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Why do not all countries introduce a VAT/GST?

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Before the 1950s, no country applied Value Added Tax (VAT). Today, more than 70 per cent of the world's population lives in countries with VAT, also called goods and services tax (GST). In this blog, the spread of VAT around the world is described. But not all countries apply a VAT. Syria and the United States (the US) are two examples. Why do not all countries introduce a VAT?

The origin and the spread of VAT

The origin of VAT is somewhat disputed. Some consider the German businessman Wilhelm von Siemens to be the father of VAT when he proposed it in 1919. Others indicate that it was invented by the economist Thomas Sewall Adams at approximately the same time. VAT was not developed by legislative bodies and implemented directly but began as a model for a general tax on consumption.

From 1953 to 1967, the US State of Michigan levied the Business Activity Tax (BAT). The BAT was imposed on adjusted receipts or income. Taxpayers deducted certain items from taxable gross income, which included the most standard and customary business expenses. These comprised all taxes except income tax, fees, the cost of goods sold, interest, rent, and depreciation on real property.

The first country to implement VAT as we know it today was France in the early 1950s. The French VAT was a transformation of the existing French production tax. Initially, the system consisted of two different taxes. One tax on production was based on the sales price of merchandise and borne by the end manufacturer. The second levy was a turnover tax that applied to all persons who manufactured the goods. As a result of tax reform in 1954, a comprehensive VAT with full deduction also for input VAT on capital goods was introduced.

In 1960 and 1961, the Ivory Coast and Senegal introduced the French VAT system. Denmark and Brazil implemented VAT in 1967, which was also the year of the first EEC VAT Directives. By the late 1970s and the early 1980s, VAT had reached Latin America and sub-Saharan Africa. Many Latin American countries were advised by organizations such as the International Monetary Fund and the World Bank to consolidate their fiscal capacity by introducing VAT. The Republic of Korea implemented VAT in 1977, New Zealand adopted GST in 1985, Turkey, Spain, and Portugal introduced EEC-based VAT systems in 1985-87 as preparations for their accession to the

European Community (EC). VAT spread to Japan in 1989, Canada and South Africa in 1991, China in 1994, Australia in 2000, India in 2005. More recent examples are Saudi Arabia which implemented VAT in 2018, the United Arab Emirates in 2018 and Bahrain in 2019, whereas Qatar and Oman are expected to introduce VAT in 2021.

Today, the vast majority of all the countries in the world apply VAT. By now, 169 of the 193 countries with full UN membership have VAT. The only major economy without VAT is the US.

Why do not all countries introduce VAT?

There are different explanations for why VAT has spread over the world. Some countries have introduced it to increase their revenue, whereas others have replaced problematic sales taxes with VAT that is considered more neutral and efficient. Another explanation is historical institutionalism, meaning that past choices influence the decision-making process. In her recent research in "*The Rise of the Value-Added Tax*", Kathrin James suggests that an interdisciplinary approach that draws on public finance, policy analysis, and legal analysis is essential for developing a further understanding of the rise of VAT. The actual reasons behind the spread of VAT have, thus far, not been thoroughly researched.

When asking why VAT has spread, it is likewise interesting to ask why some countries have chosen not to implement a VAT. Syria and the US serve as examples here.

Syria introduced a consumption tax act that replaced the special consumption taxes in 2015 (Law decree 2015/11), as a preparation to introduce VAT. However, the consumption tax base is too narrow for the tax to qualify as a general consumption tax. Subject to tax are some services in connection to tourism and entertainment (such as night clubs, hotel accommodation and amusement parks), imported goods, cars, alcohol, tobacco, and some luxury products such as make-up and jewellery, concrete and some domestically produced appliances, such as washing machines and dishwashers.

Besides the ongoing civil war, which are the explanations behind VAT not being introduced in Syria yet? The topic has been discussed in the literature and at seminars. One reason that has been put forward is that the taxpayers' tax awareness needs to increase to make the taxpayers comply. The shadow economy is still extensive. Another explanation is that the country struggles with one of the world's highest inflation rates. The prices are already high in relation to salaries. To impose a VAT on top of already high prices may make it difficult to make the consumers carry the VAT burden. A modern VAT also requires an efficient tax administration that handles big data sets. Thus, it is not easy to implement VAT in the present state. There are many examples of general consumption taxes throughout history, which have been introduced to rebuild a country after a war. Since Syria's neighbours have already introduced or are just about to introduce VAT and funding will be needed to rebuild the country, it is probably just a matter of time until also Syria introduces VAT.

If we look at the US instead, it seems less likely that VAT will be introduced in the near future. Most states have a long tradition of general sales and use taxes at the state level. There have been proposals for a federal VAT. Since consumption is already widely taxed in the US, the introduction of a federal VAT is a more complex issue than taxing a previously non-taxed tax base. A federal VAT would bring tax revenue to the federal government, most likely at the cost of the states' tax revenue. Furthermore, an argument often seen in the debate is that a VAT would have regressive effects on low-income families. An argument for introducing a VAT system is that if all surrounding countries apply the destination principle and the US does not, there is a risk of distortion of the cross-border trade competition.

To conclude, these two examples demonstrate that the reasons not to introduce VAT differ widely. VAT has the advantage that it has the potential to be neutral for the taxable businesses, but this only applies if the tax base is broad and the exemptions are few. One disadvantage is that VAT is burdensome for businesses from an administrative point of view since it is levied at all stages. However, the more automated the tax reporting and the tax administration become, the more the administrative burdens for the businesses may decrease.

In some VAT countries, namely the Philippines and Russia, there have been discussions to replace VAT with other taxes. However, the general trend is that VAT continues to spread over the world. It is difficult to predict if this trend will continue until all countries apply a VAT, if the spread of VAT will slow down and eventually stop, or if there are even more efficient ways to tax consumption in a modern, digitized world than applying a VAT.

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