EFFICIENCY AND INCIDENCE OF TAXATION WITH FREE ENTRY AND LOVE-OF-VARIETY PREFERENCES T

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ABSTRACT

We develop a theory of commodity taxation featuring imperfect competition along with love-of-variety preferences and endogenous firm entry and exit. We derive new formulas for the efficiency and pass-through of specific and ad valorem taxes. These formulas unify existing canonical ones and feature a new term capturing the effect of variety on consumer surplus. As a proof of concept, we use theoretical formulas to identify love-of-variety preferences in an empirical application. Our welfare analysis shows that the marginal excess burden is sensitive to the estimated love of variety, which overturns classical results on the desirability of ad valorem versus specific taxation. (JEL D11, D21, D91, H25)