FISCAL AFFAIRS

The VAT: An Overview of Developments and Issues

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The curious idea of Friedrich von Siemens

A tax charged on all sales but with credit or refund of tax charged on purchases

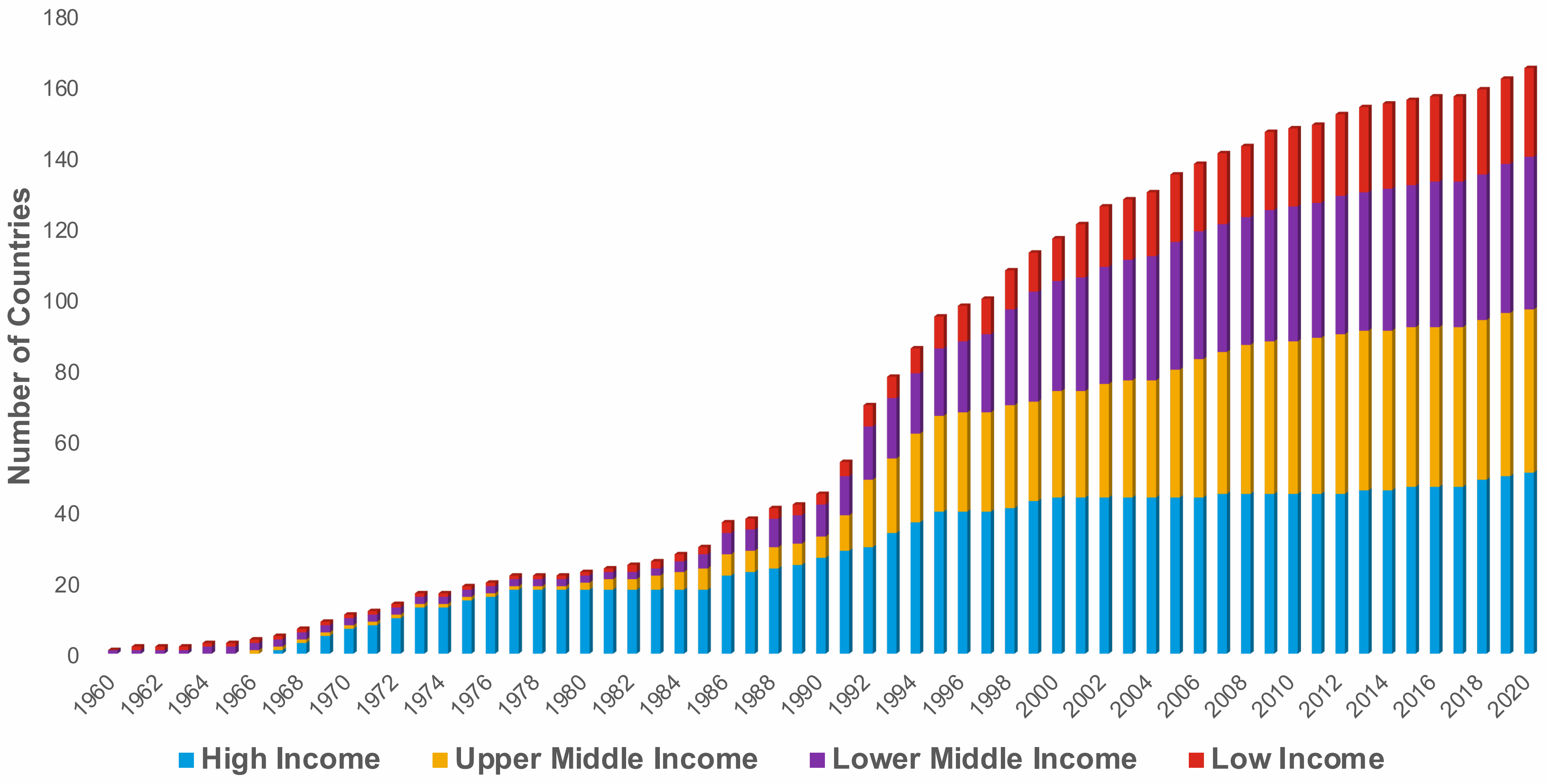
Clever because:

