

Up and Down the Value-Added Tax

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Value-Added Tax Incidence

Suppose the VAT rate is reduced by $\Delta \leq \tau$ from an initial VAT rate of τ and then increased back to its original level τ .

Standard tax incidence argument:

pass-through of a VAT cut = pass-through of a VAT increase

This paper: Prices respond strongly to increases than to cuts in value-added tax.

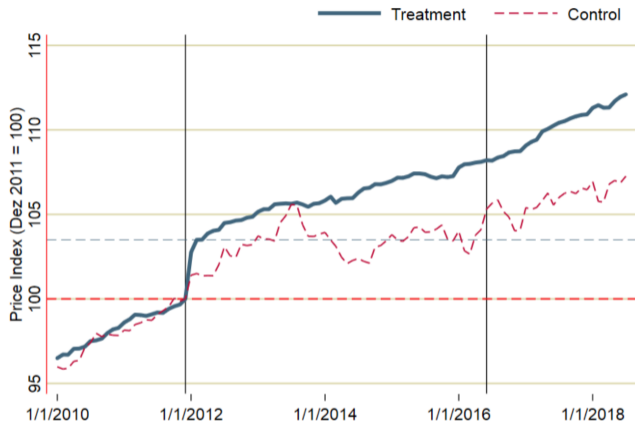
Reform: Value-added tax on purchases in Restaurants and other Catering Services in Portugal was increased from 13% to 23% in 2012, then brought back in 2016.

Data: Administrative firm-level data covering the universe of Portuguese private firms.

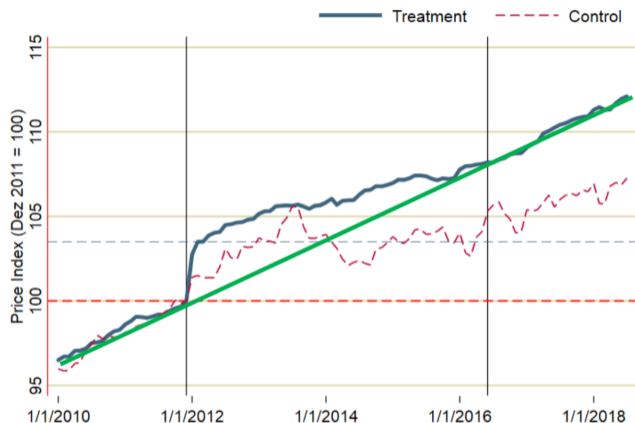
Additional Results

- ▶ In 2012, employees faced 4% and 5% reductions in hours worked and wages respectively, while firms experienced a reduction of more than 20% of their gross value-added.
- ▶ In 2016, symmetric response for employment and VA, but no increase in wages.

What Do We Learn from Comparing Treatment and Control Groups?



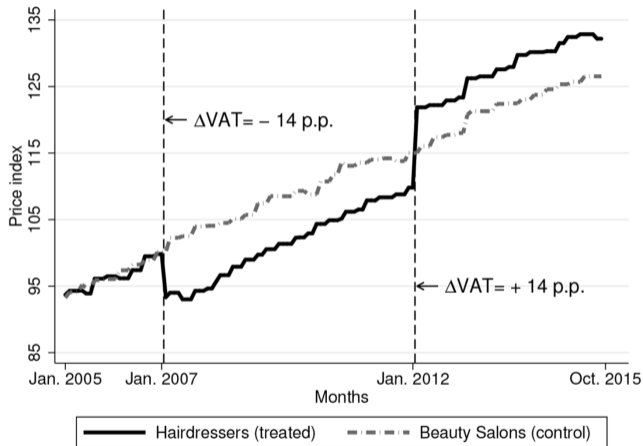
What Do We Learn from Comparing Treatment and Control Groups?



Discontinuous increase, then gradual convergence of the treatment-group prices to the pre-reform trend.

Behavior of the control group price index.

VAT Changes in Finland (Benzarti, Carloni, Harju, Kosonen, 2020)



Some Thoughts

1. Why no pass-through in 2016?
 - ▶ In *September 2013* AHRESP published a report stating that the VAT increase for restaurants led to a loss of 34 million euros of revenue in 2012 and “Therefore the government should repeal the increase, reducing VAT from 23% to 13% in order to promote employment.”
2. 2010-2014 Portuguese financial crisis \Rightarrow Differences in economic conditions between 2012 and 2016.
3. Difficult to draw statistical inferences on the magnitude of the asymmetry based on two observations of VAT changes.
 - ▶ Solution by Benzarti et al. (2020): Consider all VAT changes occurring in the European Union over 1996-2015.
4. Disentangle the effects on hours and employment.

Summary

Great Paper!

- ▶ Policy-relevant question.
- ▶ High-quality data.
- ▶ Interesting provocative results.

Future Insights

- ▶ Moving from static to dynamic tax policy effects.
- ▶ History dependence (cut \rightarrow increase \neq increase \rightarrow cut).