

Impact of Indirect Tax to the Economic Growth of Nepal

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Abstract

This study looks at the structure and trends of indirect taxation in Nepal as well as how much indirect taxation contributes to the country's GDP. The economic growth is measure by GDP. The purpose of the study is determining the impact of value added tax, custom and excise duties on economic growth in Nepal. This study is based on secondary data that was released by the Nepal government between the fiscal years 2002/03 and 2022/2023. The research has embraced the casual comparative approach of analysis. It uses correlation, regression and coefficient of determination for examine the impact of VAT, Custom duty and excise duty to GDP. Over the course of the investigation, the indirect taxes percentage contribution to GDP varies between 6.60 and 14.96. Compared to previous years, the percentage contribution reduced in 2019/20 and 2022/23 but continued rise with the fluctuation pattern until 2021/22. The study concludes that there is positive relationship between different types of indirect tax and the economic growth. However, indirect tax revenue positively impacts to GDP over the study period.

Keywords: GDP, direct tax, indirect tax, economic growth, developing countries

Introduction

One of the catchphrases that is most commonly used in all developing nations is economic development. The majority of government efforts in developing nations have been focused on development methods that achieving high rates of economic growth, reducing income gaps poverty and raising the standard of living for citizens (Puri, 2011). Economic growth is a transitory process that results in progressive, well-ordered socioeconomic change or an improvement in life quality (Akhor & Ekundayo, 2016). Our country Nepal has been trying to resolve major economic issues still trapped in poverty, lack of job opportunities, unstable governments, discrimination against gender and racism. In addition, Economic growth has proven challenging to achieve with enough food, clothes, shelter, and safety due to the population's rapid growth, which is outpacing the capability of available resources. It is true that there are significant variations throughout nations

with regard to population, wealth, resource availability, cultural features, and the extent and proficiency of the public sector (Abd Hakim, 2020).

There are two ways to raise tax either by indirect tax or direct tax. The Tax payer and tax bearer are on the same person in direct tax e.g. income tax, property tax etc. Indirect tax simply implies that a tax in which the burden or incidence of tax does not directly fall on the taxpayers but shifts towards other persons and the real income are affected indirectly e.g. Value Added Tax, custom duties, Excise duty etc. Indirect tax is flexible and payable by all recipients of goods and services, there is widespread participation (Ilaboya & Mgbame, 2012). Gross capital formation, labor force, political stability, inward foreign direct investment, human capital, and taxation on goods and services have all been supportive to domestic credit growth. Long-term effects of private investment on economic growth are negative and substantial (Rehman et al., 2020).

There are several issues with the government, including low government initiation, a lack of trained personnel, irresponsible taxpayers, lengthy tax refund processes, delays in the registration process, tax evasion, illegal trade caused by open borders, inadequate billing systems, inefficient VAT administration systems, unaware customers, and inefficient VAT collection (Chamlagain, 2018). Direct and indirect tax receipts are closely correlated with its GDP and government revenue (Ghimire, 2019). Long-term indirect taxes have a negative and substantial impact on economic growth, although their short-term effects were negligible (Ahmad et al., 2018). Indirect taxes play a major role in the Nepalese tax system, and this trend is expected to continue unless the tax system undergoes significant changes (Pangeni, 2009).

Statement of the Problem

Developing countries are typically characterized by rapid population increase, significant unemployment, improper use of limited resources, poor per capita income, etc. The government must allocate its funds in order to achieve rapid economic expansion. Because of this, income should be higher than expenses (Chamlagain, 2018). The statement of problem is current issue regarding area of interest of researcher. Fiscal instruments include revenue mobilization, international grants and loans, domestic borrowings, and changes in the cash reserve (Basaula, 2019). The study seeks to find out the answer of the following research question.

- What is the impact of value added tax on economic growth in Nepal?
- What is the impact of custom and excise duties on economic growth in Nepal?

Purpose of the Study

The purpose of the study are: -

- To determine the impact of value added tax on economic growth in Nepal
- To evaluate the impact of custom and excise duties on economic growth in Nepal.

Research Methodology

Research methodology describes the methods and process applied in the entire study. It helped us to find out accuracy, validity, and reliability of the research work.

Research Design

Research design means blue print of research. The causal comparative research design has been used to analyze the relationship between indirect tax and GDP in this study.

Instrument: Following instrument is used in this study.