- Does not ‘stick’ on businesses’ input decision (unlike turnover tax)
- Revenue protected if compliance chain breaks (unlike retail sales tax)

So long, that is, as everything works well…

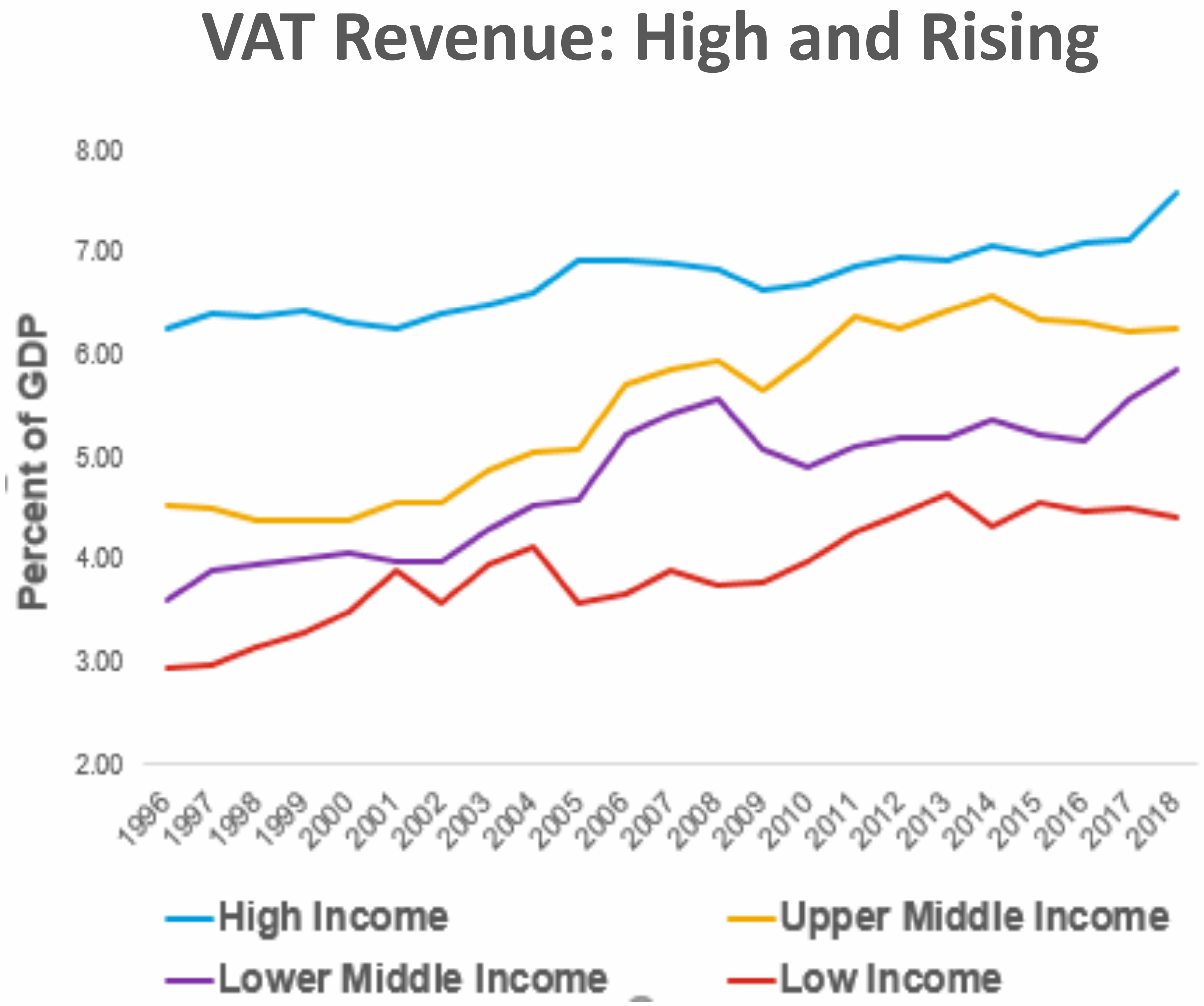
In little more than fifty years, from zero to 30 percent of all the world’s tax revenue

The Rise of the VAT



Source: IMF Internal International Tax Rates Database

Has the VAT done its job?



