Terms of trade volatility and tax revenue in Sub-Saharan African countries

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Terms of trade remain inherently volatile in the global market, exerting pressure on tax revenue with the resulting change in prices and trade (export or import) volumes. This study investigated the empirical relationship between terms of trade volatility from a regional perspective using a dynamic bias corrected model. A corrected dynamic fixed effect and one-step diff-GMM models are used to estimate the effect of terms of trade volatility using a set of panel data for 41 sub-Saharan African (SSA) countries from 1990 to 2022. The findings show that terms of trade changes have a positive effect on tax to GDP ratio and its volatility has indirect negative effects. Informal economic activities tend to deteriorate tax revenue in SSA. Thus, terms of trade volatility depress growth of GDP per capital and tax base in SSA. The findings imply the need for hedging the risks associated with terms of trade volatility, intensifying agriculture production and increasing the speed of formalizing informal sectors in order to reduce associated risks of depressing tax base in SSA.

Keyword: Corrected bias, One-step diff-gmm model, Tax base, Terms of trade volatility

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