# How Could We Improve the Federal Tax System?



## What is a VAT?

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**A. The value-added tax (VAT) is the world's most common form of consumption tax, in place in more than 160 countries, including every economically advanced nation except the United States.**

"Value added" is the difference between business sales and purchase of goods and services from other businesses. It represents the sum of wages, other labor compensation (such as health insurance), interest payments, and the profits businesses earn.

For example, suppose a farmer grows wheat and sells it to a baker for $40. The baker turns the wheat into bread and sells it to consumers for $100. The baker's value added is $60—the difference between sales and purchases. Let's further assume that the farmer has no input costs so that his value added is $40. The sum of value added at each stage of production is equal to the retail sale price of the good, in this case, $100.

The VAT is popular because it raises significant revenue, is relatively easy to administer, and, unlike an income tax, does not impinge on household saving and business investment choices. In 2015, VAT revenues averaged 5.8 percent of gross domestic product in the Organisation for Economic Co-operation and Development, the third-largest revenue source after income and payroll taxes.

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### Further Reading

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