Key questions

- Do countries with a VAT raise more revenue that those without?

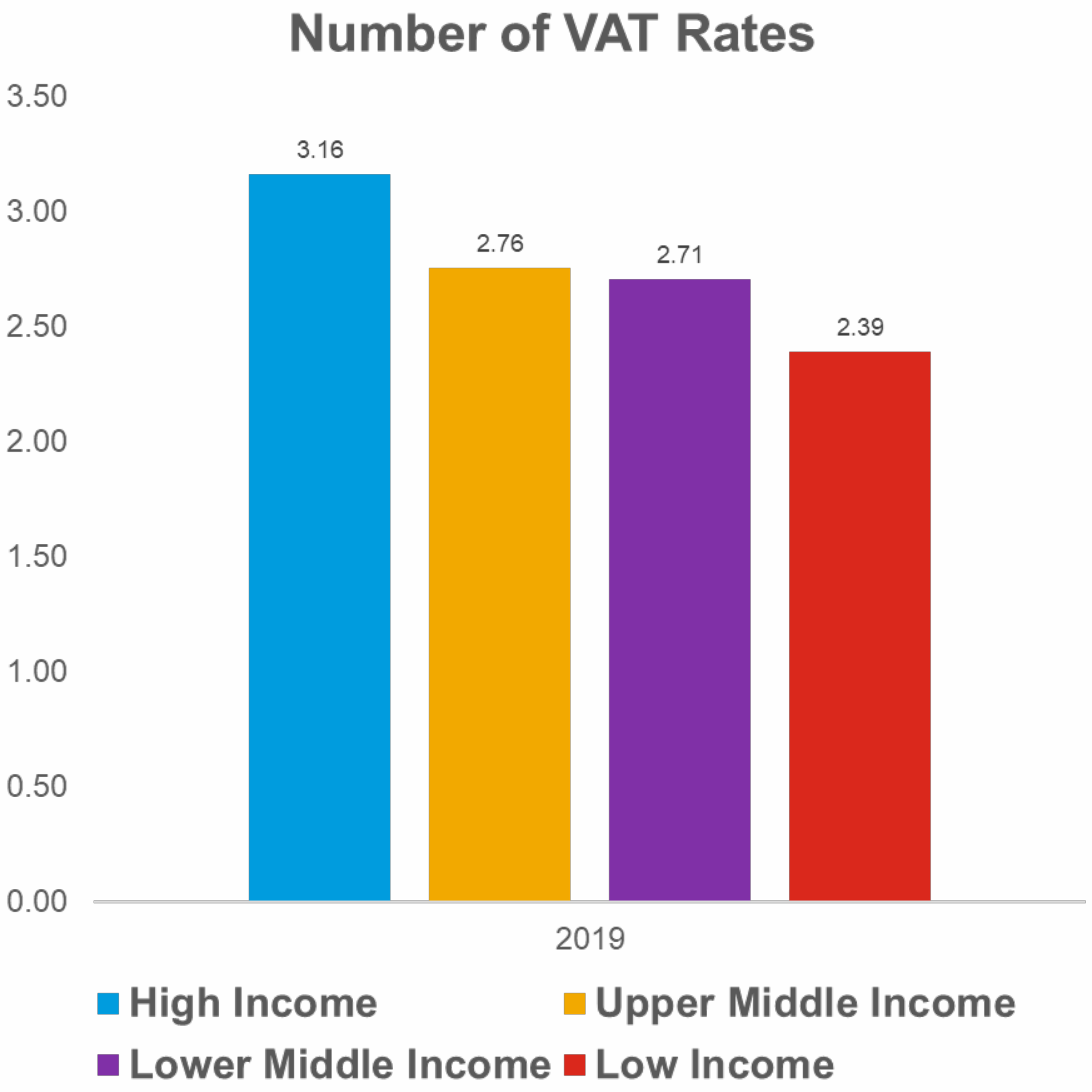
