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Documento de Investigación 2022-09

Working Paper 2022-09

Salience and Taxation with Imperfect Competition*

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Abstract: This paper studies commodity taxation in a model featuring heterogeneous consumers, imperfect competition, and tax salience. We derive new formulas for the incidence and marginal excess burden of commodity taxation highlighting interactions between tax salience and market structure. We estimate the necessary inputs to the formulas by using Nielsen Retail Scanner and Consumer Panel data covering grocery stores and households in the U.S. and detailed sales tax data. We estimate a large amount of pass-through of taxes onto consumer prices and find that households respond more to changes in prices than taxes. We also estimate significant heterogeneity in tax salience across households. We calibrate our new formulas using these results and conclude that essentially all of the incidence of sales taxes falls on consumers, and the marginal excess burden of taxation is larger than estimates based on standard formulas that ignore imperfect competition and tax salience.

Keywords: Sales taxes, Marginal Excess Burden, Incidence, Salience, Imperfect Competition. JEL Classification: D12, D22, D43, D60, L13, H25, H71

Resumen: Se estudia la tributación de bienes en un modelo que presenta consumidores heterogéneos, competencia imperfecta e inadvertencia fiscal. Derivamos nuevas fórmulas para la incidencia fiscal y la pérdida marginal en bienestar social atribuible a los impuestos, destacando las interacciones entre la inadvertencia fiscal y la estructura del mercado. Estimamos las variables necesarias mediante el uso de datos de Nielsen que cubren supermercados y hogares en EUA, y datos detallados de los impuestos. Estimamos un alto traspaso de los impuestos a los precios al consumidor y encontramos que los hogares responden más a los cambios en los precios finales que a los impuestos directamente. También estimamos una heterogeneidad significativa en la inadvertencia fiscal entre los hogares. Utilizando nuestras nuevas fórmulas, concluimos que esencialmente toda la incidencia fiscal recae en los consumidores y la pérdida marginal en bienestar social es mayor que las estimaciones basadas en fórmulas estándar que ignoran la competencia imperfecta y la inadvertencia fiscal.

Palabras Clave: Impuestos, Bienestar Social, Incidencia, Inadvertencia Fiscal, Competencia Imperfecta.

^{*}This research is based in part on data from The Nielsen Company (US), LLC and databases provided through the Kilts Center for Marketing Data Center at The University of Chicago Booth School of Business. The conclusions drawn from the Nielsen data are those of the researchers and do not reflect the views of Nielsen. Nielsen is not responsible for, had no role in, and was not involved in analyzing and preparing the results reported herein.

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1 Introduction

Standard welfare analysis of commodity taxation typically makes two key assumptions: (1) the product market is perfectly competitive and (2) consumers respond to taxes in the same way they respond to price changes. Several papers in public economics have relaxed the first assumption (see Auerbach and Hines 2002 for a review of this literature), but these papers have maintained the second assumption that taxes are fully salient. More recently, researchers have relaxed the second assumption, developing new theoretical and empirical tools to analyze the welfare effects of taxes when taxes are less salient than prices, but have maintained the assumption of perfect competition (Chetty, Looney, and Kroft 2009; Taubinsky and Rees-Jones 2018; Farhi and Gabaix 2020; Morrison and Taubinsky forthcoming). If markets are characterized by imperfect competition and consumers misperceive taxes, however, neither of these approaches is likely to provide a fully accurate characterization of the welfare effects of commodity taxes.

In this paper, we derive new formulas for the incidence and marginal excess burden of commodity taxes (both unit taxes and ad valorem taxes) in a model featuring imperfect competition and tax salience with heterogeneous consumers. Using these formulas, we show how tax salience and market structure *interact* when considering tax incidence and the marginal excess burden.

For incidence, we show that greater attention to taxes can increase the incidence on consumers under imperfect competition in contrast to the standard model of perfect competition which predicts the opposite pattern. Thus, the standard intuition of how tax salience affects the incidence of taxation in perfectly competitive markets does not always carry over to imperfect competition. We also derive new results about how heterogeneity in consumer inattention to taxes affects incidence both under perfect competition and imperfect competition. We show that consumer heterogeneity affects passthrough and incidence under all market structures including perfect competition. With imperfect competition, there is an additional effect of heterogeneity on pass-through. Intuitively, when the consumer response to taxes is heterogeneous, this effectively changes the slope of the inverse demand curve facing the firm and firms take this into account when choosing prices. Of particular relevance for firms with market power is how inattention correlates with the price elasticity of demand. We show that firms bear less of the burden of taxes when elastic consumers are more inattentive to taxes. Thus, the covariance between consumer inattention and price elasticity is important for incidence analysis.

Turning to welfare, we find that tax salience and market structure directly interact in the tax formula characterizing the marginal excess burden of taxation. In particular, while the expression for the marginal excess burden includes the additive effects of imperfect competition (via the markup) and tax salience (via the inattention parameter), it also includes the output response to the tax which in turn depends on the degree of inattention to the tax and the output response to prices. While salience has a second-order effect on excess burden under perfect competition when there are no pre-existing taxes (see Chetty, Looney, and Kroft 2009), we show that it has a first-order effect under imperfect competition and scales linearly with the markup. This is important since it highlights that, at least in some circumstances, "behavioral biases" may have a second-order effect on the welfare cost of taxation in competitive markets but a first-order effect on this welfare cost when firms have market power. Moreover, holding fixed market structure, we find that greater attention to taxes (lower "frictions") magnifies the distortionary effect of taxation under imperfect competition. We also find, similar to Taubinsky and Rees-Jones (2018) and Farhi and Gabaix (2020), that heterogeneous inattention to taxes induces misallocation, but that greater dispersion in inattention increases the welfare cost of taxes in similar ways under perfect and imperfect competition; these results extend the heterogeneity results in Taubinsky and Rees-Jones (2018) to the case with continuous demand and imperfect competition.

After presenting our theoretical results, we provide new estimates of all of the necessary inputs to our tax formulas using Nielsen Retail Scanner (RMS) data covering grocery stores selling consumer goods in the U.S., Nielsen HomeScan Consumer Panel (HMS) data covering household purchases, and county-level and state-level sales tax data. Using the RMS data, we estimate the effect of taxes on consumer prices and quantity demanded using a regression model that leverages variation in sales taxes within states and counties over time, and another regression model that focuses on differences between "border pair" counties located on opposite sides of a state border (Holmes 1998; Dube, Lester and Reich 2010). We also estimate the price elasticity of demand based on an instrumental variable strategy that exploits the "uniform pricing" across stores within retail chains (DellaVigna and Gentzkow 2019). Our estimates indicate nearly-complete pass-through of taxes onto consumer prices and a tax elasticity of demand that is smaller in magnitude than the price elasticity of demand. We combine these estimates to provide a new estimate of tax salience, which is fairly similar to other estimates reported in the literature.

One concern with the RMS estimates is that our tax salience parameter estimate will be biased if there is meaningful cross-border shopping and other substitution across stores within a county. Intuitively, tax changes affect all stores within a county, while the "uniform pricing" instrument that we use only affects certain stores within a county that are part of the same retail chain, which may cause some households to substitute across stores in a way that is different from how the same households respond to tax changes. This would cause our price elasticity and tax elasticity estimates to diverge for reasons unrelated to tax salience. To investigate this potential bias, we replicate all of our main results in the HMS data, and, reassuringly, we find very similar tax elasticity and price elasticity estimates in the HMS data compared to the RMS data, once we adjust for differences in coverage between the two datasets. This suggests limited bias from cross-store substitution within and between counties.

We also use the HMS data to directly estimate household-level heterogeneity in tax salience using two complementary empirical approaches. First, we estimate models which allow the price elasticity and tax elasticity to vary with household-level demographic characteristics such as age, income, and education. We find strong evidence of statistically and economically significant heterogeneity in tax salience along these observable dimensions. Second, we estimate a mixed-effects model that allows for random coefficients for both the tax and price elasticity. We find an even larger estimated variance in the tax salience parameter using this richer model, which suggests an important role for both observable and unobservable differences across households in driving heterogeneity in consumer inattention. In our preferred specification, we find a mean tax salience parameter of about 30 percent (implying that households on average respond to taxes only about 30 percent as much as they respond to prices), with a two-standard-deviation range around the mean of about 45 percentage points.

Lastly, we calibrate our new tax formulas using these empirical estimates. A novel feature of

our approach is the use of the pass-through formula and the generalized Lerner index to calibrate the average markup, which enters in the marginal excess burden formula. We then consider two types of calibration exercises. First, we quantify the discrepancy if one "naively" computed the welfare cost of taxation using the standard Harberger formula (Harberger 1964) that ignores salience effects and assumes perfect competition. It is an empirical question whether the actual welfare cost is larger or smaller than the standard Harberger benchmark since inattention to taxes reduces it and imperfect competition increases it. Our results show that the standard Harberger formula *understates* the marginal excess burden of taxes. Second, we calibrate the excess burden of taxation in counterfactual scenarios that increase the salience of sales taxes and change the market structure taking into account the endogeneity of the output response to the tax and pass-through with respect to tax salience and imperfect competition in determining the pass-through of taxes onto consumer prices, the effect of taxes on quantity demanded, and ultimately the incidence and marginal excess burden. For example, we find that the change in the marginal excess burden from greater tax salience is larger under imperfect competition compared to perfect competition.

Our paper is related to several streams of research. First, our paper builds on and contributes to the literature on taxation and imperfect competition (see, e.g., Seade 1987; Stern 1987; Delipalla and Keen 1992; Anderson, de Palma, and Kreider 2001a; Anderson, de Palma, and Kreider 2001b; Auerbach and Hines 2001; Weyl and Fabinger 2013; Hackner and Herzing 2016; Miravete, Seim, and Thurk 2018; Adachi and Fabinger 2019).¹ Our paper innovates in several ways. First, we consider a general model of imperfect competition and do not impose a functional form for preferences or technology, similar to Weyl and Fabinger (2013).² Second, we permit consumers to underreact to taxes and allow for heterogeneity in the degree of underreaction. Third, we derive our new formulas for both ad valorem and unit taxes (allowing for tax salience) and compare these formulas, which is important since existing theoretical work finds that these taxes are not equivalent under imperfect

¹We focus on interaction between imperfect competition and tax salience but ignore firm heterogeneiety. Adachi and Fabinger (2019) consider the welfare and incidence effects of taxation with heterogeneous firms while assuming that consumers perfectly optimize.

²Weyl and Fabinger (2013) only consider tax incidence. They do not consider the efficiency costs of taxation.

competition (Delipalla and Keen 1992). Lastly, we provide an empirical application that allows us to calibrate our new formulas, which contributes to the literature studying sales taxes empirically (see, e.g., Besley and Rosen 1999; Einav et al. 2014; Baker, Johnson, and Kueng 2021).

We also contribute to the literature in behavioral public economics (Liebman and Zeckhauser 2004; Chetty, Looney, and Kroft 2009; Goldin and Hominoff 2013; Allcott and Taubinsky 2015; Taubinsky and Rees-Jones 2018; Allcott, Lockwood, and Taubinsky 2018; Bradley and Feldman 2020; Farhi and Gabaix 2020; Morrison and Taubinsky forthcoming).³ Most of the papers in this literature assume perfect competition. Bradley and Feldman (2020), which examines tax incidence in a monopoly setting with inattentive consumers, is an important exception. Relative to this paper, we allow for heterogeneity in tax salience across consumers, allow for more general forms of imperfect competition, and move beyond incidence to also study the efficiency cost of taxation. The joint consideration of incidence and efficiency analysis is important for our calibration approach, which combines both tax formulas to identify the markup which appears in the marginal excess burden formula.

