

Income distribution effects of Value Added Tax reform in China

Topic: IO Theory: Input-Output Price Model

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The value-added tax (VAT) is imposed to manufacturing sectors and business tax (retail sales tax) is charged to service sectors in China after 1994. This dual system, however, has been considered problematic from the point of view of complexity of tax system and inter-industry fairness of tax burden. Chinese government, therefore, has decided to abolish the business tax so that VAT may be also applied to service sectors. This tax reform has partially started on January 1, 2012, and fully started for all sectors in whole China on May 1, 2016.

This paper shows a model to express the price changes caused by value-added tax to apply the input-output price equilibrium model to China's non-competitive input-output table in 2012. On this basis, we analyze the effect of the tax policy of switching business tax to value-added tax on prices, tax burden and income distribution for China's households.

The results show that this tax reform may generally make the price decline and reduce tax burden of households in China. We have observed, however, the tax reform would have a stronger regressive and higher income person friendly feature than before the tax reform even though the tax reform would reduce tax burden for households of any income classes.