- Yes, except mixed results for SSA

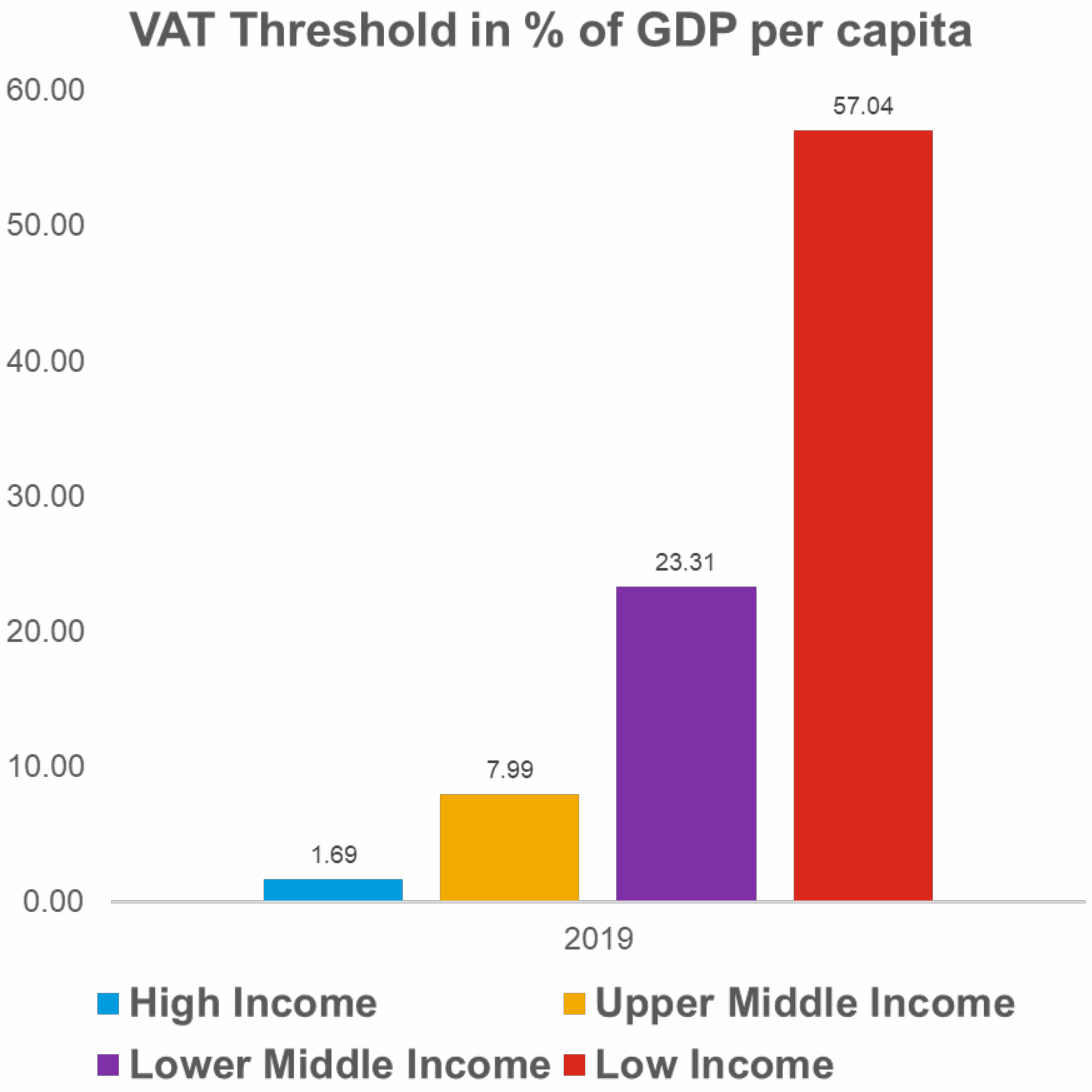
- Is the VAT more growth friendly than other taxes?