The remainder of the paper is organized as follows: Section 2 begins with a model of imperfect competition and inattention and considers the welfare and incidence effects of a unit tax. Section 3 discusses the data and the empirical results. Section 4 presents the calibration results. Section 5 concludes.

2 Theory

We consider a differentiated product market (the "inside market") which is subject to a unit tax t on each product in the market.⁴ Following Auerbach and Hines (2001) and Weyl and Fabinger (2013), we assume that markets for other goods are perfectly competitive and are not subject to taxation. There is a mass 1 of consumers each indexed by i with exogenous income Z^i . For each i, preferences

³Our paper is also broadly related to other studies of salience and consumer choice such as Bordalo, Gennaioli, and Shleifer (2013). Our paper focuses specifically on the salience of taxes compared to posted prices, while Bordalo, Gennaioli, and Shleifer (2013) study salience of other attributes of consumer products.

⁴In the Appendix we derive results for the case of an ad valorem tax and compare unit and ad valorem taxes.

are given by the quasilinear utility function $u^i(q_1, \ldots, q_J) + y$, where q_j is the quantity consumed of product $j = 1, \ldots, J$ and $y \in \mathbb{R}$ is the numeraire (representing consumption in all the outside markets).⁵ The pre-tax (or producer) price for product j is given by p_j and the after-tax (or consumer) price is given by $p_j + t$ for all $j = 1, \ldots, J$. We define $u^i(Q^i) \equiv u^i(Q^i/J, \ldots, Q^i/J)$ to be the compact notation of utility for the symmetric case where individual i consumes $q^i = \frac{Q^i}{J}$ units of each product $j = 1, \ldots, J$, where Q^i is the aggregate quantity consumed by individual i. Throughout we assume that the number of products, J, is exogenous. In a companion paper, we allow for endogenous entry and exit of firms (see Kroft et al 2022).

Following Chetty, Looney, and Kroft (2009), consumer *i*'s demand for product *j* is given by $q_j^i = q_j^i(p_1, \ldots, p_J, t)$ which is a function of both pre-tax prices and the tax. In order to connect our tax formulas to empirical objects, it is necessary to relate observed demand $q_j^i(p_1, \ldots, p_J, t)$ to consumer willingness to pay. We thus make the following two assumptions:⁶

Assumption 1. Taxes affect utility only through their effects on the chosen consumption bundle.

Assumption 2. When tax-inclusive prices are fully salient, the agent chooses the same allocation as a fully-optimizing agent.

Assumption 1 requires that taxes or salience have no impact on utility beyond their effects on consumption. This assumption may be violated if, for example, attention is costly, as emphasized by theories of rational inattention (Gabaix 2019) and recent empirical evidence (Morrison and Taubinksy forthcoming). If there is a cost to processing non-salient taxes, then Assumption 1 is violated and one must additionally account for these information costs when examining the efficiency costs of taxation (Chetty, Looney, and Kroft 2007). Assumption 2 implies that when tax-inclusive prices are fully salient, agents maximize utility. Our framework allows for salience effects by considering the possibility that $q_j^i(p_1, ..., p_J, 0) > q_j^i(p_1, ..., p_J, t) > q_j^i(p_1 + t, ..., p_J + t, 0)$.

In what follows, we assume that the demand function $q_j^i(\cdot)$ is symmetric in all other prices which we denote by $(p_k)_{-j}$ and twice differentiable and denote by $q^i(p,t)$ the demand function for individual

⁵We assume that the subutility function, u^i , which represents preferences for the differentiated products, is strictly quasi-concave, twice differentiable, and symmetric in all of its arguments.

⁶The formal statements of the two assumptions are given in the Appendix. The assumptions mirror assumptions A1 and A2 in Chetty, Looney, and Kroft (2009).

i corresponding to symmetric prices and *J* firms: $q^i(p,t) \equiv q^i_j(p,...,p,t)$. Without loss of generality on the functional form of $q^i(\cdot,0) = \frac{(u'_i)^{-1}(\cdot)}{J}$, and assuming $q^i(p,t) = q^i(p+\theta_i t,0)$ for some $\theta_i > 0$, the salience parameter satisfies $\theta_i = \frac{\frac{\partial q^i_j}{\partial t}}{\frac{\partial q^i}{\partial p}}$ and is the same for all products *j* for individual *i*.⁷

We define individual *i*'s market demand as $Q^i(p,t) = Jq^i(p,t)$. Total market demand is given by $Q(p,t) = \int Q^i(p,t)di$, from where we define the market demand elasticity $\epsilon_D \equiv -\frac{\partial Q(p,t)}{\partial p} \frac{p+t}{Q}$ and $\epsilon_{Dt} \equiv \frac{dq(t)}{dt} \frac{p+t}{q(t)}$ as the elasticity of equilibrium output, $q(t) \equiv Q(p(t),t)$, with respect to the tax t.⁸ The pass-through rate is denoted by $\rho \equiv 1 + dp/dt$. Also, for an economy without taxes, we define the representative agent's willingness to pay wtp(Q) as the inverse of $Q(\cdot, 0)$, and let mwtp(Q) = wtp'(Q) be the marginal willingness to pay.⁹ Then ms(Q) = -mwtp(Q)Q is the marginal consumer surplus and the elasticity of inverse marginal surplus is given by $\epsilon_{ms} \equiv \frac{ms(Q)}{ms'(Q)Q}$. Furthermore, define $MS(Q,t) = -\frac{Q}{\frac{\partial Q}{\partial p}(p(t),t)} = \frac{ms(Q)}{mwtp(Q(t))*\frac{\partial Q}{\partial p}(p(t),t)}$, then MS(Q,0) = ms(Q), and let $MS_t \equiv \partial MS/\partial t$.

Let $q_j(p_1, ..., p_J, t) = \int q_j^i(p_1, ..., p_J, t) di$. On the supply side, we allow for different forms of competition by introducing the market conduct parameter $\nu_p = \frac{\partial p_k}{\partial p_j}$ $(k \neq j)$ following Weyl and Fabinger (2013). Assume each firm produces a single product and has a homogeneous cost function $c_j(q_j) = c(q_j)$, where $c(\cdot)$ is increasing and twice differentiable with c(0) = 0 and $mc(q_j) \equiv c'(q_j)$. Firm j chooses p_j to maximize profits π_j :

$$\max_{p_j} \pi_j = p_j q_j (p_1 \dots, p_J, t) - c(q_j (p_1 \dots, p_J, t))$$

s.t. $\frac{\partial p_k}{\partial p_j} = \nu_p$ for $k \neq j$

The first-order condition for p_i is given by:

$$q_j + (p_j - mc(q_j)) \left(\frac{\partial q_j}{\partial p_j} + \nu_p \sum_{k \neq j} \frac{\partial q_j}{\partial p_k} \right) = 0.$$

⁷This specification of inattention rules out the possibility that θ_i may depend on producer prices as suggested by the empirical evidence in Morrison and Taubinsky (forthcoming). Relaxing this assumption would be a useful extension, but is beyond the scope of this paper. We adopted this assumption primarily for tractability to allow us to focus on interactions with imperfect competition. In our empirical analysis below, we briefly explore how $\mathbb{E}(\theta_i)$ varies between high-price and low-price products, and we do not find evidence that $\mathbb{E}(\theta_i)$ varies with average price levels in our data.

⁸Note that ϵ_{Dt} need not equal $\frac{\partial Q(p,t)}{\partial t} \frac{p+t}{Q}$; the latter holds the pre-tax price, p, fixed, while the former includes any indirect effect of taxes on the producer price.

⁹Formally, there is no representative agent for the economy since even with quasilinear utility there is a problem of aggregation given the misoptimization with respect to taxes. However, when t = 0 the economy admits a representative agent (given that there are no income effects) and we use the inverse demand function of this representative agent to characterize average and marginal consumer surplus.

We assume that $\frac{\partial \pi_j}{\partial p_j}(p_j, p)$ is strict single crossing (from above) in p_j and decreasing in p so that a unique symmetric equilibrium p(t) exists.¹⁰ By letting $\nu_q = \frac{1}{mwtp(Q)} \times \frac{1}{\frac{dq_j}{dp_j}} = \frac{1}{mwtp(Q)} \times \frac{1}{\frac{\partial q_j}{\partial p_j} + \nu_p \sum_{k \neq j} \frac{\partial q_j}{\partial p_k}}$ we can rewrite the first-order condition as a generalized Lerner index:

$$\frac{p - mc(q)}{p + t} = \frac{\nu_q}{J\epsilon_D} \tag{1}$$

Setting $\nu_q = J$ yields the monopoly (perfect collusion) outcome and setting $\nu_q = 0$ gives the perfect competition (marginal cost pricing) solution. Setting $\nu_q = 1$ corresponds to Cournot competition when goods are homogeneous and setting $\nu_p = 0$ yields the Bertrand-Nash equilibrium. The model thus captures a wide range of market conduct.

We assume that tax revenue R = tQ and profits $J\pi$ are redistributed to the consumers as a lumpsum transfer. Consumers treat profits and tax revenue as fixed when choosing consumption, failing to consider the external effects on the lump-sum transfer. Given the assumption of quasilinear utility, consumers will choose to allocate the lump-sum transfer to the outside market y. Thus, total welfare, W, is given by the sum of consumer surplus (CS), producer surplus (PS) and government revenue (R).

$$W(p,t) = \underbrace{\int u^i(Q^i(p,t))di - (p+t)Q(p,t)}_{CS} + \underbrace{pQ - Jc\left(q\right)}_{PS} + \underbrace{tQ}_{R}$$

Following Weyl and Fabinger (2013), we define the incidence of a unit tax t as $I = \frac{dCS/dt}{dPS/dt}$ and the marginal excess burden as $\frac{dW}{dt}$. We now introduce a technical assumption which helps to simplify the analysis throughout.

Assumption 3. The demand function $Q^i(p,t)$ can be represented by the linear approximation $\hat{Q}^i(p,t) = q_0^i + \frac{\partial Q(p_0,t_0)}{\partial p} (p - p_0 + \theta_i(t - t_0))$ around $(q_0^i, p_0, t_0, \theta_i)$ for $q_0^i = Q^i(p_0, t_0)$ for each individual *i*.¹¹

Assumption 3 is a formal statement of the approximation given in Bernheim and Taubinsky (2018, page 438) that allows us to focus on heterogeneity in salience effects across consumers, holding the

¹⁰The case of strategic complementarities, where $\frac{\partial \pi_j}{\partial p_j}(p_j, p)$ is increasing in p allows for the existence of multiple symmetric equilibria. However, in that case if we assume there is a continuous and symmetric equilibrium selection p(t) the same results follow.

¹¹In case this assumption is violated, the model given by $\hat{Q}^i(p,t)$ is a linear approximation to the real model with a common slope for all *i*. The corollary that follows below applies to this linear approximation.

price responses across consumers constant. Note that assuming price responses are the same across consumers at all quantity levels is not sufficient for Assumption 3 to hold exactly unless demand curves are linear. We next introduce a lemma which is quite useful for deriving the incidence formulas that we present in the paper.

