# 1

# The rise of the value-added tax

Within less than half a century, the value-added tax (VAT) has become one of the most dominant revenue instruments across the world. From relatively inauspicious beginnings in the early twentieth century, the VAT has been adopted by more than 150 countries and accounts for approximately 20 per cent of worldwide tax revenue.[1] In population terms, it is estimated that more than 4 billion people, or 70 per cent of the world's population, live in countries with a VAT.[2]

If considered as a variant of a sales tax (or specifically, a turnover tax), the origins of the VAT run deep;[3] however, the VAT is generally perceived as a thoroughly modern fiscal innovation. Attribution is variously to one of two sources. The first suggests that German businessman Dr Wilhelm von Siemens proposed the VAT in 1918 as a 'refinement' or improvement to the German cascading turnover tax.[4] The second suggests that the American economist T. S. Adams, writing between 1910 and 1921, proposed an invoice-credit method VAT as an alternative to business income taxation.[5]

[1] OECD, *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues* (OECD Publishing, Paris, 2012), 58, 211–19; Michael Keen and Ben Lockwood, 'The Value Added Tax: Its Causes and Consequences', *Journal of Development Economics* 92 (2) (2010), 138.

[2] Liam Ebrill et al., *The Modern VAT* (IMF, Washington, DC, 2001), xi.

[3] The origins of the turnover tax as a form of percentage charge on trading transactions have been traced to Ancient Greece, Hellenistic Egypt and throughout the Roman Empire: Günter Schmölders, *Turnover Taxes* (International Bureau of Fiscal Documentation, Amsterdam, 1966), 7; Robert F. van Brederode, *Systems of General Sales Taxation: Theory, Policy and Practice* (Kluwer Law International Alphen aan den Rijn, 2009), 5.

[4] The attribution to von Siemens was by younger brother Carl Friedrich von Siemens, who assumed leadership of the von Siemens' company following the deaths of his older brothers: C. F. von Siemens, *Veredelte Umsatzsteuer* (translated as 'improving sales tax' or 'the improvement of the concept of sales tax') (Siemensstadt 1921), see especially 14–18.

[5] T. S. Adams, 'Fundamental Problems of Federal Income Taxation' (1921), *Quarterly Journal of Economics* 35(4), 527, 553. Given that Adams was a German speaker and there were frequent

Irrespective of attribution, however, the rapidity of the VAT's ascendancy is remarkable. Before the 1967 decision to adopt the VAT as the common form of sales tax in the European Economic Community (EEC),[6] less than a handful of countries had experimented with the tax, and almost none in the form by which the VAT is known today.[7] Now, in terms of revenue collection, the VAT ranks among

interactions between German and US tax policy-makers at the time, it was likely there was some cross-pollination: Holger Nehring, 'The Paradoxes of State-Building: Transnational Expertise and the Income Tax Debates in the United States and Germany, c. 1880–1914' in H. Nehring and F. Schui (eds.), *Global Debates About Taxation* (Palgrave Macmillan, Basingstoke, UK; New York, 2007), 97. Due contends that it 'was likely that Adams was familiar with the German discussion': John F. Due, *Sales Taxation* (University of Illinois Press, Urbana, 1957), 138–39. Lindholm claims that 'Adams had previously supported the basic concept of VAT in 1911': Richard W. Lindholm, *Value-Added Tax and Other Tax Reforms* (Nelson-Hall, Chicago, 1976), 42. Sullivan suggests that the 'credit method was first suggested by Thomas S. Adams': Clara K. Sullivan, *The Tax on Value Added* (New York, 1965), 12, 17; Liam Ebrill et al., *The Modern VAT* (IMF, Washington, DC, 2001), 4; Dan Throop Smith, James Webber and Carol Cerf, *What You Should Know About the Value Added Tax* (Dow Jones-Irwin, Homewood, IL, 1973), 12; Alan Schenk and Oliver Oldman, *Value Added Tax: A Comparative Approach* (rev. edn., Cambridge University Press, 2007), 4.