- Yes, but design matters: broadening the base is better for growth than raising the rate

Source: IMF Internal World Revenue Longitudinal Database (WoRLD)

But VATs differ widely





Source: IMF Internal International Tax Rates Database

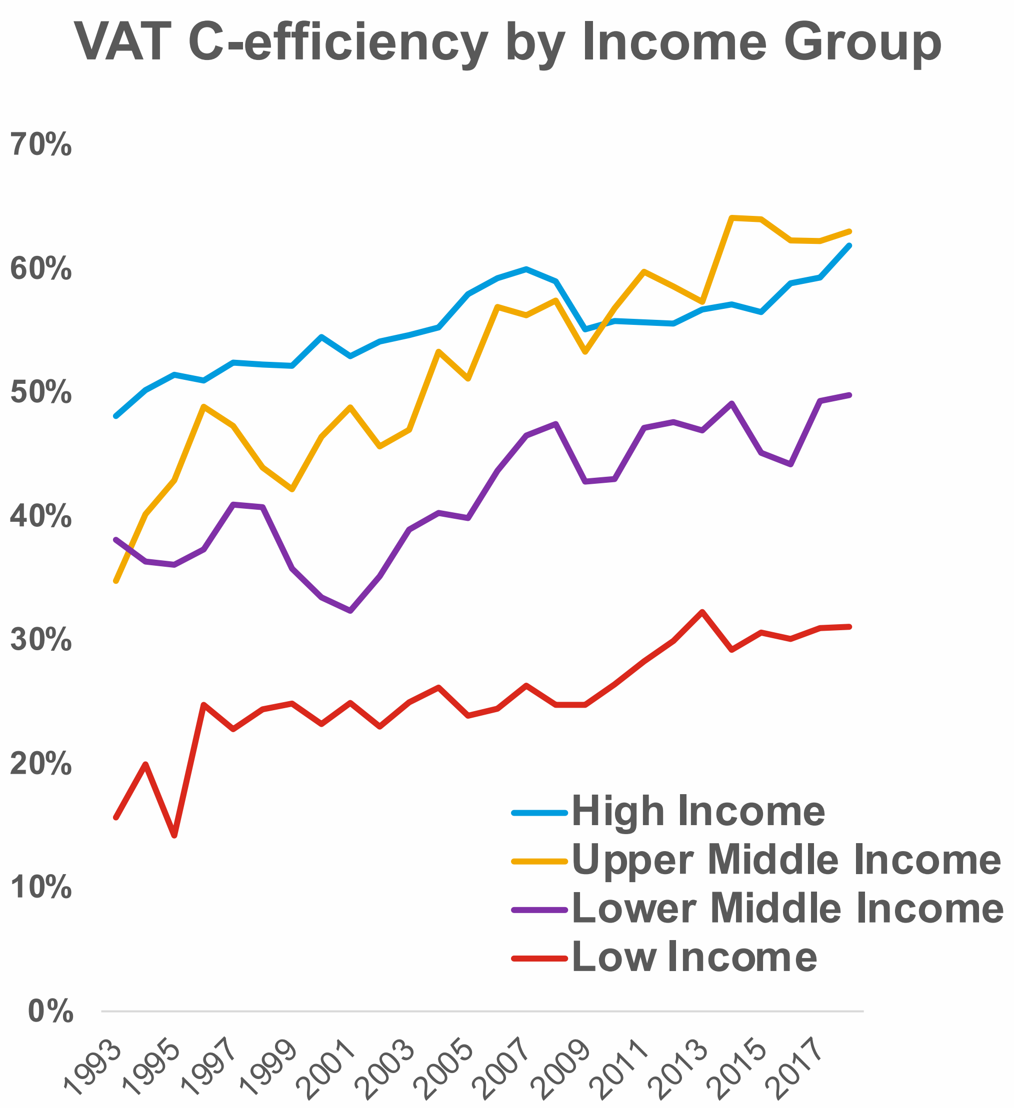
Trends in C-efficiency

A handy indicator:

$$\text{C-efficiency} = \frac{VAT\ revenue}{Standard\ rate \times Final\ consumption}$$