Lemma 1. The following relationship holds between the demand elasticities, pass-through and inattention to taxes:

$$\epsilon_{Dt} = -(\mathbb{E}(\theta_i) + \rho - 1)\epsilon_D + \frac{p+t}{Q(t)}Cov\left(\theta_i, \frac{\partial Q^i(p, t)}{\partial p}\right)$$

Under Assumption 3, we obtain the following relationship:

$$\epsilon_{Dt} = -(\mathbb{E}(\theta_i) + \rho - 1)\epsilon_D$$

Proof. See Appendix.

We can now state our main theoretical results. Consider a small increase in the tax t which applies to all goods in the inside market.

Proposition 1. The incidence on consumers, producers, government, the pass-through rate and the marginal excess burden of a unit tax, t, may be expressed as:

$$\begin{split} \frac{dCS}{dt} &= -\rho Q - (1 - \mathbb{E}(\theta_i))t \frac{dQ(p(t), t)}{dt} + tCov\left(\theta_i, \frac{dQ^i(p(t), t)}{dt}\right) \\ \frac{dPS}{dt} &= -\left(1 - \frac{\nu_q}{J}\right) [Q(1 - \rho)] - \frac{\nu_q}{J} \left[Q\left(\mathbb{E}(\theta_i) + \frac{Cov\left(\theta_i, \frac{\partial Q^i}{\partial p}\right)}{\frac{\partial Q}{\partial p}}\right)\right] \\ \frac{dR}{dt} &= Q + t \frac{dQ(p(t), t)}{dt} \\ \rho &= 1 - (1 - \omega) \left(\mathbb{E}(\theta_i) + \frac{Cov\left(\theta_i, \frac{\partial Q^i}{\partial p}\right)}{\frac{\partial Q}{\partial p}}\right) + \omega \frac{\nu_q}{J} MS_t \text{ where } \omega = \frac{1}{1 + \frac{\epsilon_D \frac{p}{p+t} - \frac{\nu_q}{J}}{\epsilon_S} + \frac{\frac{\nu_q}{\epsilon_{ms}}}{\epsilon_S}} \\ I &= \frac{\rho + (1 - \mathbb{E}(\theta_i)) \frac{t}{p+t} \epsilon_{Dt} - \frac{t}{Q} Cov\left(\theta_i, \frac{dQ^i(p(t), t)}{dt}\right)}{\left(1 - \rho\right) \left(1 - \frac{\nu_q}{J}\right) + \frac{\nu_q}{J} \frac{\mathbb{E}\left(\theta_i \frac{\partial Q^i}{\partial p}\right)}{\mathbb{E}\left(\frac{\partial Q^i}{\partial p}\right)}} \\ \frac{dW}{dt} &= (p - mc(q) + \mathbb{E}(\theta_i)t) \frac{dQ(p(t), t)}{dt} + tCov\left(\theta_i, \frac{dQ^i(p(t), t)}{dt}\right) \end{split}$$

Proof. See Appendix.

Moreover, we can make use of Assumption 3 to derive simplified versions of the formulas in Proposition 1 which only make use of $Var(\theta_i)$ (instead of the covariance between θ_i and other demand parameters) and will be used in the calibrations below.

Corollary 1. Under Assumption 3, the effect of the tax on consumer surplus, producer surplus, passthrough, incidence and welfare can be expressed as:

$$\begin{aligned} \frac{dCS}{dt} &= -\rho Q - (1 - \mathbb{E}(\theta_i))t \frac{dQ(p(t), t)}{dt} + tVar(\theta_i) \frac{\partial Q}{\partial p} \\ \frac{dPS}{dt} &= -Q \left[\left(1 - \frac{\nu_q}{J} \right) (1 - \rho) + \frac{\nu_q}{J} \mathbb{E}(\theta_i) \right] \\ \rho &= 1 - (1 - \omega) \mathbb{E}(\theta_i), \text{ where } \omega = \frac{1}{1 + \frac{\epsilon_D \frac{p}{p+t} - \frac{\nu_q}{J}}{\epsilon_S} + \frac{\frac{\nu_q}{J}}{\epsilon_{ms}}} \\ I &= \frac{\rho + (1 - \mathbb{E}(\theta_i)) \frac{t}{p+t} \epsilon_{Dt} - \frac{t}{p+t} Var(\theta_i) \epsilon_D}{(1 - \rho) \left(1 - \frac{\nu_q}{J} \right) + \frac{\nu_q}{J} \mathbb{E}(\theta_i)} \\ \frac{dW}{dt} &= (p - mc(q) + \mathbb{E}(\theta_i)t) \frac{dQ(p(t), t)}{dt} + tVar(\theta_i) \frac{\partial Q}{\partial p} \\ &= (p - mc(q) + \mathbb{E}(\theta_i)t) \frac{\partial Q}{\partial p} (\rho - 1 + \mathbb{E}(\theta_i)) + tVar(\theta_i) \frac{\partial Q}{\partial p} \end{aligned}$$

Proof. See Appendix.

Proposition 1 characterizes the consumer and producer burden, pass-through, incidence, and the marginal excess burden of a unit tax. There are several lessons that emerge. First, the expression for $\frac{dCS}{dt}$ does not depend directly on market structure, except insofar as market conduct determines pass-through and the behavioral response to the tax. When t = 0, the expression for the consumer burden is identical to the one in Weyl and Fabinger (2013), except that the pass-through term, ρ , is indirectly affected by salience effects. Intuitively, on the consumer side, when there are no taxes in the baseline equilibrium, consumers optimize and so the envelope theorem applies. Salience only affects consumers at the market level through changes in prices, as in Chetty, Looney, and Kroft (2009).

On the other hand, when t > 0, the effect of a change in the tax on consumer surplus depends on two additional terms, $-(1 - \mathbb{E}(\theta_i))t\frac{dQ}{dt}$ and $tCov\left(\theta_i, \frac{dQ^i}{dt}\right)$. In this case, one has to account for

behavioral responses to the tax since the envelope theorem does not apply when consumers misoptimize in the baseline equilibrium. The first term, $-(1 - \mathbb{E}(\theta_i))t\frac{dQ}{dt}$, relates to the "internality wedge" in Bernheim and Taubinsky (2018) and Farhi and Gabaix (2020). It enters $\frac{dCS}{dt}$ positively whenever $\mathbb{E}(\theta_i) < 1$ and $\frac{dQ}{dt} < 0$ indicating that more inattention to taxes reduces the incidence on consumers, conditional on the pass-through rate and the behavioral response to the tax. Intuitively, if consumers are overspending on taxable goods at baseline (because $\mathbb{E}(\theta_i) < 1$), then a tax increase that causes them to reduce their demand brings them closer to their privately optimal choice. In this case, the degree of over-estimation of marginal utility is given by $(1 - \mathbb{E}(\theta_i))t$ and one can think of the welfare effects of tax salience as a Pigouvian correction. The second term, $tCov\left(\theta_i, \frac{dQ^i}{dt}\right)$, relates to the misallocation term in Taubinsky and Rees-Jones (2018). Our results extend the heterogeneity results in Taubinsky and Rees-Jones (2018) to the case with continuous demand and imperfect competition. Finally, Corollary 1 shows that under Assumption 3, $\frac{dCS}{dt} = -\rho Q - (1 - \mathbb{E}(\theta_i))t\frac{dQ(p(t),t)}{dt} + tVar(\theta_i)\frac{\partial Q}{\partial p}$ which will be useful in our calibrations below which incorporate our empirical estimate of $Var(\theta_i)$.

Second, the expression for $\frac{dPS}{dt}$ is a convex combination of the monopoly and perfect competition cases with weights $\frac{\nu_q}{J}$ and $1 - \frac{\nu_q}{J}$, respectively. Under perfect competition, $\frac{\nu_q}{J} = 0$ and $\frac{dPS}{dt} = -Q(1 - \rho)$ and the producer burden depends on the price effect, which in turn depends on the degree of salience, similar to Chetty, Looney, and Kroft (2009). Under monopoly, $\frac{\nu_q}{J} = 1$ and $\frac{dPS}{dt} = -Q\left(\mathbb{E}(\theta_i) + \frac{Cov(\theta_i, \frac{\partial Q^i}{\partial p})}{\frac{\partial Q}{\partial p}}\right)$. To interpret this expression, it is instructive to consider the case where $\theta_i = 1$ for all *i*. Since the monopolist sets the price and equivalently the level of output, the effect of a small change in taxes is simply the mechanical effect of the tax change which is given by output, *Q*. Consumer inattention attenuates the reduction in consumer demand due to the tax increase on average by the amount $\mathbb{E}(\theta_i)$. The covariance term $Cov\left(\theta_i, \frac{\partial Q^i}{\partial p}\right)$ incorporates the correlation between θ_i and $\frac{\partial Q^i}{\partial p}$ which additionally determines the market-level demand response to the tax. When $Cov\left(\theta_i, \frac{\partial Q^i}{\partial p}\right) > 0$, the incidence on the monopolist is attenuated.¹² This can be easily seen in the binary case where there are two types of consumers: those who optimize perfectly ($\theta_i = 1$) and those

¹²Since $\frac{\partial Q^i}{\partial p} < 0$, this requires that consumers that are attentive to taxes are price inelastic; in other words, the absolute value of $\frac{\partial Q^i}{\partial p}$ is negatively correlated with θ_i .

who are fully inattentive to taxes ($\theta_i = 0$). If those who optimize are price inelastic and those who are inattentive are price elastic, then the monopolist earns higher profit compared to the case where inattention is uncorrelated with price elasticity. In fact, it may be optimal for the monopolist to fully disclose taxes (e.g., post tax-inclusive prices) if there are enough consumers who are both highly price elastic and overreact to taxes (so that $\theta_i > 1$).¹³ This result on optimal disclosure of taxes relates to Veiga and Weyl (2016) on how firms can optimally use nonprice product features to sort profitable from unprofitable consumers.

Turning to pass-through, as is well-known from Chetty, Looney, and Kroft (2009), $\omega < 1$ with perfect competition and an increase in $\mathbb{E}(\theta_i)$ leads to a lower pass-through and incidence on consumers. In the presence of heterogeneous consumers, pass-through additionally depends on consumer heterogeneity as reflected in the term $Cov\left(\theta_i, \frac{\partial Q^i}{\partial p}\right)$.¹⁴ Intuitively, what matters for incidence is the initial shift in demand in response to taxes and the price elasticities of demand and supply which determine how much prices need to adjust to re-equilibrate the market. Since individual-level responses to taxes can be written as $\frac{\partial Q^i}{\partial t} = \theta_i \frac{\partial Q^i}{\partial p}$, the market-level response to taxes depends on the covariance between θ_i and $\frac{\partial Q^i}{\partial p}$ across *i*. Under imperfect competition, there are interesting effects of salience on pass-through, ρ , which operate through the elasticity of inverse marginal surplus, which is positive (negative) if demand is log convex (log concave). In particular, under imperfect competition, it is theoretically possible that $\omega > 1$ which implies that an increase in $\mathbb{E}(\theta_i)$ raises incidence on consumers. To see this, consider the case of monopoly with constant marginal cost and suppose demand has constant pass-through form so that $\epsilon_{ms} = -\epsilon$ (Bulow and Pfleiderer 1983) and $\theta_i = \theta$. Under these assumptions, $\rho = 1 - \frac{\theta}{1-\epsilon}$ so that $\frac{d\rho}{d\theta} = \frac{1}{\epsilon-1}$, and so if demand is sufficiently convex, then $\frac{d\rho}{d\theta} > 0$ and increased attention to the tax makes consumers *worse off*, in contrast to the logic in Chetty, Looney,

¹³Morrison and Taubinsky (forthcoming) find that some consumers overreact to taxes but do not investigate whether this is correlated with their price elasticity of demand. To see why disclosure is never optimal when $\theta_i < 1$ for all consumers, consider the case where the monopolist discloses taxes at some Q^* . If the monopolist then shrouds taxes, it could still sell Q^* but at a higher price since the inverse demand curve with hidden taxes lies *everywhere* above the inverse demand curve with salient taxes. Thus, there is a profitable deviation and so disclosure can never be optimal when all consumers are inattentive to taxes.