6 Article 99 (ex. 93) of the EEC Treaty instructed the European Commission to 'consider how the legislation of the various Member States concerning turnover taxes, excise duties and other forms of indirect taxation…can be harmonised in the interest of the common market': *The Treaty Establishing the European Economic Community*, as revised ('EEC Treaty') (*Official Journal of the European Union*, 2006/C321/E1). *Revision of the Treaty Establishing the European Economic Community*, opened for signature 25 March 1957, 298 UNTS 11 (entered into force 1 January 1958). The First Council Directive outlined the definition and aims of the proposed VAT: *First Council Directive 67/227/EEC of 11 April 1967 on the Harmonisation of Legislation of Member States Concerning Turnover Taxes* [1967] OJ L 1/14; [1967] OJ Spec Ed 14. The Second Council Directive of 11 April 1967 provided the details for the new system (by, for example, outlining concepts such as taxable transaction and place of supply) but gave Member States considerable scope to determine the content of their domestic VATs with freedom to determine their own VAT rate structure and exemptions: *Second Council Directive 67/228/EEC of 11 April 1967 on the Harmonisation of Legislation of Member States Concerning Turnover Taxes – Structure and Procedures for Application of the Common System of Value Added Tax* [1967] OJ 1/14; [1967] OJ Spec Ed 16. The passage of the Sixth Directive in May 1977 provided greater guidance on the operation of the common VAT: *Sixth Council Directive 77/388/EEC of 17 May 1977 on the Harmonization of the Laws of the Member States Relating to Turnover Taxes – Common System of Value Added Tax: Uniform Basis of Assessment* [1977] OJ L 145/1. The current Directive is a recast of the Sixth Directive: *Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax* [2006] OJ L 347/1 (referred to hereafter as the '*Recast VAT Directive 2006/112/EEC*'). See generally: Ben Terra and Julie Kajus, IBFD, *A Guide to the European VAT Directives* [online] (15 April 2011); Rita de la Feria, *The EU VAT System and the Internal Market* (IBFD, Amsterdam, 2009); Walter van der Corput and Fabiola Annacondia (eds.), *EU VAT Compass* (IBFD Publications, Amsterdam, 2007).

7 Although France is often regarded as the first jurisdiction to introduce a national VAT, France phased in the introduction of a VAT over a two-decade period. Disputes as to the actual date of introduction can therefore arise based on the definition one might adopt of the VAT. In 1948 France introduced a fractional payment system, which meant that rather than suspending tax on physical goods acquired by manufacturers, purchasers were able to offset tax already paid on the goods against their total tax liability. In 1954 the ability to offset was extended to tax paid on capital goods. However, even then the tax was a very limited coverage tax and did not move to a full VAT extending to the retail sector until 1968. Maurice Lauré is credited with

the income tax and social security tax in 32 of the 33 member countries of the Organisation for Economic Cooperation and Development (OECD) that have adopted VATs. From 1965 to 2009, VAT revenue as a share of total tax revenue rose from an unweighted average of 1.8 per cent to 19.2 per cent across the OECD.[8]

However, it is among developing and transitional economies that the growth of the VAT has been truly ascendant. Approximately three-quarters of countries with VAT are low- to middle-income countries,[9] and two-thirds of the least developed countries in the world have VATs.[10] As Table 1.1[11] shows, the vast bulk of VAT

