
Pakistan VAT Project

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Motivation

- VAT has been implemented in many developing countries, and in many other countries VAT adoption is high on the policy agenda
- The IMF and others have pushed the VAT agenda very strongly
- It's a popular tax among (most) public finance specialists, e.g. Cnossen (1990): "... VAT is probably the best tax ever invented"
- Why is the VAT supposed to be so good?
 - VAT vs. trade taxes [production efficiency; enforcement issues?]
 - VAT vs. wage taxes [absent enforcement issues, they're the same]
 - VAT vs. RST [absent enforcement issues, they're the same]
- ➔ enforcement issues are central to this discussion

The case for VAT (in theory)

- The potential superiority of a VAT turns on enforceability
- The unique aspect of the VAT is that the tax is levied on value-added at every single stage of production (typically using an “invoice-credit system”)
- Conceptual enforcement arguments for the VAT:
 - VAT is **self-enforcing** (or at least, it is “self-correcting”)
 - Businesses selling to other business (in the VAT net) have an incentive to register for the VAT (i.e., formalize) even if they are below the exemption threshold

What do we know empirically about VAT compliance?

- Despite the influence of the VAT agenda, we know relatively little empirically
- We are not aware of any rigorous micro study of VAT compliance, even for developed countries
- The conceptual VAT argument is associated with several hypotheses that appear to have never been tested:
 - Compliance for VAT is better than for other types of taxes
 - VAT compliance is better at intermediate stages of a production chain than at the final retail stage
 - VAT compliance is better in long than in short production chains
 - VAT compliance is inter-dependent btw upstream and downstream firms

The Pakistan VAT Project: Data

- A VAT-type system has been in place in Pakistan since 1996
- We have firm-level VAT return data from 1996 to 2009
- It includes the universe of firms with VAT registration over this period (currently about 90,000 firms are registered)
- It includes information on reported sales, purchases, imports, and exports along with some limited firm characteristics
- Hopefully (!) we can get “objective measures” of firm activity based on electricity and gas usage in each firm
- Hopefully (!) we can get **invoice summary data** (only from 2006) linked across firms in order to establish VAT chains

More on data and the way forward

- Invoice summary data:
Information on sales/purchases of any given (registered) firm to/from each (registered) firm that it trades with
- This data is central because it allows us to measure VAT chains for each firm and where in the chain a given firm is located
- Ways to proceed...
 - Match sales and purchases across traders to uncover discrepancies and hence gauge one-sided (but not collusive) VAT cheating
 - Combine reported sales/purchases with objective activity measures to gauge firm compliance levels, and relate this to VAT-chain information
 - Use VAT reforms (sector specific) to estimate the response of reported value-added to the VAT rate, and relate this VAT-chain information