¹⁴This result was derived for the case of binary demand in Taubinsky and Rees-Jones (2018); see page 9 of the Appendix.

and Kroft (2009) under perfect competition.¹⁵ Intuitively, the monopolist faces a demand curve of the form $P(q,t) = wtp(q) - \theta t$. This is a standard monopoly problem where θt can be interpreted as the "effective tax", and so a larger θ implies a larger effective tax. This implies that the change in the producer price is simply the change in the producer price in the standard case scaled by the amount of inattention, e.g., $\theta(\omega - 1)$. On the other hand, the consumer price is given by P + t and pass-through is $1 + \frac{dP}{dt} = 1 + \theta(\omega - 1)$. Thus, if $\omega - 1 > 0$ (as would be the case with $\epsilon > 1$), greater attention to taxes amplifies the pass-through effect. By contrast, when $\omega - 1 < 0$ (as would be the case with linear demand where $\omega = 1/2$), greater attention to taxes leads to a greater cut in producer prices.¹⁶ In both cases, greater attention to taxes increases the effective tax and this reinforces either an increase in the producer price in the case of overshifting or a decrease in the producer price in the case of undershifting.

We also see that the expression for ρ in the general case of imperfect competition depends on MS_t . Up to first order, this term can be approximated by $MS_t \approx \frac{-q}{\left(\frac{\partial Q}{\partial p}\right)^2} Cov\left(\frac{\partial^2 Q^i}{\partial p^2}, \theta_i\right)$ (see Appendix). This new term captures that when taxes change and consumers vary in their degree of inattention, this effectively changes the slope of the demand curve. Since the optimal price depends on the slope of the demand curve, firms exploit this change in market power when re-optimizing prices. If more attentive consumers become more price elastic when taxes change, then $Cov\left(\frac{\partial^2 Q^i}{\partial p^2}, \theta_i\right) < 0$ and $MS_t > 0$. Intuitively, when the tax increases there is a reallocation of demand, whereby the negative output response Q_i is bigger (in absolute value) for more attentive and price elastic consumers; in the case where $Cov\left(\frac{\partial^2 Q^i}{\partial p^2}, \theta_i\right) < 0$, the average (or market) demand becomes more inelastic as demand is reallocated to more inelastic and less attentive consumers. Therefore, pass-through increases ($MS_t >$ 0). Depending on the magnitude of MS_t , it is possible to get overshifting of taxes onto consumer prices, even when the standard model predicts undershifting.

The relative incidence on consumers and firms is given by I. When t = 0 and markets are

¹⁵Note that even when $\epsilon_S = \infty$, the full incidence is not on consumers, unlike the case of perfect competition, although

we note that this result holds independent of salience effects. ¹⁶It can also be shown that $\omega = \frac{P'(q)}{MR'(q)}$, so that $\omega > 1$ implies that the inverse demand curve is steeper than the marginal revenue curve. This case is shown in Appendix Figure A.1, which illustrates graphically how greater attention to taxes can amplify the pass-through effect.

perfectly competitive ($\nu_q = 0$), we obtain the classical result that incidence is determined purely by the price effect of the tax, $I = \frac{\rho}{1-\rho}$. Similarly, under monopoly ($\nu_q = J$), incidence is $I = \rho$ as shown by Weyl and Fabinger (2013). In the general case of inattentive consumers under Assumption 3, $I = \frac{\rho + (1-\mathbb{E}(\theta_i))\frac{t}{\rho+t}\epsilon_{Dt} - \frac{t}{\rho+t}Var(\theta_i)\epsilon_D}{(1-\rho)(1-\frac{\nu_q}{J}) + \frac{\nu_q}{J}\mathbb{E}(\theta_i)}$. As discussed above, with pre-existing taxes, taxes play a corrective role and the numerator accounts for this, while the denominator is a weighted-average of perfect competition and monopoly. From this expression we see that pass-through is no longer sufficient for incidence analysis.

Finally, conditional on $\frac{dQ}{dt}$, the effects of salience on the marginal excess burden of the tax operate in similar ways under different market structures through the terms $\mathbb{E}(\theta_i)t$ and $tCov\left(\theta_i, \frac{dQ^i}{dt}\right)$. However, under imperfect competition the marginal excess burden depends additionally on the markup, p-mc(q). This implies that changes in the degree of inattention to taxes have larger effects on excess burden in imperfectly competitive markets as compared to perfectly competitive markets. To see this, note that we can express $\frac{dQ}{dt} = \frac{\partial Q}{\partial p}(\rho - 1 + \mathbb{E}(\theta_i))$ under Assumption 1. Thus, salience enters linearly in the welfare formula $\frac{dW}{dt}$ and interacts directly with the markup. For example, with full pass-through and homogeneous consumers, $\frac{dW}{dt} = (p - mc(q)) \theta \frac{\partial Q}{\partial p} + \theta^2 t \frac{\partial Q}{\partial p}$. Even when there are no pre-existing taxes, there is still a pre-existing distortion due to imperfect competition and thus introducing a small tax into the market has a first-order effect on welfare which scales with the degree of inattention to taxes. This shows that even when "behavioral biases" have a second-order effect on social welfare in competitive markets, they may have a first-order effect on welfare in markets where firms have market power. Holding fixed the markup, however, as frictions are reduced (i.e., increasing the value of θ), the excess burden of taxation is increased. In the calibrations below, we will impose Assumption 3 and calibrate $\frac{dW}{dt} = (p - mc(q) + \mathbb{E}(\theta_i)t) \frac{\partial Q}{\partial p}(\rho - 1 + \mathbb{E}(\theta_i)) + tVar(\theta_i) \frac{\partial Q}{\partial p}$.

To summarize, the analysis of the incidence and welfare consequences of a tax for the general case of imperfect competition suggests that the standard intuition for the case of perfect competition does not always apply when firms have market power. Instead, there are interesting interactions between tax salience and market structure. While the theoretical results in this section focus on unit taxes, we present a more general model with both unit taxes and ad valorem taxes in the Appendix. The more general model allows us to derive analogous formulas for ad valorem taxes, which is useful since our empirical analysis below is based on sales taxes which are ad valorem sales taxes. Additionally, the more general model allows us to derive new results that compare the pass-through rate and the marginal cost of public funds (MCPF) between unit taxes and ad valorem taxes when consumers may under-react to both types of taxes. We show that if consumers under-react to ad valorem and unit taxes similarly (i.e., $\theta_t = \theta_{\tau}$, where θ_{τ} refers to the tax salience parameter for ad valorem tax, τ), then the pass-through rate will be lower for ad valorem taxes than unit taxes, which is consistent with existing results in the literature that ignore tax salience (Delipalla and Keen 1992; Adachi and Fabinger 2019). However, if consumers under-react more to ad valorem taxes than unit taxes, then the pass-through rate of ad valorem taxes can be higher, even under perfect competition. Turning to the MCPF, we show that if consumers under-react to ad valorem and unit taxes similarly, then we maintain the wellknown result that ad valorem taxes are more efficient than unit taxes, under imperfect competition. If consumers are less inattentive to ad valorem taxes than unit taxes, then this reinforces the result that ad valorem taxation is more efficient.

3 Data and Estimation

3.1 Data Description

Nielsen Retail Scanner (RMS) and Nielsen Consumer Panel (HMS) Data We measure storelevel prices and quantity using the Nielsen Retail Scanner (RMS) data from 2006 - 2014, and complement these with household-level spending data from the HomeScan Consumer Panel (HMS) data.

RMS records sales and the number of units sold per week for roughly 2.5 million products which are designated as Universal Product Codes (UPC) for 35,000 stores in the United States (excluding Hawaii and Alaska) that are part of roughly 90 retail chains. We use these data, combined with sales tax data, primarily to estimate pass-through as well as price and tax elasticities of demand. Stores are assigned to one of five possible store types: grocery, drug, mass merchandise, convenience, and liquor stores. We focus on grocery stores that belong to the same retail chain throughout 2006-2014

and are present in the data for at least two years.¹⁷

HMS includes trip-level purchases for over 60,000 households each year, as well as householdlevel demographic information on an annual basis (e.g. income, education, presence of children). We use these data to estimate tax and price elasticities of demand, and to quantify the degree of heterogeneity in inattention to taxes.¹⁸

In both RMS and HMS, products (UPCs) are organized by Nielsen according to a hierarchical structure.¹⁹ At the lowest rung are approximately 1,200 *product-modules* (e.g., fresh eggs, chocolate candy, olive oil, bleach, toilet tissue). Each module is assigned to one of roughly 120 *product-groups* (e.g. candy, shortening and oil, laundry supplies, paper products). These groups belong to one of 10 broader *product-departments* (e.g., dry grocery, fresh produce, non-food grocery). In all of our analyses, we keep all products in modules that are sold in all 48 continental states, and we restrict the sample to top-selling modules that rank above the 80th percentile of total U.S. sales. These 198 modules account for almost 80 percent of the total sales in grocery stores in the RMS data.²⁰

The key variables for our empirical analysis are our measures of price and quantity. In RMS, we define these variables at the level of module (m), store (r), and time (n), where a unit of time is a year-quarter. This requires aggregating weekly revenue and quantities sold separately for each product to the quarterly level. A quarterly price is obtained by dividing quarterly revenue from the sales of product j by the number of units sold in that quarter. To address the concern that there may be compositional differences in price across stores due to different UPCs being offered, we follow Handbury and Weinstein (2015) and regress log quarterly price on UPC fixed effects and module-by-store-by-time fixed effects. We then extract the module-by-store-by-time fixed effects and use this as a composition-adjusted pre-tax price index. To measure quantity, we create a price-weighted

¹⁷These sample restrictions follow DellaVigna and Gentzkow (2019).

¹⁸Because the HMS data tracks all household purchases at stores (whether or not the stores are covered by the RMS data), the estimated tax and price elasticities using the HMS data will reflect the full (or "total") quantity demanded response from consumers, inclusive of any endogenous cross-store substitution that occurs in response to changes in taxes or prices. Appendix Figure A.1 shows the spatial distribution of RMS stores and HMS households in our analytical samples across US counties.

¹⁹Appendix Table A.1 describes the hierarchy of the data using example UPCs. UPCs without a barcode such as random weight meat, fruits, and vegetables are excluded from our sample.

