

Impact of VAT on CPI

Willem Boshoff

The increase in VAT from 14% to 15% will likely raise CPI by 0.6% for 2018. Why?

- Two common mistakes are (1) assuming that prices will rise only in April, (2) assuming that prices will rise by 1% because VAT increases by 1%.
- Research by the IMF* shows that at least half of the increase in prices following a VAT increase occurs before implementation and at least some of the increase well after.
- More challenging: estimating how much of the VAT increase will be passed on to the consumer. There are no previous VAT increases in South Africa to provide us with guidance. IMF research*, based on the experiences of 17 Eurozone countries for the period 1999-2013, finds that a change in the standard VAT rate – i.e. a general change applicable to all items, such as our increase – is passed on fully.
 - Earlier studies suggest lower than full pass-through for VAT, but focus on particular products' VAT treatment in particular countries.
 - Therefore expect high pass-through for our VAT rise, though the effect may be reduced somewhat by the greater number of products now exempted from VAT.
- My proposed calculation:
 - The CPI basket consists (roughly) of 75% core (50% services and 25% goods), 17% food, 4% fuel and 4% electricity.
 - Assumption 1: VAT increase will affect a large part of the basket, say 80%. This excludes food (clearly a simplification) and excludes a small part of core.
 - Assumption 2: Pass-through of VAT increase will be 0.8 based on the above.
 - CPI increase: $80\% \text{ of basket} * 0.8 \text{ pass-through} * 1\% \text{ VAT increase} = 0.64\%$.
- VAT-driven increase in CPI will be counteracted by a strong Rand, so may be less visible.

* Benedek, D., De Mooij, R., Keen, M. and Wingender, P. 2015. Estimating VAT pass through. IMF Working Paper WP15/214. Available: <http://www.imf.org>

Prof Willem H. Boshoff
Stellenbosch University
Ph.D. (Stell), M.Sc. (Oxford)

+27 (0)83 398 6248

wimpie2@sun.ac.za

www.ekon.sun.ac.za/wboshoff

LinkedIn: <http://za.linkedin.com/in/whboshoff>

