



THE DISTRIBUTIONAL EFFECTS OF CONSUMPTION TAXES IN OECD COUNTRIES

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Outline of presentation

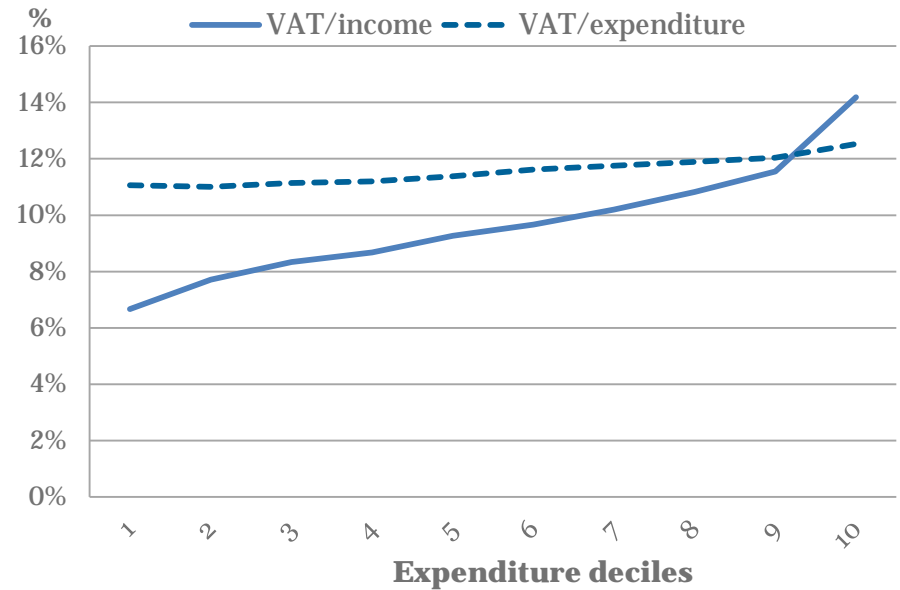
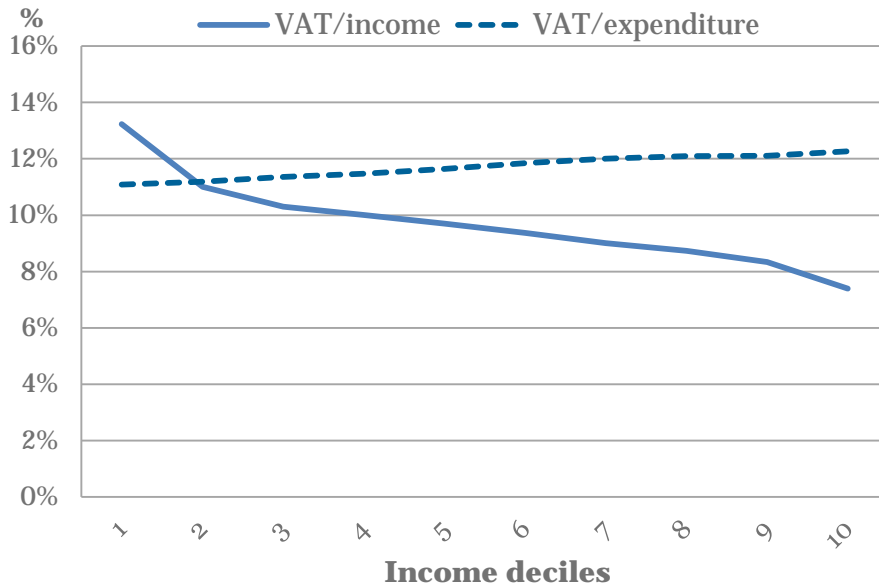
- **Methodology**
 - Non-behavioural micro-simulation
- **Results**
 - Part 1: Distributional analysis across income and expenditure deciles
 - Part 2: Effectiveness of reduced VAT rates
 - Part 3: Simulation of hypothetical reforms



- Micro-simulation based on household expenditure survey micro-data.
- 21 countries (most data is for 2010).
- Key assumptions/limitations:
 - No behavioural responses
 - VAT exemptions treated as zero rates.