developing the French tax on value-add: Maurice Lauré, *La taxe sur law valeur ajoutée* (Paris, 1952); Liam Ebrill et al., *The Modern VAT* (IMF, Washington, DC, 2001), 4; Schenk and Oldman list the date as either 1948 or 1968: Alan Schenk and Oliver Oldman, *Value Added Tax: A Comparative Approach* (rev. edn., Cambridge University Press, 2007); Alan A. Tait, *Value Added Tax: International Practice and Problems* (IMF, Washington, DC, 1988), 7–8. The first full VAT in Europe was introduced in Denmark in 1967, although it did not join the EEC until 1973. The tax replaced the Danish gross receipts tax. However, the initial VAT did not tax services in a comprehensive manner: Sijbren Cnossen, *Value Added Taxes in Central and Eastern Europe: A Survey and Evaluation* (European Commission, OECD, Paris, 1998), 424; Robert F. van Brederode, *Systems of General Sales Taxation: Theory, Policy and Practice* (Kluwer Law International Alphen aan den Rijn, 2009), 7. A number of variations and false starts preceded the introduction of these VATs. Perhaps the most infamous is the abandoned VAT reform in postwar Japan, undertaken at the suggestion of the Shoup Mission headed by Professor Carl Shoup who, upon the invitation of General Douglas MacArthur to review the Japanese tax system, recommended the introduction of a VAT at the prefectural level to replace existing turnover taxes. Although a law implementing the tax was enacted in 1950, intense opposition from the business community resulted in the introduction of the tax being postponed several times until its eventual repeal in 1954: Shoup Mission, *Report on Japanese Taxation* (SCAP, Tokyo, 1949); Shoup Mission, *Second Report on Japanese Taxation* (Japan Tax Association, Tokyo, 1950); Hiromitsu Ishi, *The Japanese Tax System* (2nd ed., Oxford University Press, 1993), 315.

8 OECD, *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues* (OECD Publishing, Paris, 2012), 65.

9 Approximately 109 of the more than 150 countries with a VAT are classified as low-, low-to-middle- or upper-middle-income countries. These income indicators are generally adopted as a rough proxy for developing countries. More than half of the 150 countries with VAT are low-income or low-to-middle-income economies. Estimates based on: Fabiola Annacondia and Walter van der Corput, 'Overview of General Turnover Taxes and Tax Rates' (2012), March/April *International VAT Monitor* 2, 2–10; World Bank, *Country and Lending Groups* (2012), http://go.worldbank.org/D7SN0B8YU0.

10 The UN classification of least developed countries (LDCs) includes countries that are 'highly disadvantaged in their development process' and are facing the risk of failing to come out of poverty more than other countries. The 48 countries currently on the list of LDCs are therefore 'considered to be in need of the highest degree of attention on the part of the international community': United Nations Conference on Trade and Development, *The Least Developed Countries Report 2009: The State and Development Governance*, UNCTAD/LDC/2009, iii.

11 Country classifications based on Liam Ebrill et al., *The Modern VAT* (IMF, Washington, DC, 2001), 6, 206–7, Table AI.1. Variations to classifications and additions are noted below nn a–f. Results reflect the author's own calculations based on data assembled from: International Tax Dialogue (ITD), 'The Value Added Tax: Experience and Issues' (Background Paper Prepared for the International Tax Dialogue Conference on the VAT, Rome, March 15–16, 2005, ITD), 9, 4–6; OECD, *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and*

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TABLE 1.1 – *VAT uptake by region as of 2013*

| | Sub-Saharan Africa[a] | Asia and the Pacific[b] | EU15 plus[c] | Central Europe and the former Soviet Union[d] | North Africa and the Middle East[e] | Americas | Small islands (population < 1 million)[f] |
|---|---|---|---|---|---|---|---|
| Countries with VAT* | 39(44) | 19(25) | 21(23) | 28(28) | 9(21) | 25(26) | 14(24) |
| 2006–2013 | 6 | 1 | 0 | 1 | 2 | 2 | 9 |
| 1996–2005 | 18 | 7 | 0 | 6 | 1 | 1 | 3 |
| 1986–1995 | 13 | 9 | 9 | 21 | 4 | 6 | 2 |
| 1976–1985 | 1 | 2 | 0 | 0 | 2 | 6 | 0 |
| 1966–1975 | 0 | 0 | 11 | 0 | 0 | 10 | 0 |
| Before 1965 | 1 | 0 | 1 | 0 | 0 | 0 | 0 |

