: CUSUM & CUSUM Square for Model 1



Source: Regression output from EViews 10 (2026)

Figure 3: CUSUM & CUSUM Square for Model 2



Source: Regression output from EViews 10 (2026)

5. CONCLUSION AND RECOMMENDATIONS

This study aimed to examine how tax revenue mobilization has affected economic growth in Ethiopia. The findings revealed that the Ethiopian economy has shown some progress during the study period. However, the tax-to-GDP ratio has remained the lowest at 6.16% GDP (in 2024), far below the average for peer Sub-Saharan African countries and the internationally recommended minimum of 15% needed to support development goals. Findings of the study revealed that tax revenue in Ethiopia has a strong impact on long-term growth. Each tax type has also exhibited mixed findings and does not provide the expected positive and significant results as hypothesized in the study. Furthermore, the immediate and long-term effects of taxation in Ethiopia were hampered by structural and institutional challenges, such as the large farming sector, which is also dominated by informality and subsistence farming. In addition, the low level of administrative capacity and digitalization would also hamper effective collection and funding of those resources for productive long-term expenditures.

The economic structure of Ethiopia is also dominated by the agricultural sector, which is one of the major sources of GDP and the main employer of the labor force compared to Sub-

Saharan African countries. Therefore, studies confirmed that economies with a larger agriculture share, characterized by high informality, low productivity, and less mechanization, have faced challenges in improving tax collection and sustaining economic growth. In addition, the huge infrastructural gaps have been found to worsen tax administration problems, which is also evidenced by the negative relationship and insignificant impact of institutional quality and economic growth.

According to studies, it is advisable to broaden the tax base, reduce exemptions/holidays, and strengthen tax administration (registration, enforcement, and auditing, and digitalizing) rather than rate changes. Moreover, restructuring the tax system, formalizing and modernizing the economic structure, and also strengthening the institutional capacity is critical to improving tax mobilization efforts and supporting long-term economic growth in the country.

This study may have limitations due to time constraints, the variables used, and the sample size selected, which is focused on the Ethiopian economy. Hence, this may limit the generalizability of the findings to other developing countries. Future studies should be conducted by broadening the geographic dimension and including emerging issues (e.g., environmental taxation and e-taxation) for a better understanding of the relationships between tax revenue mobilization and economic growth.

Statements and Declarations

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Conflict of Interest

The authors have no competing financial, professional, or personal interests from other parties.

Data Availability

The data used in the study are available in the World Revenue Longitudinal Database. Available at: https://www.imf.org/en/Topics/fiscal-policies/world-revenue-longitudinal-database and the GDP per capita data at the *World Development Indicators Database*. Available at: https://datacatalog.worldbank.org/dataset/world-development-indicators

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