Part 1: Distributional results VAT (21-country averages)





LAC countries

Table 2
VAT – Deciles According to Individual Income

1. Progressiveness	Costa Rica (2004)	Dominican Republic (2004)	El Salvador (2006)	Guatemala (2000)	Honduras (2005) (*)	Nicaragua (2001)	Panama (2003)
Effective tax rate/Income (in %)							
Poorest decile	5.4	8.8	24.0	20.2	10.2	8.6	4.4
2nd poorest decile	4.2	5.5	15.2	9.1		5.1	1.7
2nd richest decile	3.5	3.0	7.0	5.4		3.4	1.2
Richest decile	3.0	2.0	6.5	4.9	5.0	3.4	1.4

Chart 5
VAT – Deciles According to Individual Consumption

1. Progressiveness	Costa Rica (2004)	Dominican Republic (2004)	Guatemala (2000)	Honduras (2005) (*)	Nicaragua (2001)	Panama (2003)
Effective tax rate/Income (in %)						
Poorest decile	3.1	2.3	4.3	4.0	1.9	0.6
2nd poorest decile	3.6	2.6	4.6		2.3	0.8
2nd richest decile	5.1	3.0	6.2		4.1	1.3
Richest decile	5.6	3.0	6.8	8.8	4.6	1.7



Part 2: Effectiveness of reduced rates

- Simulate an increase in all zero and reduced VAT rates to the level of the standard rate.
- For each reduced rate, calculate the average “tax expenditure” per household:
 - i.e. the difference between simulated revenue at the standard rate and at the reduced/zero rate.

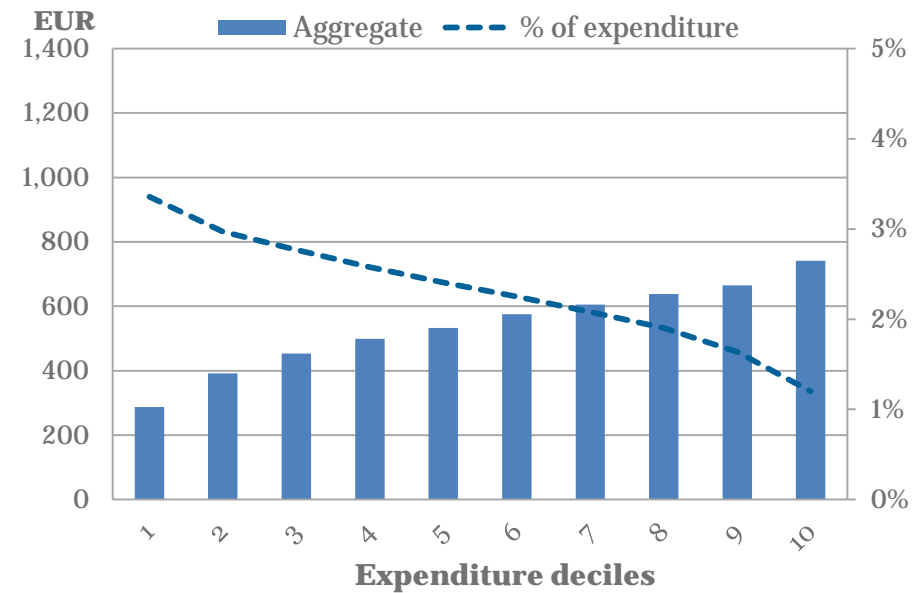
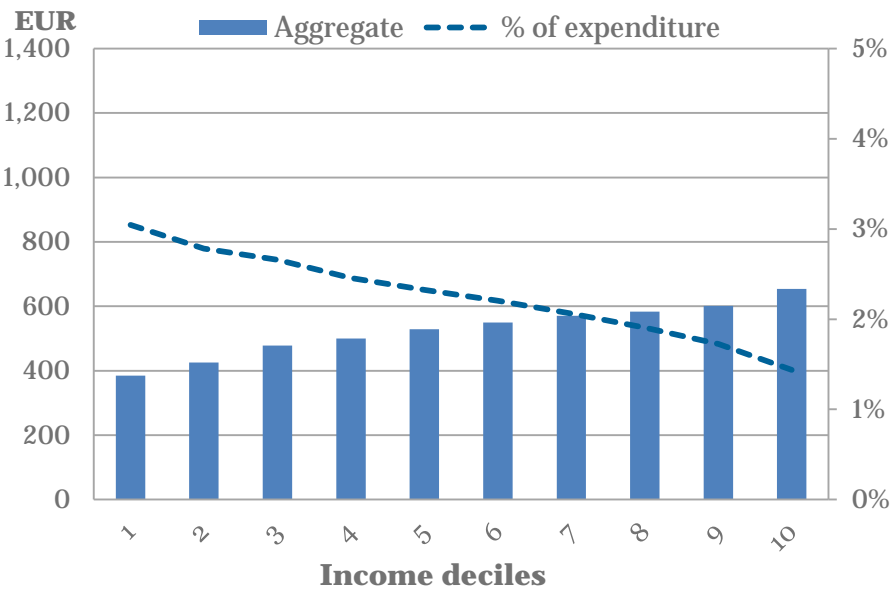


Group 1:

