

Accepted Manuscript

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PII: S0047-2727(15)00154-1
DOI: doi: [10.1016/j.jpubeco.2015.09.006](https://doi.org/10.1016/j.jpubeco.2015.09.006)
Reference: PUBEC 3614

To appear in: *Journal of Public Economics*

Received date: 6 September 2013
Revised date: 10 September 2015
Accepted date: 10 September 2015



Please cite this article as: Kosonen, Tuomas, More and cheaper haircuts after VAT cut? On the efficiency and incidence of service sector consumption taxes, *Journal of Public Economics* (2015), doi: [10.1016/j.jpubeco.2015.09.006](https://doi.org/10.1016/j.jpubeco.2015.09.006)

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More and cheaper haircuts after VAT cut?^{*}

On the efficiency and incidence of service sector consumption taxes

Tuomas Kosonen[†]

September 10, 2015

Abstract

Consumption tax rates targeted at specific sectors are often reformed without any empirical knowledge about the efficiency of these policies. This paper sheds light on tax incidence as well as the efficiency issue, the potential for welfare improving reform, by studying the impact of value added taxes (VAT) on prices and quantities of labor intensive services. I utilize a VAT reform targeted at a specific service sector, which creates a natural experiment set up. The VAT for hairdressing services in Finland was reduced from 22% to 8%, and the previous tax treatment still applied to other labor intensive services. The choice of the treatment and control groups was exogenous to circumstances in Finland, since these groups were selected from a wider European setting. The results suggest that hairdressers cut

^{*}Acknowledgments: I am grateful to the helpful comments from the editor Henrik Kleven and two anonymous referees. I want to thank Essi Eerola, Wojciech Kopczuk, Eva Mörk and Jukka Pirttilä as well as those of many conference audiences for helpful comments that provided many insights to this article. These insights provided much needed fuel for thought, although all the commentators do not necessarily share all the views in the final article. I am also grateful to the financial support of the Nordic Tax Research Council for this study and the cooperation of the Finnish Hairdressers' Association, in addition to the Finnish Competition and Consumer Authority in obtaining the data for this study.

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