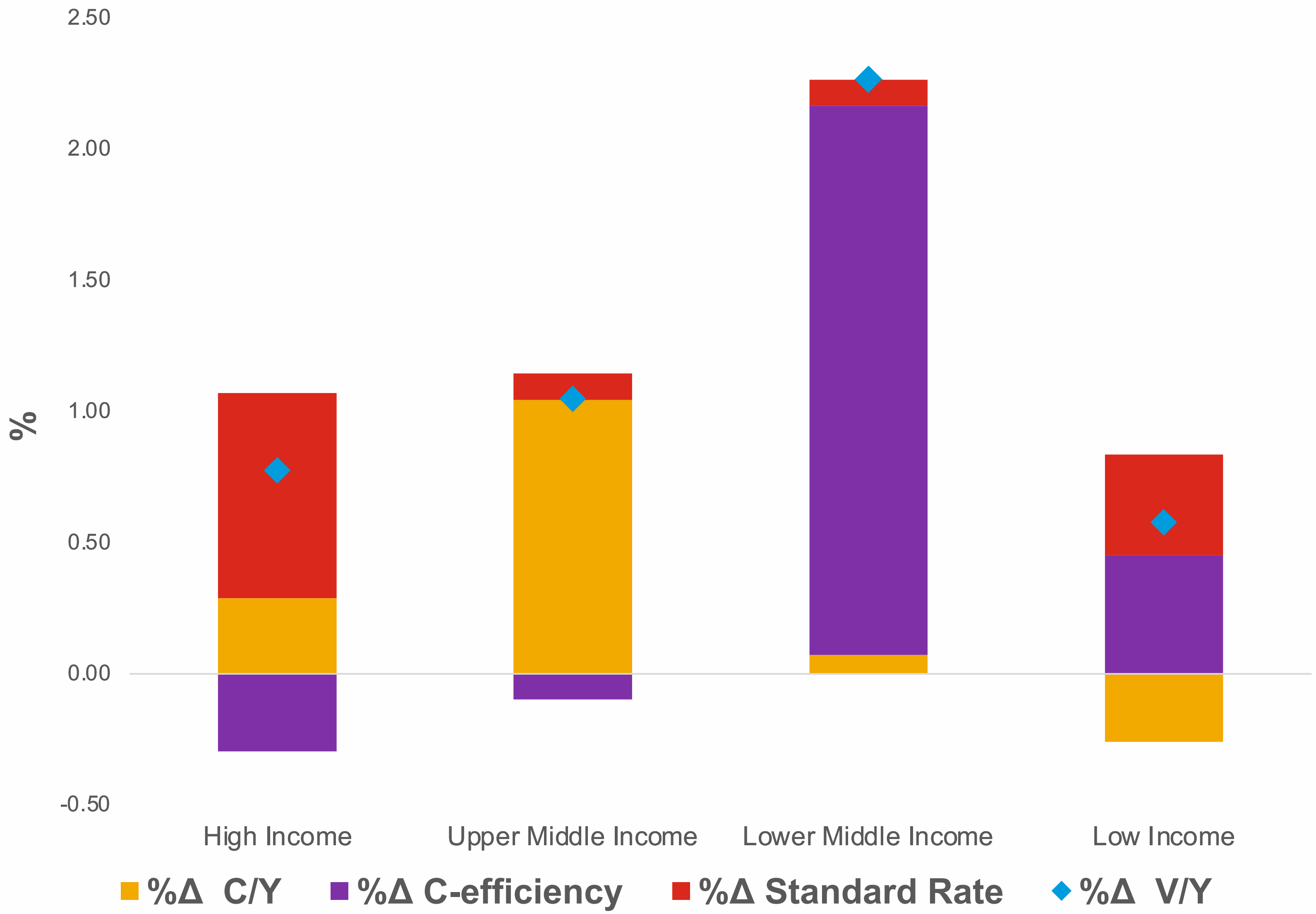
(also known as the VAT revenue ratio)

- This is 100 percent for a 'perfect' VAT (or possibly a very bad one)
- And gives a sense of revenue potential: if LIDCs in the lowest quartile by C-efficiency were to raise it to the LIDC median, they would raise additional revenue of around 3.5 percent of GDP.



Source: IMF Internal World Revenue Longitudinal Database (WoRLD), Internal International Tax Rates Database, World Economic Outlook Database (WEO)

What drives VAT revenue? (2008-2018)