Reduced rates directly aimed at supporting
poor households

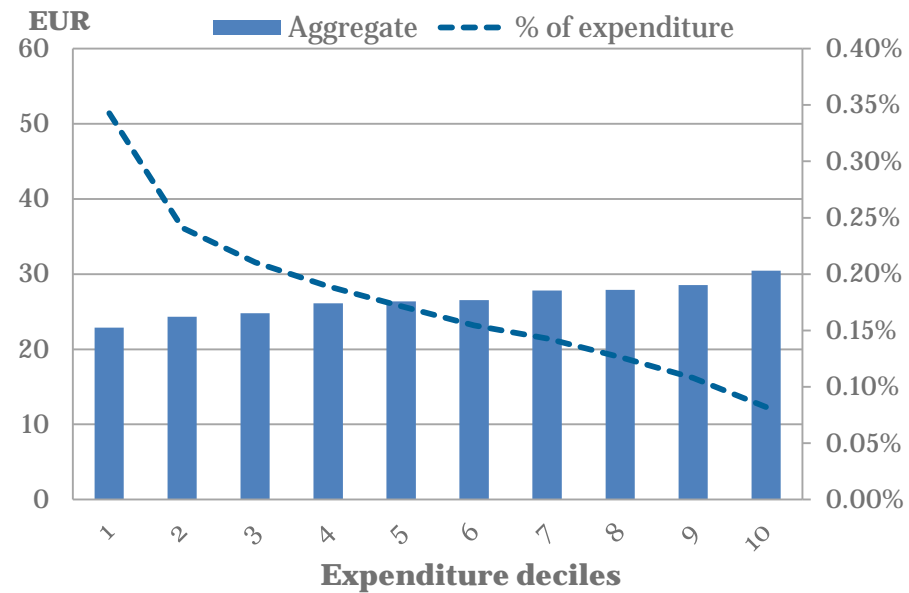
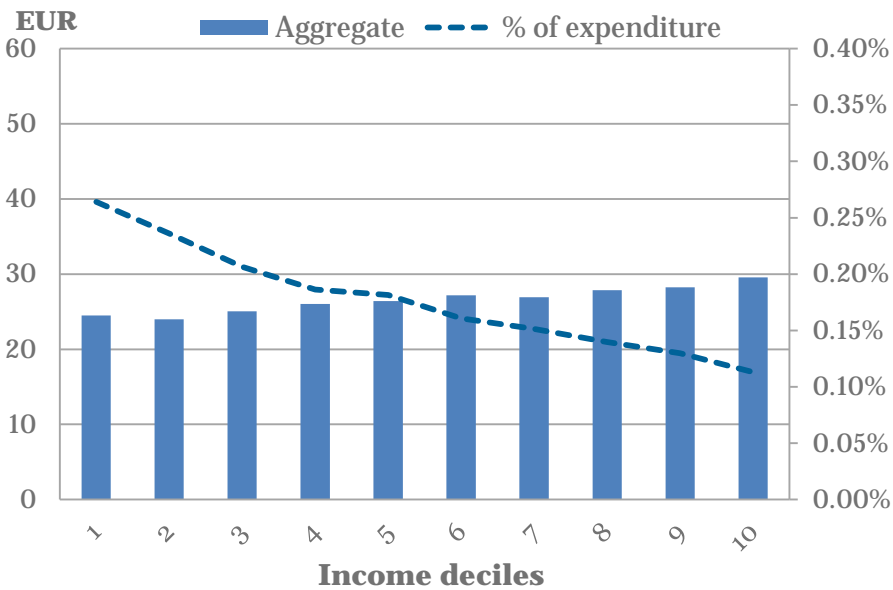


All-country average tax expenditure from reduced rates on food (16 countries)