[a] Including South Sudan: Deloitte, Taxation and Investment: South Sudan – Highlights 2014 ; IBFD, *Country Surveys* (31 January 2014), 'South Sudan'. Gambia introduced a VAT taking effect 1 January 2013: Fabiola Annacondia and Walter van der Corput, 'Overview of General Turnover Taxes and Tax Rates' (2013), March/April *International VAT Monitor* 2, 5.
[b] Modified to include Timor-Leste, which does not have a VAT but levies a separate sales tax and services tax. India has sub-national VATs in most states but no federal VAT, but is counted as a country with VAT: OECD, *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues* (OECD Publishing, Paris, 2012), 215.
[c] EU 15 include: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the United Kingdom: Liam Ebrill et al., *The Modern VAT* (IMF, Washington, DC, 2001), 6, 206–07, Table AI.1. Additions include the micro-states, sovereign and semi-sovereign states within the European geographic zone: Andorra, Republic of Cyprus (EU member state as of 2004), Iceland, Liechtenstein, Malta (EU member state as of 2004), Monaco (applies the French VAT and is included with France), Norway, San Marino and Switzerland. Andorra and San Marino have no VAT. Liechtenstein, Iceland, Norway and Switzerland are not in the EU, but all are members of the European Free Trade Association (EFTA) and all levy VATs: Ernst & Young, *Worldwide VAT, GST and Sales Tax Guide* (Ernst & Young, 2014), 746–53; OECD, *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues* (OECD Publishing, Paris, 2012), 211.
[d] Many of the states within this classification have joined the EU, including the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia in 2004; and Bulgaria and Romania in 2007. The regional classification is carried over from Ebrill et al. because it demonstrates the VAT uptake in this general geographic region following the end of the Soviet Union. Serbia (VAT introduced in 2005) and Montenegro (VAT introduced in 2003) have also been included: ibid.
[e] Bahrain, Oman, Qatar, Saudi Arabia, Syria and United Arab Emirates were expected to introduce VAT systems in 2013: OECD, *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues* (OECD Publishing, Paris, 2012), 219. This did not occur. Annacondia and van der Corput now estimate that VATs will be introduced in these jurisdictions (as well as Kuwait) 'in the near future': Fabiola Annacondia and Walter van der Corput, 'Overview of General Turnover Taxes and Tax Rates' (2013), March/April *International VAT Monitor* 2, 3, 9.
[f] Countries include Tuvalu but exclude the Republic of Cyprus and Malta (which have subsequently joined the EU), Iceland (which is included in the EU Plus category as it is in the EFTA) and San Marino (which is in the EU Plus category as it is a member of the Council of Europe). After much delay,

difficulty and IMF intervention, a VAT in the Republic of Seychelles took effect on 1 January 2013. A VAT is proposed to take effect in the Bahamas on 1 July 2014: Robert F. van Brederode, 'VAT News: Bahamas – Introduction of VAT' (July/August 2013), *International VAT Monitor* 24(4), 209, 237.
* (out of total number of countries in region)

uptake, particularly in the developing world, occurred in the final two decades of the twentieth century.

There are now far fewer countries in the world without a VAT than with a VAT. The most prominent exception in the developed world is the United States (US).[12] The pace and breadth of VAT reform means that the VAT rivals the income tax as an exemplar of twentieth-century tax policy convergence, so much so that one leading VAT commentator, Sijbren Cnossen, claims that '[t]he nearly universal introduction of the value added tax should be considered the most important event in the evolution of tax structure in the last half of the twentieth century'.[13]

## 1 WHAT LIES BEHIND THE REMARKABLE RISE OF THE VAT?

One might think that the rapid rise and growing significance of the VAT have promoted much research on what has contributed to its remarkable rise. However, very little is known about why so many countries have adopted VATs and, in particular, why different countries adopt the types of VAT they do. This state of affairs persists despite the rise of the VAT having spawned a veritable growth industry of technocrats to variously analyse, prescribe and promote it.[14]

*Administration Issues* (OECD Publishing, Paris, 2012), 211–19; Fabiola Annacondia and Walter van der Corput, 'Overview of General Turnover Taxes and Tax Rates' (2013), March/April *International VAT Monitor* 2, 2–10; Fabiola Annacondia and Walter van der Corput, 'Overview of General Turnover Taxes and Tax Rates' (2012), March/April *International VAT Monitor* 2, 2–10; Alan Schenk and Oliver Oldman, *Value Added Tax: A Comparative Approach* (rev. edn., Cambridge University Press, 2007), 459–62; Ernst & Young, *Worldwide VAT, GST and Sales Tax Guide* (Ernst & Young, 2014). The caveats that inform these sources also inform this table – the accuracy of the information varies according to the reliability of the data, which has been compiled from a number of sources over a period of time.