²⁰We limit to the top 20 percent of modules for computational reasons, and we have explored some of our main specifications in the full sample of modules and found very similar results (results not reported).

quantity index based on the average national price of products.²¹Price and quantity variables in HMS are defined at the level of module (m), household (i), and time (n). Their construction is analogous to their store-level counterparts, replacing store identifiers with household identifiers.

U.S. Sales Tax Exemptions and Rates We collect data on local (county and state) sales tax rates and tax exemptions from a variety of sources, including state laws, state regulations, and online brochures.²² In general, tax exemptions are set by U.S. states and are module-specific. A general rule of thumb is that states exempt food products from taxation and tax non-food products. However, there are several important exceptions to this rule which are reported in Table 1. First, several states tax food at the full rate or a reduced rate. Second, in a few states, food products are exempt from the state-level portion of the total sales tax rate, but remain subject to the county-level sales tax.²³ Third, in some cases where food is tax-exempt, there is a tax that applies at the product-module level. For example, prepared foods, soft drinks, and candy are subject to sales taxes in many states. Finally, some states exempt some non-food products from sales taxes. As a result, the effective sales tax rate varies by module (m), county (c), and time (n).²⁴

²¹Specifically, for each product (j), store (r), and time (n), we multiply quantity purchased by the average national price (across all stores in our sample) of product j at time n, where the national price is an unweighted average. We then aggregate quantity across products within a module-by-store-by-time cell to arrive at a quantity measure that varies at the same level as the price index.

²²All data sources used to determine the exemption status of products are listed in Appendix Table A.14.

²³Colorado, for example, allows each county to decide whether to subject food to the county-level portion of the sales tax rate.

²⁴The Appendix shows the cross-sectional variation in sales tax rates and sales tax exemptions in our data. Appendix Figure A.3 reports the total (state + county) sales tax rate in September 2008 and shows tax rates ranging from 0 in Montana, Oregon, New Hampshire, and Delaware to a maximum rate of 9.75 percent in Tennessee. Appendix Figure A.4 reports the food tax exemptions across states and shows that many of the states that tax food are located in either the South or the Midwest. Appendix Figure A.5 shows the changes in sales tax rates between Q1 2006 and Q4 2014, since our main results are based on local variation in sales tax rates over time (rather than cross-sectional variation across states and counties at a point in time). This figure shows that there is still meaningful variation in sales taxes within counties over time during this time period, including both increases and decreases in sales tax rates. Appendix Figure A.6 shows the number of tax changes within counties during the same time period. Lastly, Appendix Table A.3 decomposes the variance in tax rates in the data and reports that a two-standard-deviation change in tax rates within module-by-state-by-year-quarter "cells" is about 0.82 percentage points.

Panel A: Food Modules							
Module	Average Store- Level Expenditure	States taxing all food	States taxing module at reduced rate	States taxing module at full rate (but otherwise exempting food)			
DAIRY - MILK	3.04%	AL, ID, KS, MS, OK, SD	AR, IL, MO, NC, TN,UT,VA,WV				
SOFT DRINKS - CARBONATED	2.88%	AL, ID, KS, MS, OK, SD	AR, IL, MO, TN,UT,VA	CA, CT, FL, IA, IN, KY, MD, ME, MN, NC, ND, NJ, NY, OH, PA, RI, TX, WA, WI, WV			
BAKERY - BREAD - FRESH	2.19%	AL, ID, KS, MS, OK, SD	IL, MO, TN, UT, VA, WV				
CEREAL - READY TO EAT	1.93%	AL, ID, KS, MS, OK, SD	AR, IL, MO, NC, TN,UT,VA,WV				
SOFT DRINKS - LOW CALORIE	1.62%	AL, ID, KS, MS, OK, SD	AR, IL, MO, TN,UT,VA	CA, CT, FL, IA, IN, KY, MD, ME, MN, NC, ND, NJ, NY, OH, PA, RI, TX, WA, WI, WV			
WATER-BOTTLED	1.42%	AL, ID, KS, MS, OK, SD	AR, IL, MO, NC, TN,UT,VA,WV	LA, MD, ME, MN, NY			
ICE CREAM - BULK	1.22%	AL, ID, KS, MS, OK, SD	AR, IL, MO, NC, TN,UT,VA,WV	FL, MD			
COOKIES	1.21%	AL, ID, KS, MS, OK, SD	AR, IL, MO, NC, TN,UT,VA,WV				
CANDY-CHOCOLATE	0.64%	AL, ID, KS, MS, OK, SD	AR, IL, MO, UT, VA, WV	CT, FL, IA, IN, KY, MD, ME, MN NC ND NI NY RI TN			
		,,		Mill, 100, 100, 100, 101, 10, 110,			
		Panel B: Non-Food	Modules	,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,			
	Average Store-	Panel B: Non-Food States with no sales	Modules	States taxing module			
Module	Average Store- Level	Panel B: Non-Food States with no sales tax	Modules States exempting module	States taxing module at reduced rate			
Module WINE - DOMESTIC	Average Store- Level 2.11%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR	Modules States exempting module PA, KS, KY, MA	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES	Average Store- Level 2.11% 1.70%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE	Average Store- Level 2.11% 1.70% 1.07%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE DETERGENTS - LIQUID	Average Store- Level 2.11% 1.70% 1.07% 0.75%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE DETERGENTS - LIQUID PAPER TOWELS	Average Store- Level 2.11% 1.70% 1.07% 0.75% 0.66%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR DE, MT, NH, OR DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ NJ	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE DETERGENTS - LIQUID PAPER TOWELS RUM	Average Store- Level 2.11% 1.70% 1.07% 0.75% 0.66% 0.54%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ NJ PA, KS, KY, MA	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE DETERGENTS - LIQUID PAPER TOWELS RUM DISPOSABLE DIAPERS	Average Store- Level 2.11% 1.70% 1.07% 0.75% 0.66% 0.54% 0.50%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ NJ PA, KS, KY, MA MA, MN, NJ, PA, VT	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE DETERGENTS - LIQUID PAPER TOWELS RUM DISPOSABLE DIAPERS MAGAZINES	Average Store- Level 2.11% 1.70% 1.07% 0.75% 0.66% 0.54% 0.50% 0.41%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ NJ PA, KS, KY, MA MA, MN, NJ, PA, VT MA, ME, NY, OK	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE DETERGENTS - LIQUID PAPER TOWELS RUM DISPOSABLE DIAPERS MAGAZINES CAT FOOD - DRY TYPE	Average Store- Level 2.11% 1.70% 1.07% 0.75% 0.66% 0.54% 0.50% 0.41% 0.35%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ NJ PA, KS, KY, MA MA, MN, NJ, PA, VT MA, ME, NY, OK	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE DETERGENTS - LIQUID PAPER TOWELS RUM DISPOSABLE DIAPERS MAGAZINES CAT FOOD - DRY TYPE COLD REMEDIES - ADULT	Average Store- Level 2.11% 1.70% 1.07% 0.75% 0.66% 0.54% 0.50% 0.41% 0.35% 0.28%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ NJ PA, KS, KY, MA MA, MN, NJ, PA, VT MA, ME, NY, OK CT, FL, MD, MN, NJ, NY, PA, TX, VA, VT	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE DETERGENTS - LIQUID PAPER TOWELS RUM DISPOSABLE DIAPERS MAGAZINES CAT FOOD - DRY TYPE COLD REMEDIES - ADULT DOG & CAT TREATS	Average Store- Level 2.11% 1.70% 1.07% 0.75% 0.66% 0.54% 0.54% 0.50% 0.41% 0.35% 0.28% 0.25%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ NJ PA, KS, KY, MA MA, MN, NJ, PA, VT MA, ME, NY, OK CT, FL, MD, MN, NJ, NY, PA, TX, VA, VT	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE DETERGENTS - LIQUID PAPER TOWELS RUM DISPOSABLE DIAPERS MAGAZINES CAT FOOD - DRY TYPE COLD REMEDIES - ADULT DOG & CAT TREATS ALE	Average Store- Level 2.11% 1.70% 1.07% 0.75% 0.66% 0.54% 0.54% 0.50% 0.41% 0.35% 0.28% 0.25% 0.25%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ NJ PA, KS, KY, MA MA, MN, NJ, PA, VT MA, ME, NY, OK CT, FL, MD, MN, NJ, NY, PA, TX, VA, VT PA, KS, KY, MA	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE DETERGENTS - LIQUID PAPER TOWELS RUM DISPOSABLE DIAPERS MAGAZINES CAT FOOD - DRY TYPE COLD REMEDIES - ADULT DOG & CAT TREATS ALE DOG FOOD - WET TYPE	Average Store- Level 2.11% 1.70% 1.07% 0.75% 0.66% 0.54% 0.50% 0.41% 0.35% 0.28% 0.25% 0.25% 0.25% 0.23%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ NJ PA, KS, KY, MA MA, MN, NJ, PA, VT MA, ME, NY, OK CT, FL, MD, MN, NJ, NY, PA, TX, VA, VT PA, KS, KY, MA	States taxing module at reduced rate			
Module WINE - DOMESTIC CIGARETTES TOILET TISSUE DETERGENTS - LIQUID PAPER TOWELS RUM DISPOSABLE DIAPERS MAGAZINES CAT FOOD - DRY TYPE COLD REMEDIES - ADULT DOG & CAT TREATS ALE DOG FOOD - WET TYPE FACIAL TISSUE	Average Store- Level 2.11% 1.70% 1.07% 0.75% 0.66% 0.54% 0.50% 0.41% 0.35% 0.28% 0.28% 0.25% 0.25% 0.23% 0.22%	Panel B: Non-Food States with no sales tax DE, MT, NH, OR DE, MT, NH, OR	Modules <u>States exempting module</u> PA, KS, KY, MA CO, MN, OK PA, NJ NJ PA, KS, KY, MA MA, MN, NJ, PA, VT MA, ME, NY, OK CT, FL, MD, MN, NJ, NY, PA, TX, VA, VT PA, KS, KY, MA NJ	States taxing module at reduced rate			

Table 1: Sales Tax Exemptions for Food and Non-Food Products Across States

<u>Notes:</u> Tax exemption status as in September 2008 for selected list of modules. The list only includes modules in our analysis sample. Data collected from a variety of sources listed in Appendix Table A.2

There are two potential sources of measurement error in our sales tax rates. First, we do not incorporate county-level exemptions or county-specific sales surtaxes that apply to specific products or modules, although our understanding is that these cases are uncommon. Second, in some cases, there is some discretion in how we assign a taxability status to each module, based on interpreting the text of a state's sales tax law. While the bulk of the variation in taxes occurs at the module level or higher, there are some instances where taxability varies within module.²⁵

Overall, we are confident that we have measured sales tax rates with a high degree of accuracy. While sales tax exemptions are important for ensuring accurate measurement, the identifying variation in our empirical analysis comes primarily from changes in sales tax rates within counties over time. Changes in exemptions are very rare during our sample period.

Matched Samples As a last step in constructing our analysis samples, we merge the tax data onto the RMS and HMS data. The stores in the RMS data are geolocated at the county level so we conduct the merge at the level of module (m), county (c), and time (n). To measure the sales tax rate by quarter of year, we use the tax rate effective at the mid-point of each quarter (February for quarter 1, May for quarter 2, etc). We have also tried using the quarterly average of monthly sales tax rates and found that our estimates were almost identical. Our final RMS sample includes 8,652 grocery stores, and includes price, quantity, and tax rates for 198 modules in 1,460 counties over 36 year-quarters.

