

Discussion of  
**The Macroeconomic Effects of Trade Policy**

BY CHRISTOPHER ERCEG, ANDREA PRESTIPINO AND ANDREA RAFFO

OLEG ITSKHOKI  
Princeton University

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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  $\Rightarrow$  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
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- ③ BAT is a one-time permanent and unanticipated policy shift
  - excludes BAT adoption abroad, or policy reversal at home
- 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

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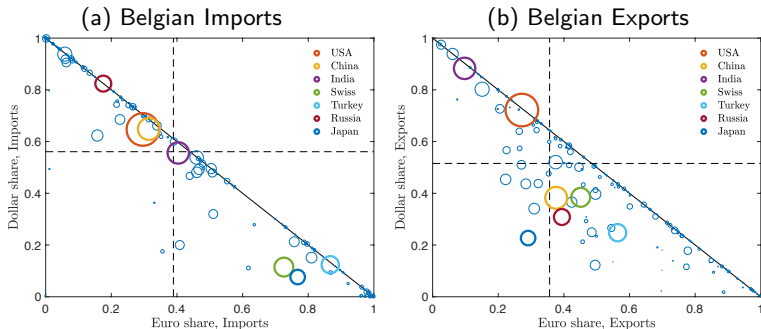
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- VAT reform (w/out payroll subsidy): could be neutral too, but under more stringent conditions. Requires no appreciation

## Assumptions in EPR

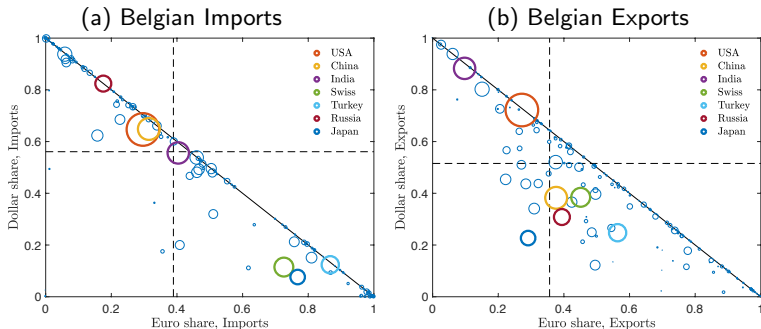
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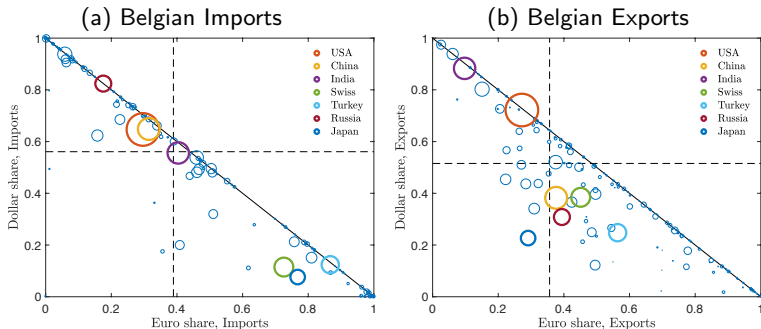


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- instantaneous VAT pass-through