12 As Table 1.1 indicates, VATs are less common across the Middle East and in smaller islands, but recent VAT reforms and proposed VAT reforms continue to address this gap: Richard Bird and Pierre-Pascal Gendron, *The VAT in Developing and Transitional Countries* (Cambridge University Press, 2007), 17.

13 Sijbren Cnossen, 'Global Trends and Issues in Value Added Taxation', *International Tax and Public Finance* 5(3) (1998), 399.

14 The use of this term is intended as descriptive only. For a similarly benign use of the descriptor in relation to tax reform, see, e.g., Robert Bates, 'A Political Scientist Looks at Tax Reform,' in M. Gillis (ed.), *Tax Reform in Developing Countries* (Duke University Press, Durham, NC, 1989), 473. For a more pejorative use see Joseph E. Stiglitz, 'Don't Trust Technocrats,' *The Guardian* (online), 16 July 2003, www.theguardian.com/politics/2003/jul/16/globalisation.economy.

Most writing on the global rise of the VAT subscribes to what this book describes as the *conventional approach*. This term denotes a general body of work by authors, often with shared organisational affiliations, who are united in their support for the VAT, are frequently active in VAT reform and share conceptions of what constitutes best-practice VAT design.[15] Nearly all authors within the conventional approach are directly or indirectly associated with organisations at the forefront of worldwide VAT reform, such as the International Monetary Fund (IMF),[16] the OECD[17] and the World Bank.[18]

The core of the conventional approach is a body of work published by these organisations or written by employees of these organisations.[19] As the references within this book demonstrate, most authoritative VAT texts are published by these

15 Bird and Gendron, for example, refer to the 'conventional wisdom' on VAT: Richard Bird and Pierre-Pascal Gendron, *The VAT in Developing and Transitional* Countries (Cambridge University Press, 2007), 2, 8; Ebrill et al. refer to the 'conventional wisdom' regarding the advantages of a VAT over a retail sales tax: Liam Ebrill et al., *The Modern VAT* (IMF, Washington, DC, 2001), 23; Bogetic and Hassan in 1993 referred to 'the emerging conventional wisdom' on VAT design: Zeljko Bogetic and Fareed Hassan, 'Determinants of Value-Added Tax Revenue: A Cross-Section Analysis' (Policy Research Working Paper No. WPS 1203, Washington, DC, 1993), 2; Keen makes repeated reference to the 'conventional wisdom' on the VAT: Michael Keen, 'What Do (and Don't) We Know about the Value Added Tax? A Review of Richard M. Bird and Pierre-Pascal Gendron's *The VAT in Developing and Transitional Countries*', *Journal of Economic Literature* 47(1) (2009), 159, 161, 165, 169.

16 See, e.g., Liam Ebrill et al., *The Modern VAT* (IMF, Washington, DC, 2001); Michael Keen, 'VAT Attacks!' (Working Paper No. WP/07/142, IMF, 2007); Graham Harrison and Russell Krelove, 'VAT Refunds: A Review of Country Experience' (Working Paper No. WP/05/218, IMF, 2005); Michael Keen and Ben Lockwood, 'The Value Added Tax: Its Causes and Consequences' (2010), *Journal of Development Economics* 92(2), 138; David Williams, 'Value-Added Tax,' in V. Thuronyi (ed.), *Tax Law Design and Drafting* (IMF, Washington, DC, 1996), vol. 1, 164; Jean-Paul Bodin and Vincent Koukpaizan, 'The Rise of VAT in Africa – Impact and Challenges' (2009), *International VAT Monitor*, 178; Parthasarathi Shome (ed.), *Tax Policy Handbook* (Tax Policy Division, Fiscal Affairs Department, IMF, Washington, DC, 1995), especially Part III.

