BanRep Blog: VAT exemption days in Colombia: How did Household Consumption respond?

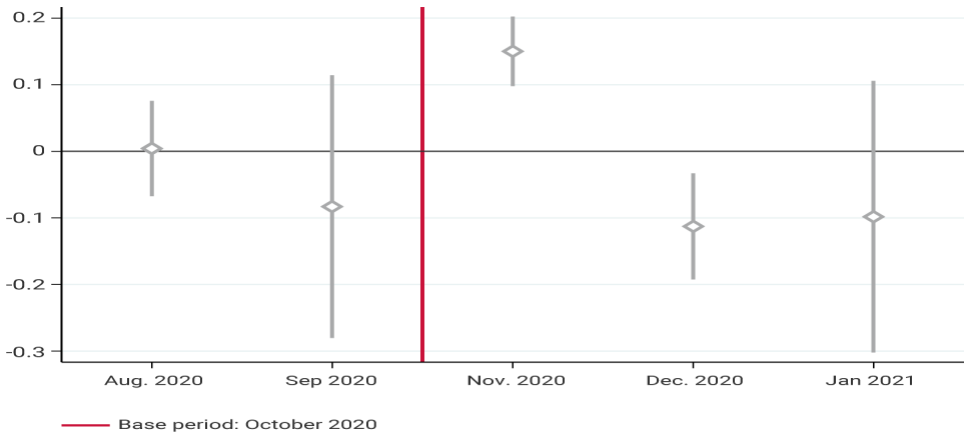
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The value added tax (VAT) exemption days policy has been used in the United States and in the European Union to encourage the consumption of goods and services that are important for lower-income households. In Colombia, after the crisis caused by the COVID-19 pandemic and to help boost the economy, the Colombian Government implemented the VAT-exempt days policy, regulated by Decree 682 of 2020 and subsequent regulations. With this policy, the purchase of certain goods was exempt from VAT for a day. The goods covered by the temporary exemption included clothing, household appliances, toys, and school and sports items. A total of three days were VAT-exempt in 2020, three days in 2021, and two more in 2022.

A recent paper published in the series Working Papers on Economics (Borradores de Economía) published by *Banco de la República* (the Central Bank of Colombia, Banrep) studies the implementation of VAT-exempt days in Colombia. Researchers Luis Eduardo Arango and Luz Adriana Flórez from Banrep, who participated in the study, use disaggregated data from the National Administrative Department of Statistics (DANE in Spanish) and econometric techniques to estimate the effects of this policy on household consumption. The authors found evidence that the VAT-exempt days had a positive and significant effect (between 9.0% and 17%) on the consumption of exempt versus non-exempt goods, but this effect was transitory and correlates with subsequent declines after the policy was implemented.

As an example, Graph 1 illustrates the effect of the VAT-exempt day implemented on 21 November 2020. This day has the advantage of not having had other VAT-free days in the preceding or following months. The graph exhibits the average difference in sales of exempt goods vis-a-vis non-exempt goods before, during, and after the month in which the policy was implemented. The magnitude of the vertical lines represents the statistical confidence interval of the estimated differences. As may be seen, the relative sales of exempt goods increased significantly during the month in which the policy was implemented but decreased notoriously in the following month.

Graph 1: Effects before, during, and after the VAT-exempt day on 21 November 2020. Consumption logarithm.



Note: The gray lines indicate the range of values that the estimate can take with 95% confidence.

By using additional techniques, the paper provides robust evidence of intertemporal substitution as a generalized consumer response to the policy's application. In other words, there is evidence of reductions in purchases of exempt goods during the months around the month of the VAT-exempt day and of increases in purchases during the months in which the policy was applied. Thus, for example, sales of computers and telecommunications equipment decreased by an average of 7.0% and 9.0% in the months before and after the month of the VAT-exempt day, respectively, while in the month of the VAT-exempt day, sales increased by an average of 9.0%.

The paper also shows evidence of intra-temporal substitution effects by consumers. That is, in the months around the VAT-exempt day and even during the month of the policy's implementation itself, sales of non-exempt goods may have fallen to partially finance purchases of exempt goods. This was the case for products such as food, alcoholic beverages, and other non-exempt goods, which experienced declines in sales between 1.0% and 3.0% around the policy's application, although these declines were not statistically significant in all cases.

These substitution effects over time and across products reduce the positive effects of the policy on economic activity. Therefore, assessment of the policy must weigh in these effects versus its benefits and substantial fiscal costs.

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