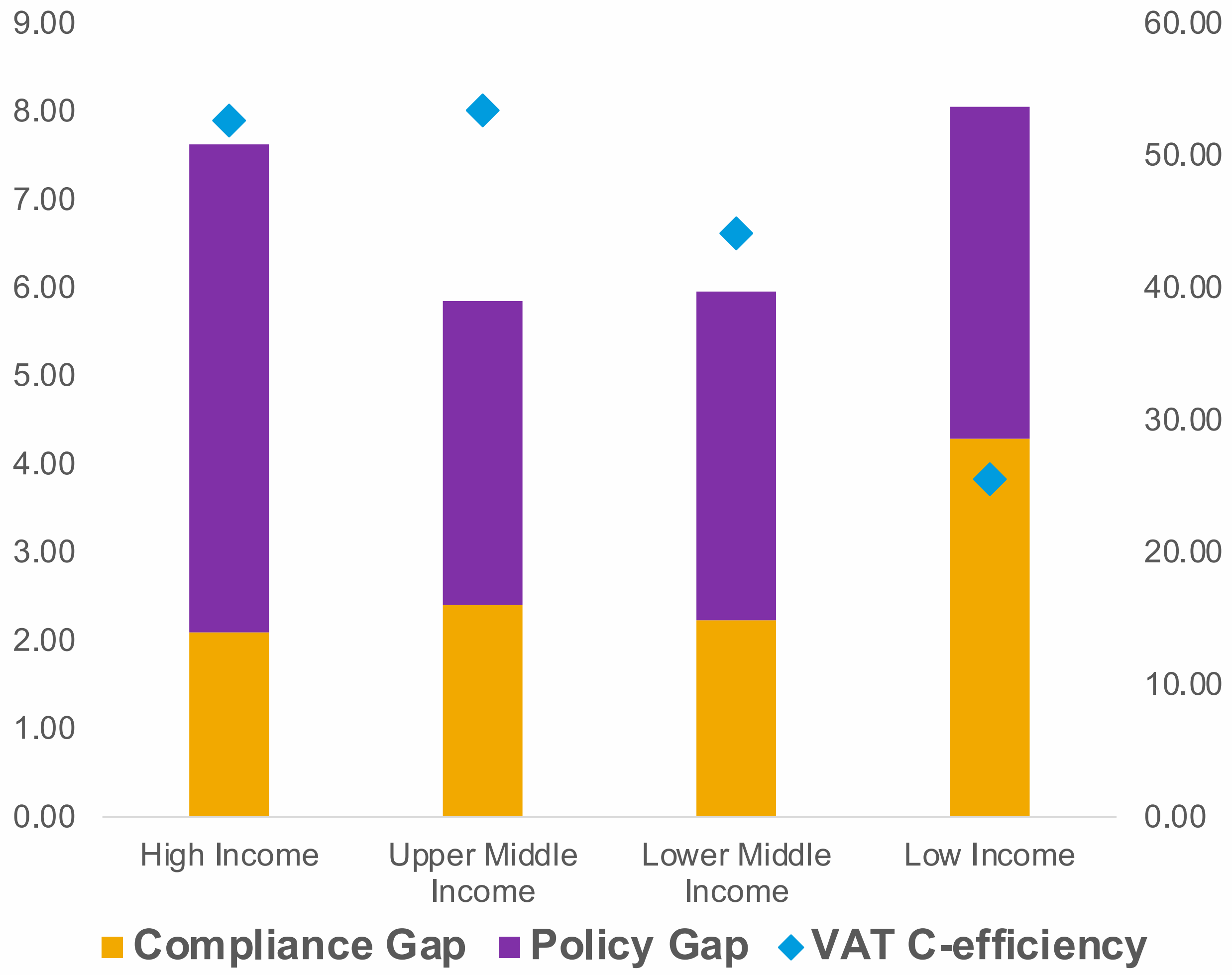


Source: IMF Internal World Revenue Longitudinal Database (WoRLD), Internal International Tax Rates Database, World Economic Outlook Database (WEO)

And shortfalls of C-efficiency from 100 can be decomposed

- A **compliance gap**: The additional revenue that could be raised if current VAT rules were perfectly enforced

- A **policy gap**: The additional revenue that would be raised, given perfect enforcement, if all consumption were taxed at the current standard rate



