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# The collection efficiency of the Value Added Tax: Theory and international evidence

Joshua Aizenman & Yothin Jinjarak

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3.6%, respectively. A one standard deviation increase in urbanization, trade openness and the share of agriculture, changes the VAT collection efficiency by 12.7%, 3.9% and –4.8%, respectively. Qualitatively identical results apply for the ratio of VAT revenue to GDP divided by the standard VAT.

Keywords:

- VAT
- tax collection costs
- trade openness
- political instability
- urbanization

JEL Classification:

- F15
- H21

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## Notes

1. The growth rate of the economy is exogenous to the policy choice (de-jure or de-facto) of the government. The growth rate is greater (smaller) than the world growth rate if the government chooses to switch to a VAT (sales tax). See Aizenman (2015) for a discussion of the challenges of switching to a VAT.
2. See Gokhale (2003) for a discussion of the challenges of switching to a VAT.
3. See Emswiler (2003) for a discussion of the challenges of switching to a VAT.

be total consumption (being the ideal VAT base, exempting investment), and not GDP. In addition, GDP may be subject to greater measurement error than consumption.

4. It is easy to verify that . Hence,  $\lambda$  is negligible when  $\beta$  is small. Note that audit risk is idiosyncratic, and may be diversified away by distributing it across agents. The risk adjustment would be zero in the presence of such insurance. Our analysis can be extended to the case where the risk adjustment factor is positive, without affecting the main results.

5. As in Cuikerman et al. ([1992](#)), since the tax capacity is set one period in advance, and is reset each period, the infinite horizon equilibrium is characterized by looking one period ahead. The symmetry of the specification implies that the policy maker at time  $t$  is setting the tax capacity for the next period,  $\theta$ , by maximizing . The term , is the discounted expected utility of the policy maker next period, recognizing that the equilibrium private consumption does not depend on the identity of the regime, and that the policy maker is reappointed (losing power) with probability  $1 - \pi$  ( $\pi$ ), enjoying utility from fiscal consumption of  $X(\theta)$ , respectively. The second term,  $-\theta$ , is the present resource cost of the fiscal investment in future tax capacity, reducing the present fiscal consumption enjoyed by the decision maker.

6. France was the first to implement a VAT, in 1948. Cape Verde recently implemented a VAT in 2004. Due to data limitations, these two countries were excluded from the sample.

7. See Fatas and Mihov (2003) for a discussion of the problem of dealing with missing data.



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