17 See, e.g., the OECD Consumption Tax Trends series, of which the latest is OECD, *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues* (OECD Publishing, Paris, 2012); OECD, 'Consumption Taxes: The Way of the Future? (Policy Brief)' (2007), *OECD Observer*, 1; Erik Jørgensen and Jeffrey Owens, 'The Move to VAT', *OECD Observer* (August/September 1995), 21; OECD, *International VAT/GST Guidelines* (OECD Publishing, Paris, 2014); OECD, *Forum on Tax Administration: Compliance Sub-Group, Information Note, Developments in VAT Compliance Management in Selected Countries* (OECD, Centre for Tax Policy and Administration, Paris, 2009); OECD, Global Forum on VAT (2015) www.oecd.org/ctp/consumption/vat-global-forum.htm.

18 See, e.g., Malcolm Gillis, Carl S. Shoup and Gerardo P. Sicat (eds.), *Value Added Taxation in Developing Countries* (World Bank, Washington, DC, 1990); Zeljko Bogetic and Fareed Hassan, 'Determinants of Value-Added Tax Revenue: A Cross-Section Analysis' (Policy Research Working Paper No. WPS 1203, Washington, DC, 1993); Farid Tadros, 'Introducing the Value-Added Tax: Considerations for Implementation' (The Investment Climate In Practice Note Series. No. 4, World Bank, 2009); Z. Shalizi and World Bank Group, *Lessons of Tax Reform* (World Bank, Washington, DC, 1991), 24–25, 29–33.

19 See the references quoted above in notes 16 to 18. Current or former staff members of these organisations include Bodin, Cnossen, Smith, Keen and Tait.

organisations or are written by authors with affiliated links.[20] The leading text to which most analyses refer is a 2001 IMF publication titled *The Modern VAT*.[21] Such is the dominance of the conventional approach to global VAT analysis that one is hard pressed to find accounts that, if not made from within the conventional approach, will not at least reference one or more of the main works or dominant ideas within it.[22]

At the periphery of the conventional approach exists a larger body of work written predominantly by scholars who share a commitment to the VAT as well as a shared view of what constitutes best-practice VAT design. These scholars also generally have practical experience in VAT reform, with many having acted in some consultative capacity for the IMF, World Bank or OECD.[23]

[20] See the references quoted above in notes 16 to 18. Keen notes the dominance of the IMF in particular when he equates the "Fund view" to the conventional wisdom on the VAT: Michael Keen, 'What Do (and Don't) We Know about the Value Added Tax? A Review of Richard M. Bird and Pierre-Pascal Gendron's *The VAT in Developing and Transitional Countries*', *Journal of Economic Literature* 47(1) (2009), 159, 160–61. See also: The International Tax Dialogue (ITD), which defines itself as a 'collaborative arrangement involving the EC [European Community], IDB [International Development Bank], IMF, OECD, World Bank Group and CIAT [Inter-American Center of Tax Administrations] to encourage and facilitate discussion of tax matters among national tax officials, international organisations, and a range of other key stakeholders'. ITD, *ITD Web*, www.itdweb.org/Pages/Home.aspx.

[21] Liam Ebrill et al., *The Modern VAT* (IMF, Washington, DC, 2001). Bird and Gendron state that:

> The most comprehensive of these [VAT] studies remains Ebrill et al. (2001) which is more subtle and restrained in its analysis than the practical application of the advice contained therein seems to have been in some instances.

Richard Bird and Pierre-Pascal Gendron, *The VAT in Developing and Transitional Countries* (Cambridge University Press, 2007), 2.

[22] For rare criticisms of the *conventional approach*, see, e.g., Scott Riswold, 'VAT in Sub-Saharan Africa – A Critique of IMF VAT Policy' (March/April 2004), *International VAT Monitor* 97; M. Shahe Emran and Joseph E. Stiglitz, 'On selective indirect tax reform in developing countries' (2005), *Journal of Public Economics* 89, 599.