The perennial question: The incidence of the VAT

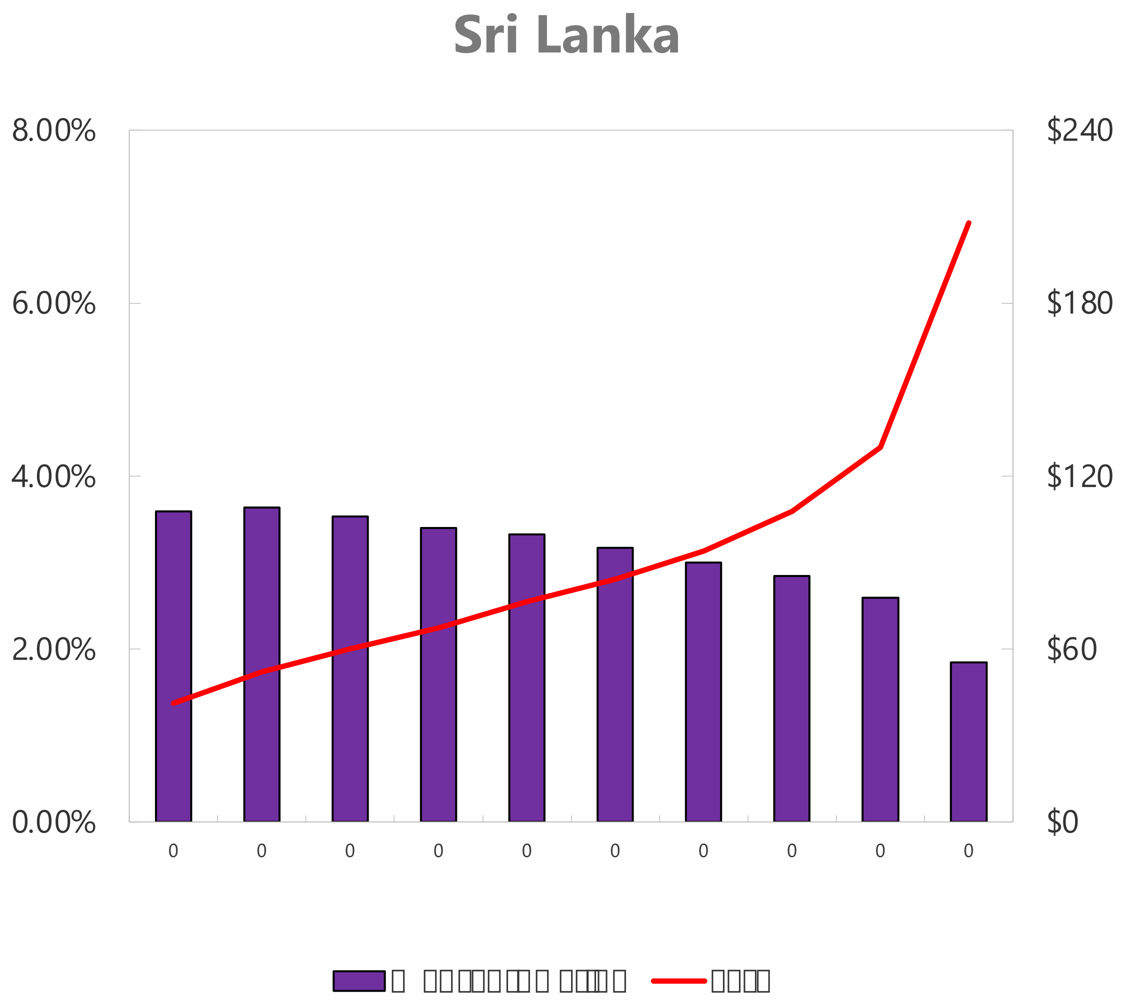
- Preferential rates on items on which the poor spend a large proportion of their income are badly targeted—because the rich spend absolutely more on them

- Question is whether there are better targeted instruments; which, increasingly there are

To bear in mind too:

- Is the VAT fully passed on to consumers? Some signs that reduced rates are not

- Poor may buy largely from small unregistered businesses



Other issues

Some old

- Noncompliance, refund fraud and other: But is VAT more vulnerable than, say, the income tax?
- Treatment of financial sector: Exemption distorts business use and misses consumer margin
- Treatment of government: Revenue washes out, but concerns to ensure a level playing field; budgetary management issues
- VAT in federations: Now many models addressing in different ways problems from zero-rating across internal borders. How well have they worked?

Some new

- Cross-border intangible services
- Digital platforms
- Links with corporate taxation as it become open to an element of destination basing
- Technological innovations – with blockchain, will we need a VAT?