Discussion of
The Macroeconomic Effects of Trade Policy

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Border Adjustment Taxes

• A hugely important topic
  — not just the corporate tax with border adjustment (C-BAT) proposal
  — also possible VAT reforms, which on the surface may appear to do little with trade (e.g., the 2007 German reform)

• State of the literature (Grossman, Feldstein-Krugman):
  — largely assumes neutrality of border adjustment
  — Lerner symmetry under flexible prices and wages
  — offsetting exchange rate movements with nominal rigidities (FGI, 2014: under fixed ER, akin to a devaluation)

• This paper, along with a few other recent contributions, challenges the neutrality and works out the implications of border taxes in full complexity
Rational for the policy

- Limit the incentives for cross-border transfer pricing (Auerbach et al.)
  - destination-based tax system with tax jurisdiction based on location of consumption, rather than location of production
  - non-macroeconomic effect?
  - effects on the extensive margin: entry and exit of firms

- Political rational: raise tax revenues to pay for the reduction in the corporate tax rate
  - BFGI (2018): indeed the case, even if BAT is neutral
  - “the magic of BAT”
  - but only in the short run under trade deficits, while NPV of fiscal revenues proportional to the country’s NFA
Conditions for neutrality from BFGI (2018)

1. Short-run pass-through symmetry (import and export prices)
   - symmetric response of border prices to both border taxes and exchange rates
   - satisfied under theoretical PCP and LCP, unlikely in the US ⇒ likely decline in both US imports and exports, and world trade

2. International assets and liabilities in foreign-currency bonds
   - otherwise, international transfer. also domestic transfers

3. BAT is a one-time permanent and unanticipated policy shift
   - excludes BAT adoption abroad, or policy reversal at home
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4. Conventional monetary policy (Taylor) rule
   - can condition on effective CPI inflation and output gap
   - no direct response to exchange rate swings

5. BAT is uniform and applies to all imports and exports
Departures from BAT Neutrality

- Dollar appreciation with dollar-denominated debt results in a large transfers towards the rest of the world (∼ 100% of GDP)
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• BAT neutrality requires complete appreciation of the dollar. Complete appreciation is quantitatively robust to:
  — nature of price stickiness
  — structure of product markets
  — structure of asset markets

• Appreciation is very sensitive to:
  1. Expectations
     — what is a good benchmark?
  2. Monetary policy response
     — would the Fed accommodate?
     — what is the optimal accommodation?

VAT reform (w/out payroll subsidy): could be neutral too, but under more stringent conditions. Requires no appreciation.
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Assumptions in EPR

- **Producer currency pricing**
  — not a great assumption even outside the US

(a) Belgian Imports

(b) Belgian Exports

Source: Amiti, Itskhoki and Konings (2018b)
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• instantaneous VAT pass-through