[23] Texts in this category include Richard Bird and Pierre-Pascal Gendron, *The VAT in Developing and Transitional Countries* (Cambridge University Press, 2007); Alan Schenk and Oliver Oldman, *Value Added Tax: A Comparative Approach* (rev. edn., Cambridge University Press, 2007); Robert F. van Brederode, *Systems of General Sales Taxation: Theory, Policy and Practice* (Kluwer Law International Alphen aan den Rijn, 2009). See further the authors referred to in the footnotes to this chapter. They include authors who have acted as consultants of the IMF, World Bank or OECD (Bodin, Koukpaizan, Gillis, Bird, Schenk, Shoup). Shoup has been labelled the 'intellectual father of the value-added tax': Wayne Thirsk, 'Intellectual Foundations of the VAT in North America and Japan,' in L. Eden (ed.), *Retrospectives on Public Finance* (Duke University Press, Durham, NC and London, 1991), 133. The dominance of the conventional approach is sometimes acknowledged by those within it. Keen, for example, notes that one of the 'great potential advantages' of the Bird and Gendron text is that the authors 'are not full-time employees of the IMF': Michael Keen, 'What Do (and Don't) We Know about the Value Added Tax? A Review of Richard M. Bird and Pierre-Pascal Gendron's *The VAT in Developing and Transitional Countries*', *Journal of Economic Literature* 47(1) (2009), 159, 160.

Whereas the conventional approach devotes enormous attention to questions of how best to design a VAT and to articulating the associated merits that ensue from a well-designed VAT, very little attention has been paid to explaining its rise. When attention is paid to this question, the conventional approach explains the introduction of VAT in more than 150 countries by reference to the merits of a well-designed VAT. The book demonstrates that this explanation generally rests on the merits of an ideal or *good VAT* that is rarely, if ever, realised in practice by *real VATs*. While this book does not dispute the merits claimed of the good VAT, or real VATs for that matter, the negative component of the book contends that an explanation of the rise of the VAT by reference to its merits does not withstand scrutiny at both a theoretical and an empirical level. In light of the insufficiency of existing explanations for the rise of real VATs, the positive component of the book suggests better ways to explain the rise of this increasingly important revenue instrument.

## 2 OVERVIEW OF THE BOOK

This book proposes a new approach to explaining the rise of the VAT and adopts a tripartite structure to do so.

### 2.1 *Part I – The rise of the value-added tax – Exploring the gap between expectation and delivery*

Part I traces the trajectory of the VAT's rise and explores the gap between the promise of the good VAT supported by the conventional approach and the reality of the more than 150 real VATs in existence.

Chapter 2 explores the type of VAT the conventional approach promotes, labelled the *good VAT*. The *good VAT* does not refer to a theoretically pure VAT but rather represents the consensus position within the conventional approach on what a best-practice VAT should look like based on certain shared normative preferences and common experiences in real-world VAT implementation. The term *good VAT* is not intended to endorse or pass judgment on the conventional approach's preference for this best-practice VAT but simply to describe it in the terms used by the conventional approach. The good VAT is, in essence, achieved through three design norms that require the VAT be levied: (1) on a broad consumption base at a single rate; (2) through the invoice-credit method; and (3) on a destination basis. The chapter discusses these design norms and highlights the associated merits they are said to facilitate. These merits include those traditionally related to the evaluation of revenue instruments such as revenue generation, efficiency, neutrality, simplicity and equity. The chapter also introduces some problematic aspects in the design of the good VAT – *frontier issues* which test the limits of the good

VAT,[24] such as the application of the VAT to real property and cross-border supplies, as well as the increasingly problematic issue of VAT fraud. The remainder of the book focuses on one frontier issue – the taxation of financial supplies – to illustrate the types of issues that arise when the limits of the good VAT are reached.

Chapter 3 assesses how the many real VATs in existence fare against the three design norms of the good VAT. The term *real VATs* is deployed to encompass the variety of VATs which actually exist in practice. The analysis shows that even by the conventional approach's own assessment few, if any, real VATs resemble the prescriptions or promises of the good VAT. That is, they infrequently apply to a broad base at a single rate and there are various difficulties in levying the VAT through the invoice-credit method and on a destination basis. As a result, these real VATs fail, in various ways, to realise the promised merits of the good VAT.

### 2.2 *Part II – Explaining the rise of the VAT*

Part II focuses on the much-neglected question of explaining the rise of the VAT. It identifies that more than mere neglect contributes to a poor understanding of the rise of the VAT and proposes an alternative to the dominant and insufficient explanations provided by the conventional approach.