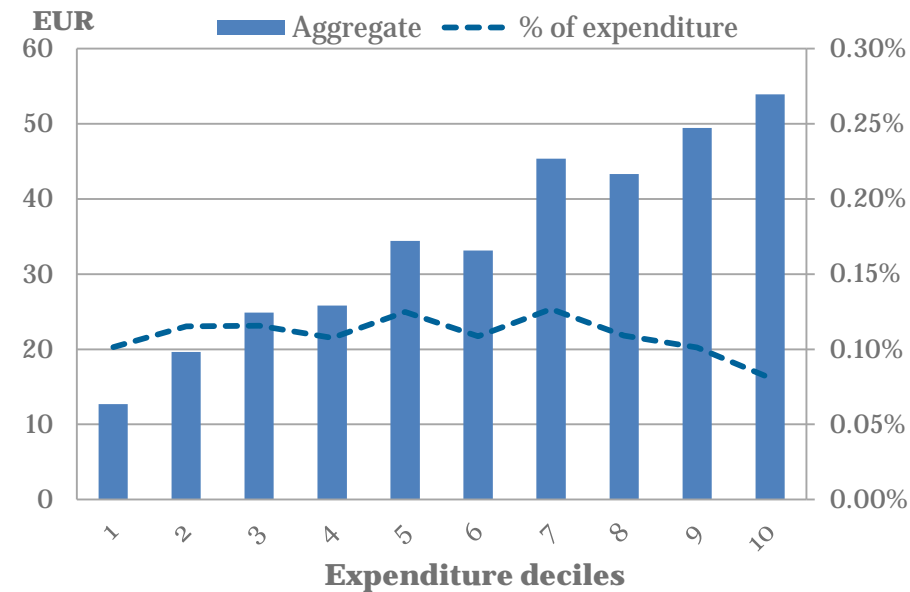
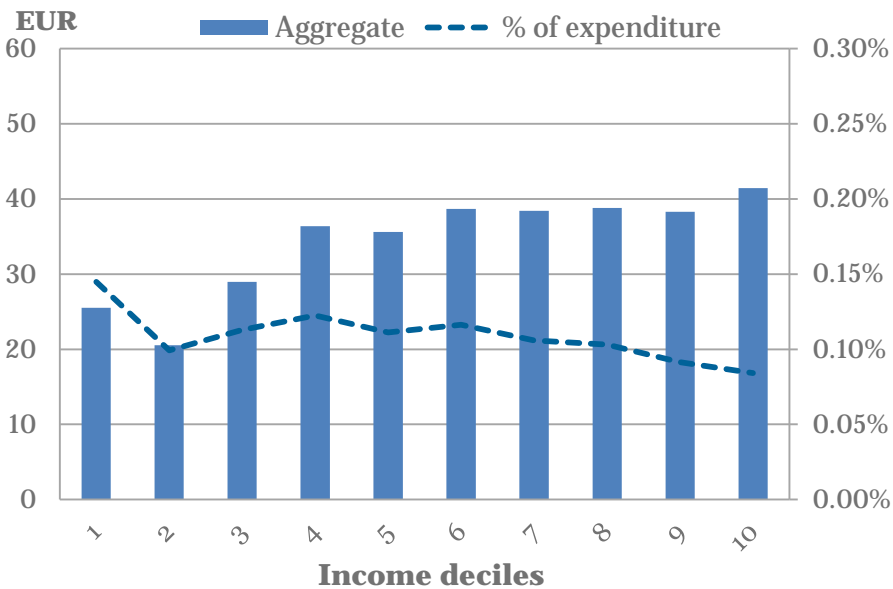


All-country average tax expenditure from reduced rates on water (9 countries)





All-country average tax expenditure from reduced rates on children's clothing and shoes (5 countries)



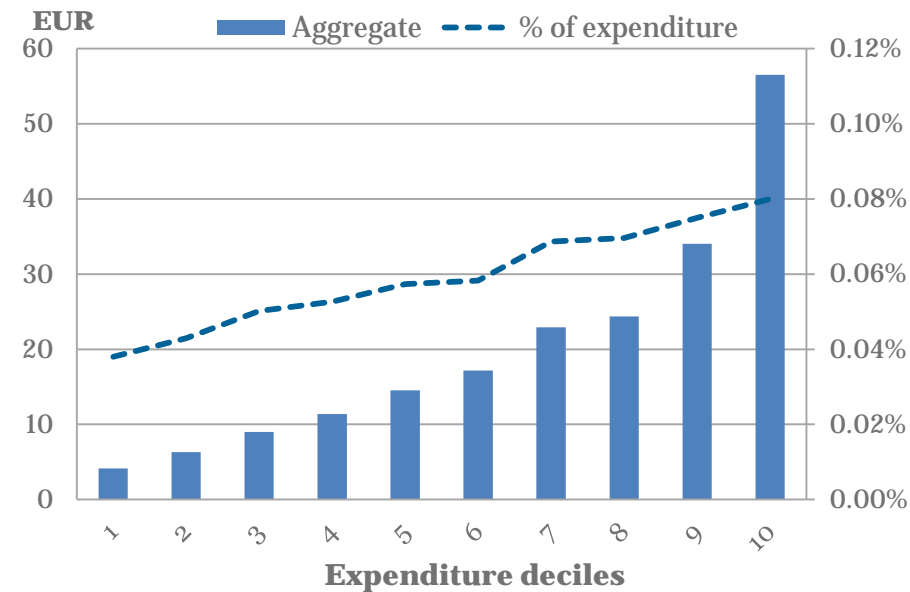
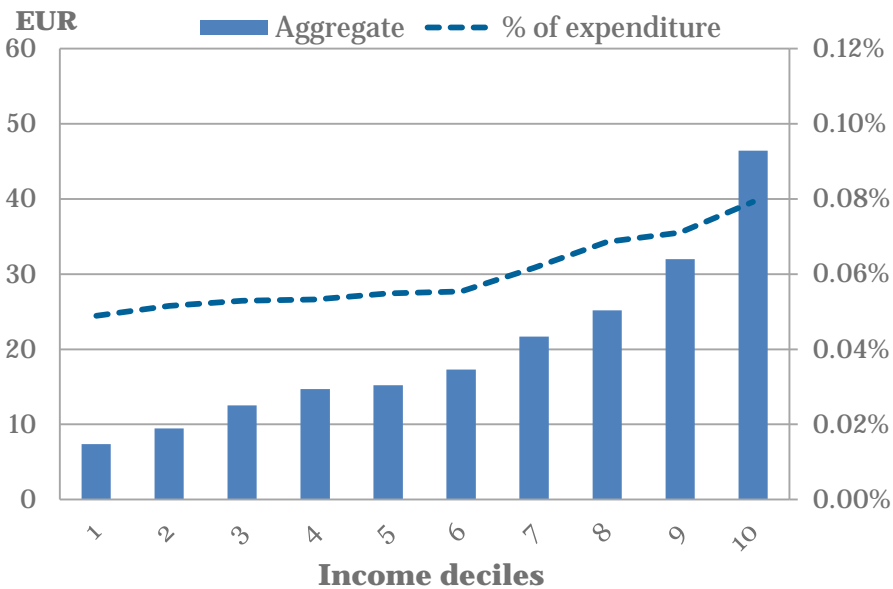