Since households in the HMS data may purchase goods in multiple counties, we calculate the average tax rate $\bar{\tau}_{imn}$ paid by household *i* for their actual expenditures on module *m* in time *n*. This requires assigning tax rates to trip-level purchases using information on the location of stores where households shop. For about one-third of purchases, the location of the store is missing in the HMS data. In such cases, we assign the tax rate that prevails in the county of residence of household *i*. This may introduce measurement error in the average tax rates, which we address using an instrumental variable strategy described below. Our final HMS sample covers purchases for 198 modules over 36

²⁵For example, in New York, fruit drinks are tax exempt as long as they contain at least 70% real fruit juice, but are subject to the sales tax otherwise. Therefore, some products in Nielsen's module "Fruit Juice- Apple", may or may not be taxed in New York, but we code these products as tax exempt since we cannot readily identify the real fruit juice content. In cases where it is impossible to tell whether the majority of products in a given module are subject to the tax or not, we code the statutory tax rate as missing. This results in excluding less than 3 percent of the observations in our sample.

year-quarters for 107,188 households who reside in 2,635 counties.

3.2 Store-level Estimation Strategy

The Effect of Taxes on Prices and Quantity We use the following model to estimate the effect of sales taxes on consumer prices and quantity:

$$\log y_{mrn} = \beta^y \log(1 + \tau_{mcn}) + \delta_{msn} + \delta_{mr} + \varepsilon_{mrn}$$
(2)

where the outcome y_{mrn} is either consumer prices $(p(1 + \tau))$ or quantity (Q) for module m, store r, and time n. The term τ_{mcn} is the sales tax rate that applies to module m in county c at time n. The terms δ_{msn} and δ_{mr} are module-by-state-by-time and module-by-store fixed effects, respectively. The identifying assumption is that changes in sales taxes within counties over time are uncorrelated with changes in consumer demand (conditional on the fixed effects). This model allows for arbitrary trends across states and modules and therefore relies on within-county-over-time variation in tax rates. The parameter β^y is the elasticity of prices or quantity with respect to taxes ($\beta^{p(1+\tau)}$ and β^Q , respectively). Note that the quantity measure is a market-level measure so that the parameter represents a marketlevel elasticity of quantity demanded with respect to taxes.

For robustness, we also report results based on a model that uses a subsample of counties and a "county border pair" research design, following Holmes (1998) and Dube, Lester, and Reich (2010). This alternative model identifies the effects of sales taxes on prices and quantity by isolating variation in taxes within pairs of counties on opposite sides of a state border; it is designed to address the concern that sales tax rates are endogenous to local economic conditions. Under the assumption that local economic conditions are similar within a pair of border counties, the effects of sales tax rates on prices and quantity can be identified through "local" comparisons within each county border pair. As a result, for this analysis we restrict the sample to stores located in contiguous counties on opposite sides of a state border. Two contiguous counties located in different states form a county-pair *d*, and counties are paired with as many cross-state counties as they are contiguous with. The estimating

equation is the following:

$$\log y_{mrn} = \beta^y \log(1 + \tau_{mcn}) + \delta'_{mdn} + \delta'_{mr} + \varepsilon'_{mrn}.$$
(3)

where δ'_{mdn} and δ'_{mr} are module-by-border-pair-by-time and module-by-store fixed effects, respectively. This specification includes flexible trends for each module in each border pair. To estimate equation (3), the original dataset is rearranged by stacking all county pairs and weighting each store by the inverse of the number of times it is included in a border pair. In this regression model, the identifying assumption is that within a border pair, variation in tax rates for a given module over time is not correlated with other unobserved determinants that differentially affect one of the counties in the pair.

The main results from estimating equations (2) and (3) are reported in Panel A of Table 2. Standard errors are clustered by state-module and reported in parentheses.²⁶ The first column uses the full sample, and the second column uses the "border pair" subsample. The first row reports results for log consumer prices. In column (1), the coefficient estimate $\widehat{\beta^{p(1+\tau)}} = 0.970$ (s.e. 0.046) indicates a large amount of pass-through of taxes onto consumer prices. The point estimate implies incomplete pass-through ($\beta^{p(1+\tau)} < 1$), but the estimate is not statistically significantly different from 1. However, classical measurement error in the effective tax rate biases our estimate of $\beta^{p(1+\tau)}$ towards 1, because classical measurement error using an instrumental variable (IV) approach that instruments the county sales tax rate with the state tax rate within the sample of "border pair" counties.²⁷ Appendix Table A.4 reports these IV estimates of the effect of sales taxes on prices, which are slightly smaller than the corresponding border-pair-sample OLS estimates (0.952 vs 0.980), suggesting a small amount of attenuation bias from measurement error in our main results.²⁸

²⁶Clustering by state-module is more conservative than clustering by state-by-module-time. We also note that the passthrough estimates are based on a module-level price index which is a generated regressor, but for computational reasons, we ignore the uncertainty in this generated regressor and treat it as measured without error.

²⁷Instrumenting the total tax rate with the state tax rate also addresses the concern that the "border pair" counties may adjust their tax rates endogenously based on economic conditions within the border pair.

²⁸Additionally, in Appendix Table A.5 we find that the pass-through rate decreases with the degree of market concentration, as measured by a normalized Herfindahl index, where a market is a county-module pair and market shares are calculated separately for each UPC. This is consistent with the theoretical model in Section 2 under some additional parameter restrictions. For example, with constant marginal costs (so that $\epsilon_S = \infty$) and constant elasticity of demand

Sample:	Full Sample	County Border Pair Subsample	Full Sample			
Weights:	Unweighted	Inverse of number of border-pairs	HMS-based weights			
	(1)	(2)	(3)			
Panel A: Reduced-form OLS Estimates of the Effects of Sales Taxes on Consumer Prices and Quantity						
$d \log(p (1 + \tau))/d \log(1 + \tau)$ [pass-through]	0.970	0.980	0.968			
	(0.046)	(0.016)	(0.054)			
$d \log(Q)/d \log(1+\tau)$ [tax elasticity]	-0.775	-0.649	-0.311			
	(0.187)	(0.084)	(0.292)			
Panel B: 2SLS Estimates of the Price Elasticity of Demand						
$d\log(Q)/d\log(p)$	-1.150	-1.170	-1.258			
	(0.027)	(0.027)	(0.031)			
Panel C: "Plug-in" Estimate of Tax Salience Parameter						
θτ	0.680	0.556	0.273			
	(0.151)	(0.122)	(0.210)			
Average tax rate, τ	0.036	0.034	0.024			
Specification:						
Store × Module fixed effects	У	У	у			
Module × State × Year-Quarter fixed effects	У		У			
Module \times Border Pair \times Year-Quarter fixed effects		У				
Ν	53,987,430	33,749,257	48,051,884			

 Table 2

 Store-level Estimates of Pass-Through, Tax Elasticity, Price Elasticity of Demand, and Tax Salience

Notes: This table reports estimates of the effects of sales taxes, of the price elasticity of demand, and of the tax salience parameter. In Panel A, the estimates come from OLS estimates of equations (2) and (3), and the independent variable is quarterly sales tax rate of module m in county c in state s. One observation is a module in a store in a given quarter. Consumer prices $p(1+\tau)$ are tax inclusive. The sample is restricted to modules above the 80th percentile of the national distribution of sales. In Panel B, the reported coefficients are 2SLS estimates of the effect of consumer prices on quantity sold, estimated using equations (4) and (5), where prices are instrumented with leave-self-out chain-level average prices. In Panel C, we report the estimate of the tax salience parameter using equation (6). For this parameter, standard errors are based on 100 bootstrap replications. All standard errors in this table are clustered at the state-module level and are reported in parentheses. In column (1), the sample includes our full sample of stores and the regression model includes module-by-store and module-byquarter-by-state fixed effects. In column (2), the sample is restricted to stores in border counties and the regression model includes module-by-store and module-by-border-pair-by-year-quarter fixed effects, where border pairs denote pairs of contiguous counties on opposite sides of a state border. In column (2), observations are weighted by the inverse of the number of times a store appears in the data. In column (3), observations are weighted, where each module-store cell is weighted by the total expenditures by HMS consumers over the study period. Some cells have no observed purchase in HMS, and are therefore assigned a weight of zero. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

(so that $\epsilon_{ms} = 1/\epsilon_D$), then the pass-through formula in Corollary 1 shows that as market power increases – i.e., as ν/J increases towards 1, which represents monopoly – the pass-through rate decreases.

The next row reports the estimate $\widehat{\beta^Q} = -0.775$ (s.e. 0.187), indicating a meaningful quantity response to tax changes. The results in column (2) show similar results using the county border pair sample. The similar results across the columns is consistent with limited endogeneity bias in the full sample.²⁹

Tax salience parameter To estimate the tax salience parameter θ_{τ} , the effect of sales taxes on quantity needs to be scaled by the effect of price changes on quantity.³⁰ To estimate the price elasticity of demand, we follow the recent literature on uniform pricing by retail chains and construct a store-level instrument based on the pricing of products of other stores in a given retail chain (DellaVigna and Gentzkow 2019). This instrumental variables strategy relates to earlier work by Hausman (1996) and Nevo (2001), and has been used in several recent papers (e.g., Atkin, Faber and Gonzalez-Navarro 2018 and Allcott et al. 2019).

Specifically, we construct an instrument z_{mrn} that is equal to the average log pre-tax price for a given model across all stores in the same retail chain excluding store r:

$$z_{mrn} = \frac{\sum_{x \in f} \log(p_{mxn}) - \log(p_{mrn})}{N_{fn} - 1}$$

where f denotes the retail chain to which store r belongs and N_{fn} is the number of stores in chain fat time n. This is a valid instrument under the assumption that chain-level prices predict "own" store prices, but are not correlated with unobserved store-level demand determinants. A threat to the validity of this instrument is the presence of correlated demand shocks within retail chains. To address this, we continue to include store-by-module fixed effects in all of our specifications. The inclusion of module fixed effects accounts for the fact that more expensive modules may reflect chains responding to strong demand for these modules. Intuitively, our identification is coming from differences in relative prices across modules and chains. To the extent that this variation is driven by differences in product-specific

³⁰Formally, in the case of ad valorem tax (τ), the tax salience parameter is defined as follows: $\theta_{\tau} \equiv \frac{\partial D}{\partial T} \frac{\partial T}{\partial p} \times \frac{1}{p}$. Intuitively, full salience of an ad valorem tax implies that an increase in the tax rate leads to the same demand response as an equivalent proportional change in prices. We begin by estimating a single tax salience parameter that corresponds to the average tax

²⁹The minimum wage literature has also tended to find that results using all counties and "traditional" fixed effects models are similar to results based on the county border pair approach (see, e.g., Dube, Lester, and Reich 2010).

proportional change in prices. We begin by estimating a single tax salience parameter that corresponds to the average tax salience in the population (or $\mathbb{E}(\theta_i)$ in the model above), and then we will allow for heterogeneity in the tax salience parameter across households.

marginal costs across chains, differences in distribution costs across chains (such as supply-sourcing costs), or differences in bargaining power across chains, we can consistently estimate our elasticity of interest using this instrumental variables approach. Intuitively, this approach requires that chains select store locations based on overall demand factors (that are common across modules), but not module-specific demand factors. In Appendix Table A.6, we report the reduced-form relationships between this instrument and price and quantity. To further verify that our results are not contaminated by local module-specific demand shocks, we present corresponding estimates based on an alternative instrument that is equal to the average log pre-tax price across stores in the same chain excluding all stores located in county c, and we show that our estimates are robust to using this alternative instrument. Across all specifications, we find a strong positive relationship between the instrument and price and a strong negative relationship between the instrument and quantity in both the full sample and the county border pair sample.