Correlation Analysis

Correlation analysis is defined as the statistical technique which measures the direction of relationship (or association) between/among the variables. In other words, it helps in studying the covariance of two or more variables. Correlation analysis does not tell anything about cause-and-effect relationship i.e. if there is a high degree of correlation between the variables, it cannot say which cause is and which the effect is. The coefficient of correlation can range between -1 and +1. And unless the r is exactly or very near to +1, -1 or 0, its meaning remains more or less unclear. A positive r indicates that the two variables move in same direction whereas a negative r value indicates that the two variables move in opposite directions.

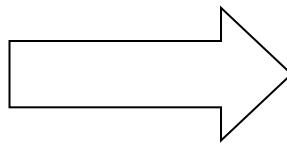
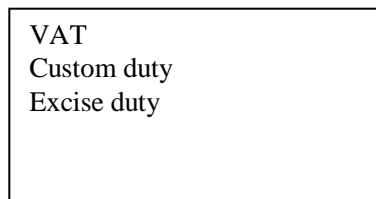
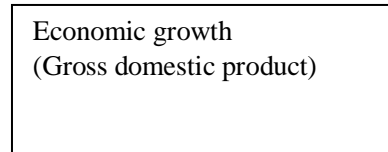
Regression Analysis: - Regression analysis is a set of statistical processes for estimating the relationships among variables. It includes many techniques for modeling and analyzing several variables, when the focus is on the relationship between a dependent variable and one or more independent variables (or 'predictors'). More specifically, regression analysis helps one understand how the typical value of the dependent variable changes when any one of the independent variables is varied, while the other independent variables are held fixed.

Coefficient of determination

One very convenient and useful way of interpreting the value of coefficient of correlation between two variables is coefficient of determination. The square of coefficient of correlation is coefficient of determination. It examined the effect of explain variable and unexplained to the result.

Conceptual Framework

As per the review of articles, previous thesis and related books the total revenue of government is affected by tax revenue and non-tax revenue. Tax revenue includes the direct tax and indirect tax. Similarly, direct tax consists income tax, property tax, vehicle tax etc. and indirect tax includes the value added tax, excise duty, custom duty etc. The tax revenue covers highest percentage of total revenue. Non tax revenue comprises charges, fees, and fines receipts from sale of commodities and services. Non tax revenue has contributed lower percentage as compare to tax revenue in total revenue. Ultimately, they have positive or negative effect on revenue generation in Nepal. In this original research work the variable for conceptual framework are: -

Independent Variable**Dependent Variable**

(Chamlagain, 2018).

Custom Duty

A custom duty is a levy that is applied to both the import and export of goods. It is a border tax. A key part of trade policy is customs policy, which consists of all laws and rules that the government issues through its authorized agencies to control the entrance or departure of commodities from a nation (Postole & Ciobănașu, 2013).

Nepalese customs administration collects custom duty, value added tax, excise duty and other taxes at the border points. The government of Nepal has enacted Custom Act 2064 with an aim to amend and consolidate the prevailing custom laws in order to make safe and facilitate international trade by making custom administration systematic, transparent and accountable.

Excise Duty

An Excise duty is broadly defined as an inland tax on the production or sales of a specific good. Due to their lack of attention in the tax literature, excise taxes were formerly referred to as the orphans of tax policy (Cnossen, 2011).

Excise duty is an indirect tax, meaning that the producer or seller who pays the tax to the government is expected to recover the tax by raising the price paid by the buyer. Excises duty is typically imposed in addition to another indirect tax such as a VAT. In common terminology an excise duty is distinguished from VAT in three ways: 1. Excise duty is applied to a narrower range of products. 2. An excise duty is heavier, accounting for higher fractions of the retail prices of the targeted products. 3. An excise duty is specific.

Value Added Tax

Value Added Tax (VAT) has become an integral part of domestic tax reforms in many developing countries. In the instance of Nepal, VAT links several reimbursements to various private sector endeavors to encourage investment in areas with greater potential for growth and export (Acharya, 2016).

VAT is an indirect tax. It is an improved and modified form of sales tax. It is levied on value added of goods and services at each stage in the process of production and distribution chain. These stages can be import, manufacturing, wholesale and retail. Value added for a firm is sales value minus all expenditures on goods and services purchased from other firms. Although VAT is eventually borne by the final consumer, it is collected at each stage of production and distribution chain.

Limitation of the study

The information and data were collected from the Economic survey, MOF and other concerned offices. The limitation of the study will be.

- The study is based on primary and secondary data
- This study has been concentrated about effect of Value Added Tax, Custom duty and excise duty to GDP.
- It is not complete study of the whole tax system in Nepal.