Group 2:

Reduced rates intended to support cultural activities and social goods

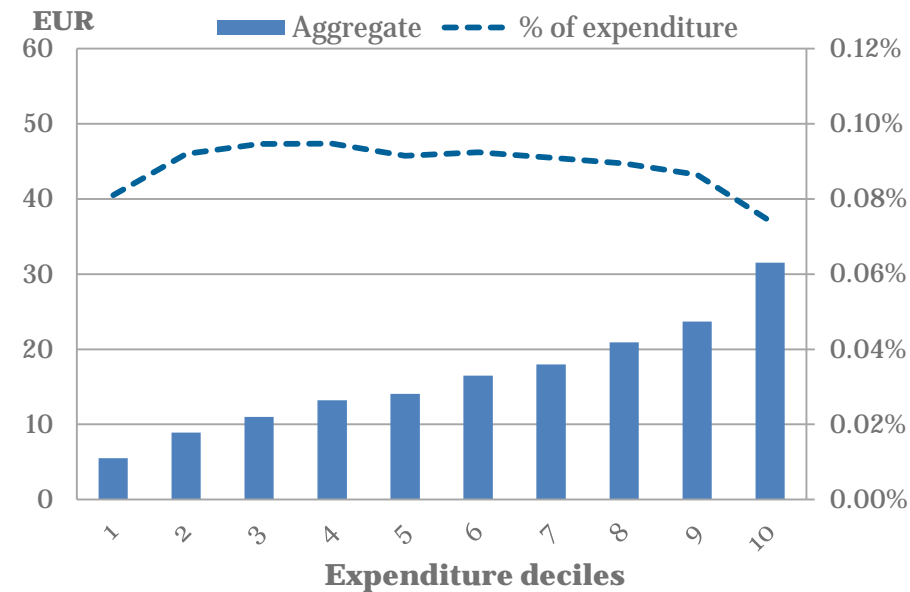
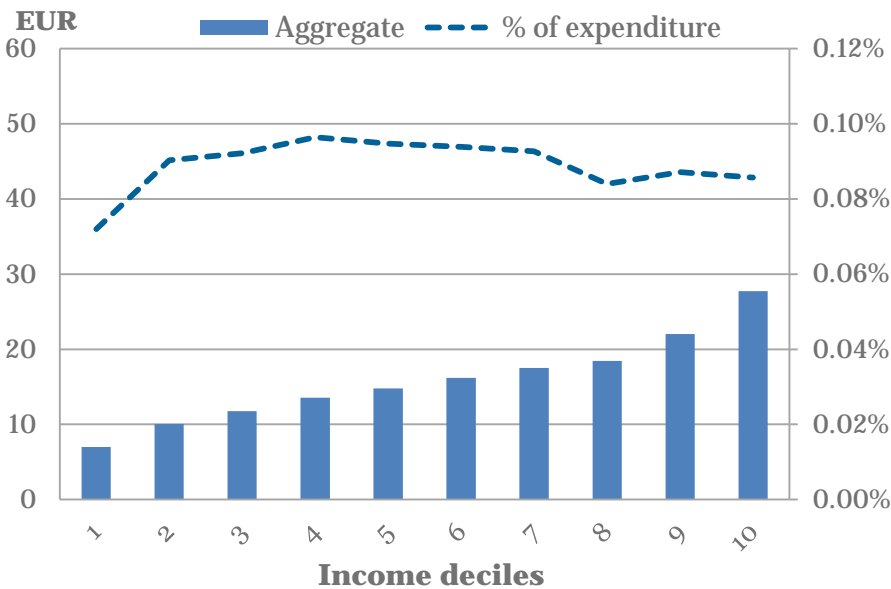


