Price effects of VAT reform in China:With a focus on “refund rate of export tax” and “tax credit of investment goods”

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The introduction of a VAT type indirect tax is advanced in developing countries in order to stabilize the tax revenue. China is not an exception. Value Added Tax (VAT) was experimentally introduced in China as a replacement of the previous indirect tax (industry and commerce tax) in the national tax reform given in 1984. Chinese government reformed the tax system in large in 1994 while the VAT was also reformed for full-fledged introduction after a decade of experimental period.
The current VAT rate is 17% and the VAT revenue as of 2007 amounts to 1.56 trillion RMB (approximately 205 billion USD), which accounts for about 32% of the total tax revenue of 4.95 trillion RMB (approximately 650 billion USD). Now VAT is the largest source of the government revenue in China.
According to the principle Border Tax Adjustment (BTA), all of the VAT included in exports (export tax) should be refunded to exporters, export tax in China, however, is not necessarily refunded to the exporters. In other words, Chinese government has been used the refund rate of the export tax as a policy instrument to adjust domestic industry structure. This policy is criticized since this could distort the relative price structure in China and the frequent change of the refund rate makes it difficult for exporters to estimate the production cost.
The VAT system in China used to have another problem. The VAT system did not have tax credit system for investment goods. It is said that this has disturbed investment activities in the private sector. In response to such criticism, Chinese government implemented a tax reform again on January 1st, 2009 where the tax credit system was enlarged to cover investment goods.
This research has two proposes: (1) to give a theoretical model to calculate the price change by industry and tax revenue of VAT in the framework of input-output analysis, and (2) to implement simulation analyses regarding the regime change on “refund rate of export tax” and “tax credit of investment goods” based on this theoretical model.