Using the chain-level instrument, we estimate the price elasticity of demand using the following Two-Stage Least Squares (2SLS) regression model:

$$\log(p(1+\tau)_{mrn}) = \lambda z_{mrn} + \kappa'_{msn} + \kappa'_{mrn} + v'_{mrn}$$
(4)

$$\log Q_{mrn} = \alpha \log(p(1+\tau)_{mrn}) + \kappa_{msn} + \kappa_{mr} + \upsilon_{mrn}$$
(5)

where the log consumer price, $\log(p(1 + \tau)_{mrn})$, is instrumented with z_{mrn} . The κ and κ' terms correspond to the same set of fixed effects as in the regression models in the prior section. Panel B of Table 2 reports the 2SLS estimates of α . The price elasticity of demand estimate in the full sample is $\hat{\alpha} = -1.150$ (s.e. 0.027), and for the border pair subsample, the estimate is $\hat{\alpha} = -1.170$ (s.e. 0.027). Both of these values are larger in magnitude than the estimated tax elasticity in Panel A. Given that we estimate pass-through to be very close to one, our finding of a larger price elasticity than tax elasticity suggests that consumers underreact to taxes relative to posted prices.

We next estimate the tax salience parameter θ_{τ} directly by plugging in each of the estimates in Panel A and Panel B of Table 2 using the following formula:

$$\theta_{\tau} = \frac{(1 - \rho_{\tau})\,\tilde{\epsilon}_D + \tilde{\epsilon}_{D\tau}}{(1 + \tau\rho_{\tau})\,\tilde{\epsilon}_D} \tag{6}$$

The derivation of equation (6) is provided in the Appendix and comes directly from a result that is analogous to Lemma 1 for the case of ad valorem taxes instead of unit taxes. In this formula, $\rho_{\tau} = \frac{d\log(p(1+\tau))}{d\log(1+\tau)}$ and corresponds to the estimate $\beta^{p(1+\tau)}$, $\tilde{\epsilon}_D \equiv \frac{d\log(Q)}{d\log(p(1+\tau))}$ and corresponds to the estimate α , and $\tilde{\epsilon}_{D\tau} \equiv \frac{d\log(Q)}{d\log(1+\tau)}$, which corresponds to the estimate β^Q . If there is complete passthrough ($\rho_{\tau} = 1$), then the "plug-in" estimate of θ_{τ} reduces to the ratio of the tax elasticity ($\tilde{\epsilon}_{D\tau}$) to the price elasticity ($\tilde{\epsilon}_D$) when $\tau = 0$. The formula accounts for the fact that when pass-through is incomplete and taxes are not fully salient, manipulating the actual after-tax price is not the same as manipulating the perceived price.

Panel C of Table 2 reports our "plug-in" estimates of θ_{τ} using our reduced-form results and using $\tau = 0.036$, which is the sample average sales tax rate across all modules.³¹ We estimate $\hat{\theta}_{\tau} = 0.680$ (s.e. 0.151) using the full sample and $\hat{\theta}_{\tau} = 0.556$ (s.e. 0.122) using the border-pair subsample. We also explore whether the tax salience parameter differs between high-price and low-price product modules, and in Appendix Table A.7 we report similar tax elasticity, price elasticity, and implied tax salience parameter estimates across high-price and low-price modules. These results imply that assuming the tax salience parameter is independent of producer (pre-tax) prices is likely to be a reasonable approximation in our setting.³²

We assess the robustness of our estimates of θ_{τ} in several ways. First, we consider an alternative method for calculating the tax elasticity and the price elasticity, as well as the associated value of θ_{τ} , in Appendix Table A.8. In Panels A and B, we report the effect of taxes and of the price instrument on total expenditures.³³ We then back out the implied effect on quantity by subtracting the effect on prices (column 2) from the effect on expenditures (column 3). The implied values of the average tax

³¹In our baseline calibrations, we use the sample average tax rate covering all modules, including modules that are often tax-exempt, since we include these modules in our empirical analysis, and we have identifying sales tax variation in these modules, as well. For completeness, in the Appendix we report additional results using an alternative sample average tax rate that excludes modules which are often tax-exempt. For non-exempt products, state+county sales tax rates are typically in the range of 5 to 10 percent (see, e.g., https://taxfoundation.org/2020-sales-taxes/).

³²Of course, our results do not rule out that tax salience may vary with prices in other settings, and some previous work (see, e.g., Morrison and Taubisnky forthcoming) finds some evidence that salience varies with pre-tax prices. We speculate that the similarity in the estimated tax salience parameter across the high-price and low-price sub-samples likely reflects the fact that the modules in our data are all fairly low-priced products.

³³Total expenditures on module *m* is equal to $\sum_{j \in m} (q_{jrn} \times p_{jrn})$, where *j* denotes a UPC. The effect on expenditures, therefore, captures both the effects on prices and on quantity.

salience parameter are $\hat{\theta_{\tau}} = 0.625$ and $\hat{\theta_{\tau}} = 0.501$ for the full sample and the border-pair subsample, respectively. Second, in Appendix Table A.9 we present results based on alternative ways to account for spatial heterogeneity in consumption trends in our main sample, and we find broadly similar (though slightly lower) values of θ_{τ} .³⁴ Lastly, we re-run our main specification excluding any module that is ever observed to have an excise tax (which excludes all alcohol and tobacco product modules), and we find very similar results excluding these modules (see Appendix Table A.10).

Overall, we conclude that the tax salience parameter estimate is robust to a wide range of alternative samples, specifications, and estimation approaches. However, we identify three potential limitations with the store-level estimates of the average tax salience parameter. First, the average estimate may mask important consumer-level heterogeneity in tax salience. Tax salience could vary with income and education, for example, and heterogeneity in tax salience is one of the key inputs to the welfare formulas developed in Section 2. Second, while the store-level RMS data set tracks a very large number of stores and products, the geographic coverage is incomplete and is not nationally representative. This may lead to a biased estimate of the average tax salience parameter if there is consumer-level heterogeneity in tax salience that varies with the geographic coverage in the storelevel data. Third, store-level price and tax elasticities may capture different substitution margins, and if this is the case, then the two elasticity estimates may differ for reasons unrelated to tax salience. For example, consumers may avoid high taxes rates by engaging in cross-border shopping, and they may avoid high store-level prices by substituting between stores within a county; in both cases, this behavior may lead to biased estimates of the average tax salience parameter when relying entirely on store-level data.

As a result, we address these potential limitations by estimating total consumer demand responses to prices and taxes using household-level data to complement the store-level results. Since the cover-

³⁴Specifically, to account for county-level time-varying heterogeneity, we parameterize country-specific trends for each module as linear time trends (module-by-county-by-year-quarter fixed effects leave no residual variation in tax rates and therefore cannot be used). We also consider store-specific linear trends for each module. The tax and price elasticities under these alternative specifications are smaller than our preferred estimates and imply lower values of θ_{τ} , ranging between 0.372 and 0.509. The pass-through rate is also lower, around 0.94. We note that the inclusion of module-by-state-by-year-quarter fixed effects in our preferred specification effectively shuts down variation from state-level tax rates, whereas county-module linear trends do not.

age of the store-level RMS and household-level HMS are different, we first re-estimate our store-level model weighting each observation by the total value of purchases made by HMS consumers for each module in each store. This effectively shifts the weight towards stores that have larger market shares in HMS in order to better align the two samples. Results are shown in column (3) of Table 2. Consistent with substantial underlying consumer-level heterogeneity, re-weighing stores does alter estimates of average effects. While our estimate of pass-through remains largely unchanged, the effect of taxes on quantity is about 50 percent smaller and less precisely estimated, at $\widehat{\beta^Q} = -0.311$ (s.e. 0.292), and the price elasticity of demand is slightly greater, at $\hat{\alpha} = -1.258$ (s.e. 0.031). The associated estimate of θ_{τ} is 0.273.³⁵ For comparison, Chetty, Looney, and Kroft (2009) estimate $\hat{\theta_{\tau}} = 0.35$ using a field experiment which posted tax-inclusive prices in a grocery store. Taubinsky and Rees-Jones (2018) and Morisson and Taubinsky (forthcoming) conduct online shopping experiments in which participants face different tax rates on common household goods. Using experimental variation in tax rates along with a pricing mechanism used to elicit willingness to pay, they report ranges of experimental estimates of θ_{τ} between 0.23 and 0.54 and between 0.23 and 0.79, respectively. We now turn to household-level estimates of tax salience, which reassuringly show similar average levels of tax salience between the two data sets after adjusting for differences in coverage.

3.3 Household-level Estimation Strategy

The Average Effect of Taxes and Prices on Total Consumer Demand The household-level estimating equations mimic the store-level design:

$$\log Q_{imn} = \bar{\beta} \log(1 + \bar{\tau}_{imn}) + \delta_{msn} + \delta_{im} + \varepsilon_{imn} \tag{7}$$

$$\log Q_{imn} = \bar{\alpha} \log p_{imn} + \kappa_{msn} + \kappa_{im} + \varepsilon_{imn} \tag{8}$$

where $\log Q_{imn}$ is quantity purchased by household *i* for module *m* and time (year-quarter) *n*, and p_{imn} and $\bar{\tau}_{imn}$ are respectively the average price and taxes paid by household *i* for those purchases. The terms δ_{msn} and δ_{im} are module-by-state-by-time and module-by-household fixed effects, respec-

 $^{^{35}}$ The average sales tax rate is 0.024 in the weighted sample and 0.036 in the unweighted sample. The column (1) estimates, therefore, put slightly more weight on stores located in high-tax counties.

tively.³⁶ We cluster standard errors at the household-module level. To address simultaneity bias between price, tax, and unobserved household-level demand shocks, we construct price and tax instruments following the methodology developed in Allcott et al. (2019). First, let $s_{ij(m)r,c}$ be the share of household *i*'s expenditures on module *m* while residing in county *c* that are of UPC *j* in store *r*. These shares characterize household *i*'s usual shopping behavior for module *m* while residing in county *c*. We then calculate predicted taxes Z_{imn}^{τ} and predicted prices Z_{imn}^{p} by fitting tax rates and retail-chain average prices for UPC *j* in store *r* at time *n* to these time-invariant shares:

$$Z_{imn}^{\tau} = \sum_{r \in RMS} \sum_{j \in m} s_{ij(m)r,c} \tau_{jrn}$$
$$Z_{imn}^{p} = \sum_{r \in RMS} \sum_{j \in m} s_{ij(m)r,c} z_{jrn}$$

where τ_{jrn} is the tax rate on product j in store r at time n, and z_{jrn} is the average log pre-tax price for UPC j at time n across all stores in the same retail chain excluding store r.³⁷

These chain-level averages are calculated in the RMS data and therefore are only observed at RMS stores. To maintain consistency across samples, we construct these instruments using the subset of grocery stores used in our main store-level analysis. Since the location of these stores is known, the tax instrument also helps address any attenuation bias associated with measurement error in average tax rates for all purchases.

