Potential of Tax Resources in WAEMU Member States: estimating the VAT Gap and its determinants

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RÉSUMÉ

This paper focused on the estimates of the VAT gap in WAEMU Member States using the “top-down approach” and conducted econometric analysis to assist in the understanding of the nature and causes of the VAT gap, and to identify country-specific characteristics that appear related to different levels of the VAT gap. The VAT gap is the difference between the theoretical VAT liability and VAT actually collected. It is often expressed in relative terms as a ratio of a theoretical VAT liability. Panel Corrected Standard Errors, robust OLS regression and instrumental variable methods have been used to identify the factors which explain the different levels of VAT gap. Two variables were found to have the strongest relationship with the level of the VAT gap. The VAT gap share increases with the final consumption (% of GDP) of households and non-profit organizations. Second, if the VAT burden, characterized by the ratio theoretical VAT liability to GDP is included as a candidate explanatory variable, then we find a significantly positive connection with the VAT gap. But, we have identified the risk that this estimated correlation could be biased by the measurement errors in the estimation of the theoretical liability. After taking into account this risk through instrumental variable regression, we conclude on a negative and significant relationship with the VAT gap. However, it is up to policymakers to account for not only the VAT rates but also the structure of the tax base with a view to a more efficient VAT system.

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