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Remittances and Public Finances: Evidence from Oil-Price Shocks

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Abstract

We study the effect of inflowing remittances – a major source of capital for many countries – on tax revenues and tax policy. Instrumenting remittances with changes in the oil-price interacted with a country's distance to oil-producing countries, we find that remittances have a large positive effect on VAT revenues, but no effect on income-tax revenues. This suggests that remittances often escape the income tax but can be taxed via consumption. We further show that tax policy is responsive to shocks in incoming remittances; they lead to a decrease in VAT-rates and increase the likelihood for a VAT introduction. We find no evidence for effects of remittances on income-tax rates.

JEL Classification: F24, H20, O23.

Keywords: Remittances, Tax revenue, Tax policy, Value added tax, Personal income tax, Migration, Development.

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