All-country average tax expenditure from reduced rates on books (18 countries)



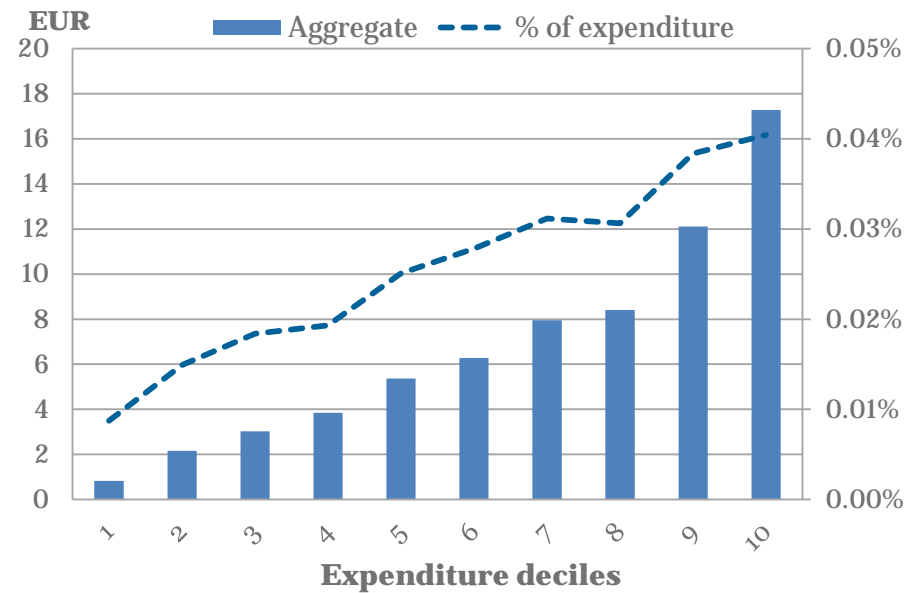
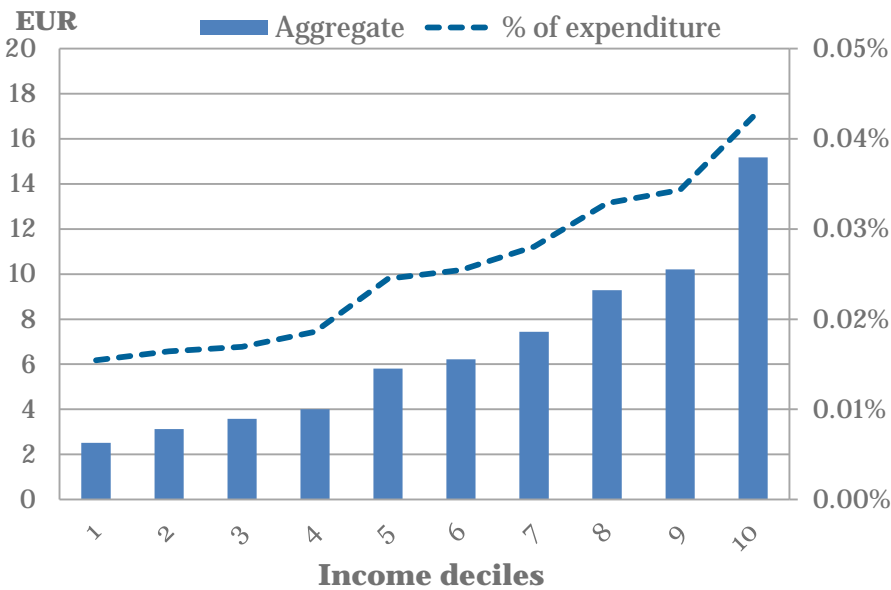


All-country average tax expenditure from reduced rates on newspapers and periodicals (17 countries)





All-country average tax expenditure from reduced rates on cinema, theatre and concerts (10 countries)