Chapter 4 examines the various attempts to explain the rise of the VAT. It reveals that the dominant explanation provided by the conventional approach attributes the VAT's rise to the merits of the good VAT despite the conventional approach's own acknowledgement that few, if any, countries actually have a good VAT. Such is the confidence in the belief of the merits of the good VAT by the conventional approach that many of its proponents treat the history of VAT reform as irrelevant or unproblematic. Whereas the histories of VAT reform are treated as having little or no bearing on the VAT's design and operation, the design of the VAT is presented as having ultimate bearing in explaining the history of the VAT's rise.

The book contends that an explanation of the rise of the VAT by reference to its merits cannot hold. First, at a basic level, the good is not self-realising – 'good' ideas might never get adopted, while 'bad' ideas often are.[25] Second, in light of the discrepancy between the good VAT and real VATs, an explanation that attributes the VAT's rise to the merits of the good VAT falters when confronted by the fact that no one in practice has a good VAT. When it is acknowledged that no one has a good VAT, or that the merits of real VATs operate in different and sometimes contradictory ways, the empirical account of the conventional approach fails. In essence, the conventional approach is explaining the rise of something that does not exist – there

[24] For this notion of a frontier issue, see Richard Bird and Pierre-Pascal Gendron, *The VAT in Developing and Transitional Countries* (Cambridge University Press, 2007), 2, 97.
[25] Raymond Geuss, *Philosophy and Real Politics* (Princeton University Press, Princeton, NJ, 2008), 28.

is no one good VAT in practice, just as there is no one meritorious real VAT that appeals to all people in all places at all times. Instead, there are a number of real VATs that appeal for overlapping, different and sometimes contradictory reasons dependent on local context. However, right at the point when the merits matter the most, at the point of a country deciding whether to introduce a VAT, rather than examining this context and deriving some useful insights into how merits are actually perceived and how real VATs come about, the conventional approach circumvents the analysis by simply attributing the VAT's rise back to its general merits.

Chapter 4 demonstrates that one major problem with the explanations provided by the conventional approach of the rise of the VAT is a failure to adequately take account of the policy-making processes that result in real VATs. Some authors treat the merits of the VAT as solely determinative of its rise. The promise of more sophisticated explanations which begin to take account of mediating factors, such as the role of transnational actors, the impact of fashionable trends, or yardstick competition, is cut short by the authors treating these factors as mere consequences of the merits of the VAT, good or real. So, international government actors, such as the IMF and World Bank, simply become mere messengers of the virtues of the good VAT, and countries converge on fashionable trends not because it is the fashion but because the fashion is virtuous or good. There is little discussion, for example, of what deeper forces, if any, underpin the fashionable trend toward VAT reform, or of how key intergovernmental actors have shaped VAT reform or of what might have prompted their actions. Moreover, there is virtually no discussion of the role of other transnational actors, such as consultants, private firms and aid and development agencies, in promoting VAT reform. These omissions are particularly striking given that it is those within the conventional approach who have been at the forefront of VAT reform.

In light of the many deficiencies in the explanations for the VAT's rise provided by the conventional approach, Chapter 5 proposes refocusing the inquiry from a general one into how the VAT has risen to one that better reflects the empirical reality and therefore examines how *real VATs* have risen. Chapter 5 brings to light those aspects of the policy process ignored or downplayed by the conventional approach. It considers two prominent yet divergent approaches to policy analysis, public choice and historical institutionalism, for an alternative means by which to explain the rise of the VAT. Both approaches highlight the manner in which policy outcomes are constrained by a combination of factors that challenge the very perceptions of merits, let alone the realisation of those merits. Public choice, for example, shows how the constraints on, and choices of, actors in the tax-policy-making process can result in policy outcomes that might be considered politically optimal but decidedly unmeritorious from the perspective of the conventional approach.[26] So, the much-derided

[26] See, e.g., Walter Hettich and Stanley L. Winer, *Democratic Choice and Taxation: A Theoretical and Empirical Analysis* (Cambridge University Press, 1999).