Result and Discussion

Based on the above literature review, data were taken from various secondary sources from 2002/2003 to 2022/23 has been analyzed in this subheading. At present, VAT, customs, excise duty and other taxes are the major sources of indirect tax in Nepal.

Table: 1 Composition of Indirect Taxes in Nepal (In crore rupees)

Fiscal year	GDP	Custom Duty	Excise duty	VAT	Others	Total indirect tax
2002/03	49220	1423	478	1346	-	3247
2003/04	53680	1555	623	1448	-	3626
2004/05	58910	1570	645	1889	-	4104
2005/06	65410	1534	651	2161	-	4346
2006/07	72780	1671	934	2610	-	5215
2007/08	81510	2106	1119	2982	-	6207
2008/09	98830	2679	1622	3972	1.65	8275
2009/10	119280	3515	2431	5509	16.71	11472
2010/11	137500	3571	2654	6187	20.45	12432
2011/12	153600	4339	3002	7093	27.41	14461
2012/13	170119	5689	3666	8351	47	17753
2013/14	194262	6798	4541	10110	49	21498
2014/15	218661	7100	5253	11516	55	23924
2015/16	234140	7794	6578	12241	65	26678
2016/17	272056	9854	8481	16107	77	34519
2017/18	301102	12172	10258	20681	81	43192
2018/19	334248	13725	12185	24012	87	50009
2019/20	342853	11770	10393	22402	98	44663
2020/21	371493	16818	8159	28192	103	53272
2021/22	425598	18731	10313	31423	107	60574
2022/023	473898	14275	10410	28660	201	53546

Sources: Economic Survey 2002/03, to 2022/23 and Revenue Advisory Committee Report 2015, by Ministry of Finance, Kathmandu, Nepal

Table: 2 Indirect Taxes % on GDP

Fiscal year	GDP	Total indirect tax	Percentage (%)
2002/03	49220	3247	6.60
2003/04	53680	3626	6.75
2004/05	58910	4104	6.96
2005/06	65410	4346	6.64
2006/07	72780	5215	7.16
2007/08	81510	6207	7.61
2008/09	98830	8275	8.37
2009/10	119280	11472	9.61
2010/11	137500	12432	9.04
2011/12	153600	14461	9.41
2012/13	170119	17753	10.43
2013/14	194262	21498	11.06
2014/15	218661	23924	10.94
2015/16	234140	26678	11.39
2016/17	272056	34519	12.68
2017/18	301102	43192	14.34
2018/19	334248	50009	14.96
2019/20	342853	44663	13.03
2020/21	371493	53272	14.33
2021/22	425598	60574	14.23
2022/23	473898	53546	11.30

Table: 3 Correlation and coefficient of determination

Variable	Correlation (r)	Coefficient of determination (r^2)
Custom duty and GDP	0.97	0.9409
Excise duty and GDP	0.9482	0.8990
VAT and GDP	0.9863	0.9728

Table: 3 Regression Analysis

Independent Variable	Dependent variable	Intercept (a)	Slope(b)
Custom duty	GDP	38196.24	23.0483
Excise duty	GDP	48364.82	30.7817
VAT	GDP	48841.17	12.8701

From above calculation the indirect tax are continuously increasing trends in each year. It is continuously increase since 2002/2003 to 2012/2013 after that little bit fluctuate up to 2022/2023. The correlation of various type of indirect tax and GDP is perfectly positive; it indicates increase in indirect tax increase the GDP and vice versa. The coefficient of determination is portion of explain variable. The coefficient of determination is less than 1, it symbolizes that it has some unexplained variable to study of GDP. The slope of regression is positive, it shows positive effect of indirect tax and GDP.

Conclusion

The study concludes that there is a positive relationship between indirect tax and economic growth of Nepal. There is positive significant impact of VAT, Excise duty and Custom duty on economic growth of the Nepalese economy.

It appeared that the indirect tax made up a larger portion of the revenue. Excise duties, customs duties, and VAT like that taxes were used to collect the bigger portion of the tax.

The outcome demonstrates VAT's superiority over other indirect tax categories. Indirect taxes are essential at the early stages of economic development. However, direct taxes become important if economic development reaches a certain level.

When it comes to economic development, indirect taxes have a number of significant benefits. These include: maximizing government revenue for capital investment and infrastructure financing; more efficiently redistributing luxury consumption, which allows for higher rates of saving and investment; limiting the import of luxury goods, which secures a significant amount of foreign exchange, administrative use and less detrimental to incentives than direct taxes.

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