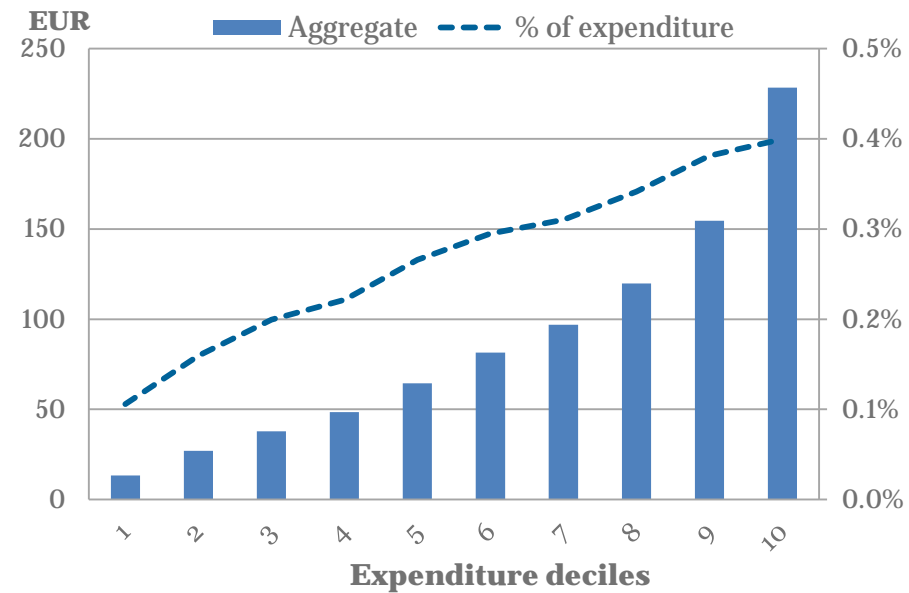
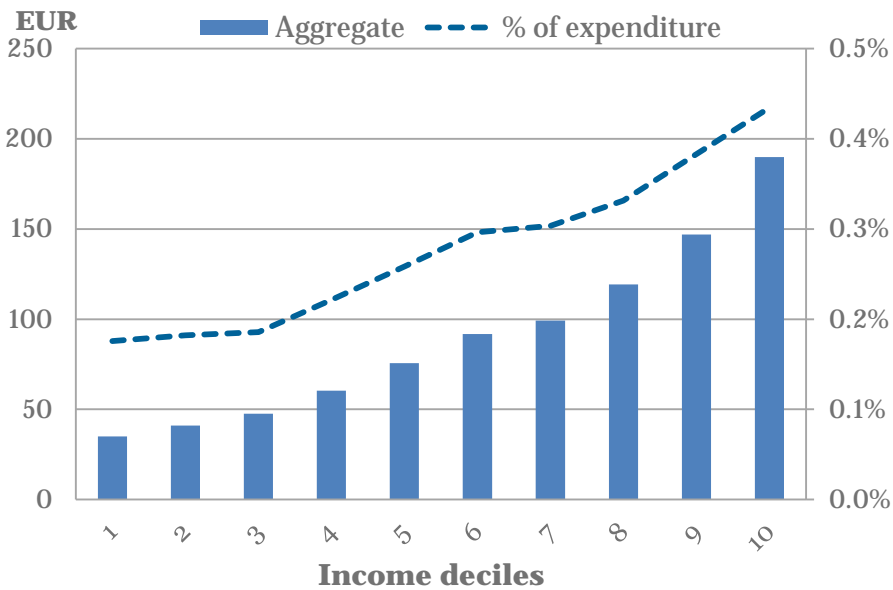


Group 3:

Reduced rates introduced for other purposes

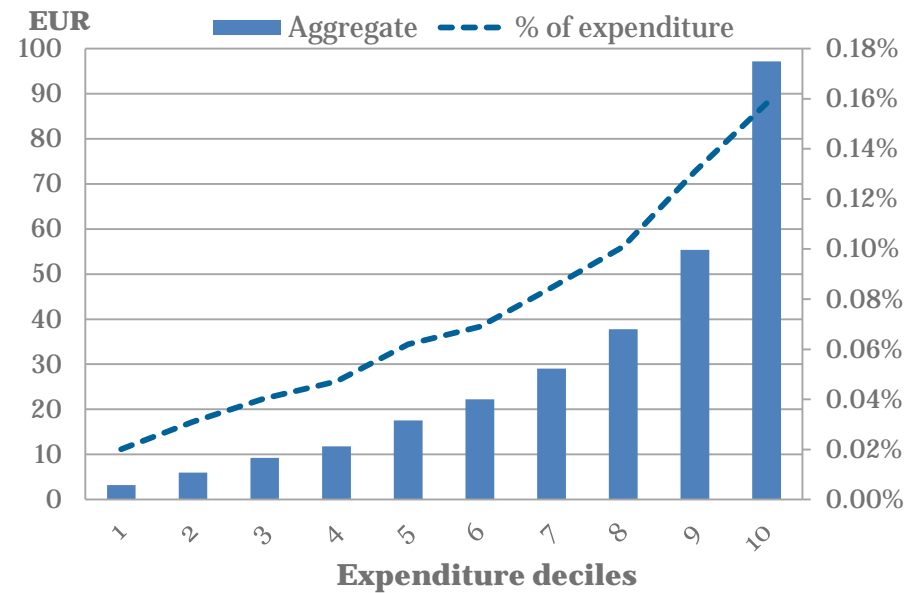
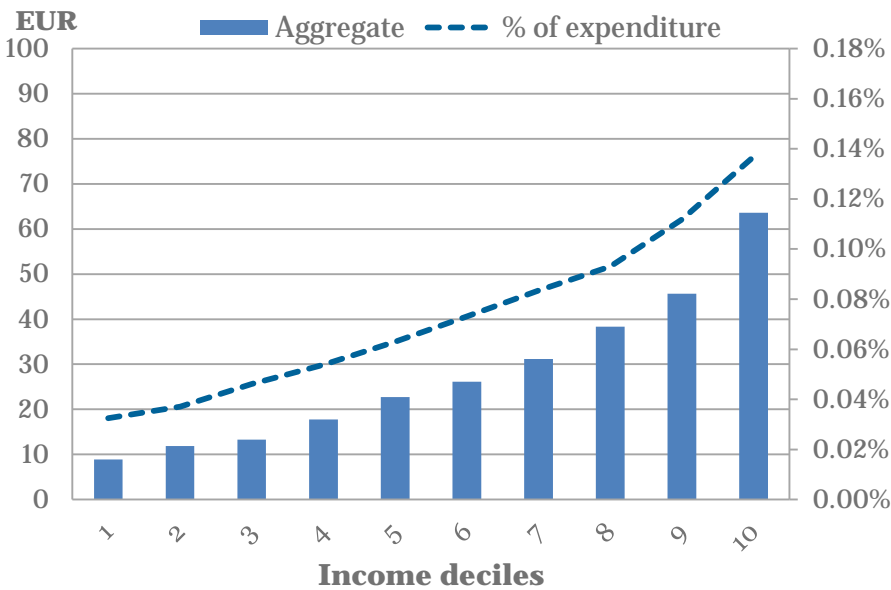


