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SIX QUESTIONS FOR STEFAN BACH

»Relief for the middle class through value-added tax cuts«

1. Mr. Bach, to what extent could cutting the value-added tax rate relieve low- and middle-income earners? *If you want to provide significant fiscal relief to lower and middle income groups, you should focus more on the value-added tax and less on the income tax. The value-added tax puts the burden on consumption, and consumer spending accounts for a much higher proportion of lower incomes than higher incomes. High earners pay high direct taxes and social security contributions. They are also able to save a large portion of their income, so they are less affected by the value-added tax burden than low earners are. This is called a regressive tax burden and refers to current income.*
2. Which rate should the value-added tax be lowered to in order to create tangible relief for consumers? *The current regular value-added tax rate is 19 percent. It could be cut to 18 percent. This would provide consumers with relief worth 11 billion euro. In addition, policy makers could cut the reduced tax rate for food and public transportation to five percent. This would also provide additional relief to lower income groups because food and public transportation costs account for a relatively high portion of their spending. The result would be a tax relief volume of 15 billion euro, which is frequently called for in politics today.*
3. Would cutting the value-added tax have any effects on consumption? *Cutting the value-added tax would not only improve the distribution of the tax burden, but also increase consumption. We don't need the latter at present because the economy is in good shape. However, we should increase private consumption in the long term—not least in view of the major macroeconomic imbalances and Germany's high account surpluses. Cutting the value-added tax would play a role in stimulating consumption and in turn, imports.*
4. How great is the risk of companies failing to pass the lower value-added tax on to consumers? *Of course companies must first pass the value-added tax cut on to consumers. There is no blanket guarantee that they will do so. There must be adequate competitive pressure as well. In the current economic situation, it could take a few years until consumers can feel the value-added tax cut in their purses. However, that will indeed be the case in the long term because competitive pressure is high enough in most sectors.*
5. How long do you think it will take? *We can assume that the process of passing on the cut will be completed in five years at the latest. After all, competition will force companies to pass the tax relief on to consumers in the form of lower prices.*
6. Why does the debate on tax reform appear to be ignoring the option to cut the value-added tax rate? *The value-added tax has been gradually expanded in the past two decades and is now a main cornerstone of government finance. The revenues from it have allowed the government to reduce direct taxes and finance the social security system as a means of lowering social security contributions. This has become an established mechanism, and fiscal policy is reluctant to change it for no reason. And on the other hand, the issue of passing on the cut has not been clarified. If value-added taxes are raised, companies will obviously raise their prices as well. It is not universally apparent that companies will also permanently lower their prices if value-added taxes are cut.*

Interview by Erich Wittenberg



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