

**A Static, Stylized CGE model applied to South Africa to evaluate the incidence of  
VAT on different income groups**

by

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**Abstract**

The last increase in the VAT-rate in South Africa was in April 1993 when it increased from 10% to 14%. Although it was expected that VAT would be increased in the 2001/2002 budget, the increase did not materialize. An increase in VAT could be a contradiction of South Africa's current macroeconomic policy GEAR which focuses on economic growth, employment and the redistribution of income, while an increase in VAT could burden the lower income group more contributing to poverty. VAT is, on the other hand, a potential additional source of revenue and the possibility to expand this source must be investigated.

A static stylized multi-sector model applied to South Africa is used to evaluate the effect of an increase in VAT on the lower income groups. The model includes all the major South African tax types, namely income tax, company tax, VAT, and import tariffs. The sectors included in the model are households, the government, firms and the foreign sector. There are two types of markets, namely a commodity market and factor markets. The factor market consists of two inputs, namely capital and labor. The model allows for intermediate inputs which is also known as inter industry flows, where the output of one firm is used as an input for another. South Africa is assumed to be small relative to world markets and therefore world prices are regarded as fixed.

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A Social Accounting Matrix (SAM) is used to configure the model and to determine initial equilibrium. The economy is shocked with an increase in VAT (from 14% to 15%) and the resultant change is observed. Changes in the price index of the income groups, government revenue, and consumer demand are some of the results that are obtained.