All-country average tax expenditure from reduced rates on restaurant food (11 countries)





All-country average tax expenditure from reduced rates on hotels and other accommodation (14 countries)





Part 3: Targeting with cash transfers instead...

- We simulate:
 - An increase in all zero and reduced VAT rates to the level of the standard rate. (We do not alter exemptions).
 - A set of income-tested cash transfers, funded by **two-thirds** of the revenue generated from the VAT rate increase.
- This is work-in-progress.
- Preliminary results for four countries...



Average gain/loss across income deciles (national currency)

	AUT (2009)	ESP (2010)	GRC (2010)	SVK (2010)
Poorest	1,059	1,069	898	27
2	510	702	764	10
3	158	310	383	10
4	-104	92	132	-5
5	-448	-564	-228	-9
6	-285	-773	-576	-14
7	-822	-492	-654	-15
8	-853	-907	-897	-19
9	-915	-982	-1,079	-22
Richest	-1,028	-1,203	-1,292	-23



Winners and losers...

	AUT (2009)		ESP (2010)		GRC (2010)		SVK* (2010)	
	Winners	Losers	Winners	Losers	Winners	Losers	Winners	Losers
Poorest	94%	6%	98%	2%	99%	1%	76%	21%
2	75%	25%	91%	9%	99%	1%	49%	44%
3	61%	39%	74%	26%	80%	20%	52%	42%
4	40%	60%	63%	37%	66%	34%	26%	65%
5	25%	75%	23%	77%	45%	55%	19%	71%
6	38%	62%	8%	92%	16%	84%	12%	77%
7	8%	92%	28%	72%	16%	84%	11%	77%
8	0%	100%	5%	95%	3%	97%	1%	83%
9	0%	100%	0%	100%	0%	100%	0%	83%
Richest	0%	100%	0%	100%	0%	100%	0%	83%



Conclusions

- Measured as a percentage of income, VAT is regressive.
- Measured as a percentage of expenditure, the VAT is generally either proportional or slightly progressive.
- Reduced rates and exemptions do generally aid progressivity.
- But reduced rates are a very poor tool for targeting support to the poor:
 - Reduced rates introduced to support the poor provide at least as large a tax saving to the rich, and generally more.
 - Reduced rates introduced for cultural, social good or other purposes provide a vastly greater tax saving for the rich than the poor.
- Removing reduced VAT rates and compensating the poor via a cash transfer can raise substantial revenue and increase progressivity, while still making almost all low-income households better off.
- But it is virtually impossible to fully compensate absolutely all low-income households for the removal of reduced VAT rates.



Conclusions (cont.)

- Political economy implications:
 - Don't introduce reduced VAT rates! (as once introduced, reduced VAT rates are very difficult to get rid of).
 - For countries already with reduced rates, a “step-by-step” approach to reform may be best.
- Further work:
 - Country-specific analysis is needed to understand exactly who wins and loses from reforms, including examining the characteristics (age, number of children, retired, unemployed, students...) of the winners and losers.



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