EDITORIAL

HOW TO SPEND IT? VOUCHERS VERSUS VAT CUTS

The bleak outlook for the labour market implies there is a strong case for measures to boost consumer spending in order to keep the recovery on track. A host of instruments can be considered: vouchers, VAT rate cuts, income tax cuts, tax credits, negative income taxes. Amongst these, a voucher programme offers many advantages given the possibility for fine-tuning the target group, the final beneficiaries, the type of spending and the regional dimension. However, it comes with considerable administrative costs.

Survey, activity and spending data are improving in countries where the lockdown measures have been eased. At the same time, the frequency of corporate restructurings and announcements of lay-offs has increased, painting a bleak outlook for the labour market.

Given the weight of household consumption in GDP[1], there is a strong case for trying to boost consumer spending in order to keep the recovery on track. Several countries have already taken initiatives in this respect, such Germany -temporary VAT cut, incentives to buy electrical car- or France -incentives for buying environment-friendly cars. In general, a variety of measures can be considered to stimulate spending. In addition to those already mentioned, there are vouchers, income tax cuts, tax credits[2], negative income taxes[3], etc.

The choice may depend on different factors. First, there is the ease and speed of implementation. Tax cuts, tax credits and negative income taxes score high in this respect whereas distributing vouchers take more time and are administratively cumbersome. Second, there is the question of how fast the additional spending power becomes available. For VAT cuts, once passed into law, this can be quick. For vouchers it takes more time as it depends on the efficiency of the distribution system whereas an income tax cut only leads to higher spending power with considerable delay.

A third, important consideration is the possibility to target the beneficiaries. Rather than having everybody benefitting, a government might want to reach low income households or people having lost their job. Such a preference can be based on ethical grounds –helping those who suffer most- but also on economic considerations because these target groups can have a higher marginal propensity to consume out of extra income. This would imply a bigger bang-per-buck for the economy at large. This type of targeting is very much feasible with vouchers and income tax measures but not with VAT cuts.

Forth, the ability to focus on certain expenditure items is high in case of vouchers and VAT reductions but is absent for the other measures. Governments might want to focus on certain goods and services, in an effort to kill two birds with one stone –e.g. a subsidy for buying an electric car has an economic effect but is also welcome in the context of climate change policy-, to favour certain sectors which suffer from subdued demand and high unemployment or to target activities with a high domestic value added and a low import content.

Fifth, vouchers can also be limited to people living in certain regions, towns and villages. The rationale would be based on a bigger multiplier effect in those parts of a country suffering from a deeper recession. The regional or local government could introduce such a programme as well. Income tax related measures could also be deployed regionally. Sixth, in case of vouchers, the cost of the initiative is known in advance[4]. For several other measures, any estimate will be very imprecise and depend on hypotheses. Finally, there is the important question of who is the direct financial beneficiary[5]. For most instruments, this is the household but in case of a VAT reduction, producers including

1. In 2019, private consumption represented 53.5% of GDP in the eurozone, 53.7% in France, 52.2% in Germany and 68.0% in the US (data based on national sources).
2. A tax credit is an amount that can be deducted from the income taxes which are owed.
3. A negative income tax means that taxpayers earning less than a certain threshold would receive money from the government, rather than paying income taxes.
4. To be precise, this concerns the maximum cost. In reality, some people might not use the vouchers thereby lowering the cost of the programme.
5. A measure has a direct beneficiary –who benefits from the voucher, tax cut, etc.- and indirect beneficiaries, benefitting from the increased spending of the direct beneficiaries.

VOUCHERS VERSUS VAT CUTS

	Vouchers	Temporary VAT cut	Income tax cut	Tax credit	Negative income tax
Speed of implementation	slow	high	high	high	high
Speed of money being available	average	high	slow	high	slow
Possibility to target beneficiaries	high	no	high	high	high
Possibly to target in terms of items	high	high	no	no	no
Possibly to target in terms of geography	can be easily applied regionally, locally	difficult	possible	possible	possible
Cost estimate	precise in terms of maximum cost	imprecise	imprecise	precise	imprecise
Direct beneficiary	consumers	consumers and producers	consumers	consumers	consumers

SOURCE: BNP PARIBAS

A voucher programme to boost household spending offers many advantages given the possibility for fine-tuning the target group, the final beneficiaries, the type of spending and the regional dimension.

shopkeepers may try to keep some of the benefit for themselves by lowering their prices less than the decline in indirect taxes.

All in all, a voucher system has many advantages if the objective is to kickstart spending, in particular because it allows for targeted measures with a with a maximum cost known from the outset. However, they come with a considerable administrative cost. Tax credits also score high on most dimensions.

Focussing on vouchers and VAT cuts –measures which seek to directly influence consumption- the key question of course is about their macroeconomic effectiveness, in terms of impact on consumption and GDP. A key condition is the temporary nature of the measures, creating an incentive to quickly step up spending. This is far less likely in case of a permanent reduction in VAT or if vouchers would not expire.

Like with any increase of domestic demand, the multiplier effect will depend on the import leakage –to what extent does higher domestic demand lead to increased imports- but a key factor is the existence of substitution effects. Households may decide to maintain their level of spending, but with a changed financing mix: part income, part vouchers or the extra spending power from the VAT reduction. There can also be an intertemporal substitution effect: consumption is brought forward, to the detriment of future consumption.

With so many conflicting influences, one needs to look at empirical studies to get a better insight. Research on a temporary voucher programme in March 1999 in Japan shows a positive impact on spending on semi-durables, without a drop in consumption after the programme had ended[6]. On the other hand, a nationwide voucher programme in Taiwan in 2009 "*may have had no effect on stimulating the economy*"[7]. Research on the reduction in 2009 of the VAT on sit-down restaurants in France concludes a limited effect for consumers, whereas a subsequent increase in VAT rates had a bigger impact on prices[8]. To conclude, comparing different ways of stimulating household spending, a voucher programme offers many advantages given the possibility for fine-tuning the target group, the final beneficiaries, the type of spending and the regional dimension.

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6. *Did Japan's shopping coupon program increase spending?* Chang-Tai Hsieh, Satoshi Shimizutani, Masahiro Hori, Journal of Public Economics, 2010, pp. 523–529. Semi-durables consist of clothing, footwear, sporting goods, video games, computer hardware and software and books. The programme was targeting families with young children as well as elderly people. The vouchers needed to be spent in the local communities.
7. *Did the Consumption Voucher Scheme Stimulate the Economy? Evidence from Smooth Time-Varying Cointegration Analysis*, Feng-Li Lin and Wen-Yi Chen, Sustainability, 2020
8. *Who benefitted from the July 2009 sit-down restaurant value-added tax cuts?* Youssef Benzarty and Dorian Carloni, Institut Politiques Publiques, note n° 32, 2018 En français: Qui a bénéficié de la baisse de la TVA dans la restauration en 2009?