2SLS estimates of the average effect of taxes and prices on total consumer demand are presented in Table 3, columns (1) and (3). The tax elasticity of demand is -0.401 (s.e. 0.277) and the price elasticity of demand is -1.365 (s.e. 0.013). These magnitudes are both fairly similar to the corresponding store-level weighted estimates (see Table 2, column (3)).³⁸ Using a pass-through rate of 0.968 and the sample average tax rate of 0.024 (see Table 2, column (3)), the plug-in estimate of θ_{τ} is 0.318, which represents the average tax salience parameter across consumers.

 $^{^{36}}$ The module-by-state-by-time fixed effects are based on household *i*'s state of residence at time *n*.

³⁷In practice, to standardize the construction of price indices, the price instrument is obtained by regressing log quarterly retail-chain average price on UPC fixed effects and module-by-household-by-time fixed effects, weighting observations by $s_{ij(m)r.c.}$ The estimated module-by-household-by-time fixed effects serve as the price instrument.

³⁸In Appendix Table A.11, we investigate whether consumers engage in cross-store substitution to avoid higher prices and tax rates. We find that when prices and taxes increase at the RMS stores used in the construction of the instrument, the quantity purchased at these stores decreases more than the total quantity purchased at any store does. This is consistent with cross-store (including cross-border) substitution being an important margin for both the tax and price elasticity of demand.

Independent variable (x):	Taxes,	Taxes, $(1 + \tau)$		Prices, $p(1+\tau)$	
	(1)	(2)	(3)	(4)	
Panel A: 2SLS Estimates of the	e Tax and Pri	ce Elasticities			
$\log(x)$	-0.401	-0.386	-1.365	-1.371	
	(0.277)	(0.277)	(0.013)	(0.013)	
$log(x) \times Income$		0.094		0.065	
		(0.025)		(0.007)	
$\log(x) \times Age$		0.002		0.002	
		(0.004)		(0.000)	
$log(x) \times Single Family House$		-0.025		-0.043	
		(0.051)		(0.012)	
$log(x) \times Married$		-0.140		-0.083	
		(0.057)		(0.011)	
$log(x) \times Children$		-0.217		-0.125	
		(0.041)		(0.012)	
$log(x) \times Full-time employment$		0.033		0.056	
		(0.037)		(0.010)	
$log(x) \times College$ educated		0.032		0.039	
		(0.052)		(0.010)	
$\log(x) \times \text{Internet}$		0.073		-0.019	
		(0.045)		(0.013)	
Joint significance test of interactions, p-value		[0.000]		[0.000]	
Panel B: "Plug-in" Estimate o	f Tax Salienc	e Parameter			
θ_{τ} (no consumer heterogeneity, columns (1) and (4))		0.3	18		
$E[\theta_{\tau}]$ (heterogeneous consumers, columns (2) and (4))		0.292			
$\operatorname{Var}(\theta_{\tau})$	0.009				
Average tax rate, τ		0.024			
Additional variance and covariance terms:					
$\operatorname{Var}(\widetilde{\epsilon}_{D\tau})$		0.027			
$\operatorname{Var}(\widetilde{\epsilon}_D)$		0.013			
$\operatorname{Cov}(heta_v, \tilde{\epsilon}_D)$		-0.010			
Specification:					
Household × Module fixed effects	У	У	У	У	
Module × State × Year-Quarter fixed effects	У	У	У	У	
Ν	51,34	6,211	51,34	6,211	

 Table 3

 Household-level Estimates of Tax Elasticity, Price Elasticity of Demand, and Tax Salience

<u>Notes:</u> This table reports estimates of the effects of sales taxes, of the price elasticity of demand, and of the tax salience parameter. In columns (1) and (2), the independent variable is the average quarterly sales tax rate faced by household i on module m. In columns (3) and (4), the independent variable is the average quarterly price paid by household i for purchases on module m. All reported coefficients in panel A are 2SLS estimates using the tax and price instruments described in the main text. In columns (2) and (4), the set of instruments include all linear interactions between tax (price) and the listed observable characteristics. In Panel B, we report estimates of the variance of the tax salience parameter. All standard errors in this table are clustered at the household-module level and are reported in parentheses. Observations are weighted using Nielsen's projection factors in order to obtain national representativeness. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Heterogeneity in Consumer Inattention As a first step, we use household-level demographic information to investigate whether price and tax elasticities vary along observed dimensions. To this end, we supplement equations (7) and (8) with linear interaction terms, and also include the covariates on their own as regressors. We augment the set of instrumental variables to include linear interactions between the price and tax instruments and the covariates. The variables we include are income, age, and indicators for living in a single-family house, for being married, for the presence of children below the age of 18 in the household, for full-time employment, for college education, and for having internet at home. All covariates are centered around their sample mean. Results are shown in columns (2) and (4) of Table 3. The degree of responsiveness to both taxes and prices decreases with income, and increases with the presence of children. Several interactions are statistically significant at conventional levels, and a joint test of statistical significance of the interaction terms indicates we can reject the null of no heterogeneity.

Demographic variables vary across households and years. We therefore obtain household-year specific elasticities, by producing fitted values using the coefficients on the main effects of taxes and prices as well as the coefficients on the interaction terms. With a slight abuse of notation, we denote these household-year price and tax elasticities by $\tilde{\epsilon}_{D,i}$ and $\tilde{\epsilon}_{D\tau,i}$, although in practice they will vary across years within households. With these in hand, we calculate household-year-specific values of the inattention parameter

$$\theta_{\tau,i} = \frac{(1-\rho_{\tau})\tilde{\epsilon}_{D,i} + \tilde{\epsilon}_{D\tau,i}}{(1+\tau\rho_{\tau})\tilde{\epsilon}_{D,i}}$$
(9)

and calculate the variance of $\theta_{\tau,i}$ in the estimation sample.³⁹ We calibrate pass-through using our RMS estimate of $\rho_{\tau} = 0.968$ and set $\tau = 0.024$, the average tax rate on household purchases in HMS. This yields an estimate of $Var(\theta_{\tau,i}) = 0.009$. The variance of tax elasticities $Var(\tilde{\epsilon}_{D\tau,i}) = 0.027$ is twice as large as the variance of price elasticities $Var(\tilde{\epsilon}_{D,i}) = 0.013$.⁴⁰

While this approach is useful for identifying observable characteristics that are associated with

³⁹Since the reduced-form effects of taxes includes the (endogenous) effect of taxes on consumer prices in both the household-level analysis and the store-level analysis, the inattention parameter is calculated the same way.

⁴⁰Since they are functions of the same observables, the two elasticities are highly correlated, which attenuates the variance of $\theta_{\tau,i}$. To see why, consider the case of $\rho_{\tau} = 1$ and $\tau = 0$. Then, $\theta_{\tau,i}$ reduces to the ratio of the two elasticities, $\tilde{\epsilon}_{D\tau,i}/\tilde{\epsilon}_{D,i}$. If the two elasticities were perfectly correlated, the ratio would be constant across consumers.

consumer heterogeneity in the price elasticity and tax elasticity, it likely provides a lower-bound estimate of the true degree of dispersion in consumer inattention since it does not capture unobserved heterogeneity. To overcome this limitation, we turn to a mixed-effects model that allows for random coefficients, and we estimate the model using maximum likelihood. The model permits random household-year intercepts and random household-year coefficients on the tax and price coefficients. We identify the model using parametric functional form assumptions, assuming that the random effects are jointly normally distributed (with unknown variances and covariances).

The estimation proceeds in two steps. First, we re-estimate the effect of taxes and prices on quantity using a control function approach. For taxes, we estimate

$$\log Q_{imn} = \bar{\beta} \log(1 + \bar{\tau}_{imn}) + \underbrace{[\lambda \omega_{imn} + \delta_{msn} + \delta_{im}]}_{\Gamma X_{imn}} + \varepsilon_{imn}$$

where ω_{imn} are the residuals from the first-stage estimating equation (i.e., the residuals from firststage regression of $\log(1 + \bar{\tau}_{imn})$ on Z_{imn}^{τ} , controlling for δ_{msn} and δ_{im}). We then partial out the covariates to obtain adjusted residuals, $\hat{\varepsilon}_{imn} \equiv \log Q_{imn} - \hat{\Gamma} X_{imn}$.

In the second step, we fit a mixed-effects model on the adjusted residuals allowing for a fixed (constant) effect of $\log(1 + \bar{\tau}_{imn})$, as well as random slopes β_i on $\log(1 + \bar{\tau}_{imn})$ and random intercepts ν_i that vary at the household-year level⁴¹:

$$\hat{\varepsilon}_{imn} = \bar{\beta} \log(1 + \bar{\tau}_{imn}) + \beta_i \log(1 + \bar{\tau}_{imn}) + \nu_i + \varepsilon'_{imn}$$

We use the mixed-effect model results to obtain empirical Bayes predictions $\hat{\epsilon}_{D\tau,i} = \hat{\beta} + \hat{\beta}_i$. We then follow the same approach to estimate the effect of prices on quantity, and we obtain $\hat{\epsilon}_{D,i}$ estimated analogously. With these two estimates, we use equation (9) to calculate $\theta_{\tau,i}$, and from this we can directly estimate the variance of $\theta_{\tau,i}$ in the estimation sample.

Table 4 presents the mixed-effects model results. The variance of tax elasticity random coefficients $Var(\tilde{\epsilon}_{D\tau,i}) = 0.099$ is roughly 3 times greater than that based on observables characteristics. By contrast, the variance of price elasticities $Var(\tilde{\epsilon}_{D,i}) = 0.002$ is close to zero.⁴²

⁴¹This two-step approach mimics the methods developed in Chetty, Friedman, and Rockoff (2014) for the estimation of teacher value-added.

⁴²It must be noted that we implicitly assume constant effects for the first-stage relationships between average prices

Specification	Random coefficients only	Combining fixed and random coefficients					
Panel A: Tax Elasticity							
Average tax elasticity, $E[\tilde{\epsilon}_{D\tau}]$	-0.396	-0.374					
Variance of tax elasticity, $\operatorname{Var}(\tilde{\epsilon}_{D\tau})$	0.099	0.126					
Panel B: Price Elasticity							
Average price elasticity, $E[\tilde{\epsilon}_D]$	-1.375	-1.362					
Variance of price elasticity, $Var(\tilde{\epsilon}_D)$	0.002	0.015					
Panel C: Heterogeneity in Tax Sa	lience						
Average tax salience, $E[\theta_{\tau}]$	0.313	0.292					
$\operatorname{Var}(\theta_{\tau})$	0.051	0.062					
$\operatorname{Cov}(heta_v, \tilde{\epsilon}_D)$	0.001	-0.009					
Ν	51,346,211	51,346,211					

Table 4 Mixed-Effects Estimates of Tax Elasticity, Price Elasticity of Demand, and Tax Salience

<u>Notes:</u> This table reports estimates of the variance of tax and price elasticities of demand based on mixed-effects models. Panel A and Panel B report the average elasticities as well as the sample variance of the associated empirical Bayes predictions of the random coefficients for the tax elasticity and price elasticity, respectively. Panel C reports estimates of the variance of the tax salience parameter. The mixed-effects models allow for random coefficients on the tax and price variables across household-year cells. In column (1), heterogeneity is based on random coefficients from mixed-effects models. In column (2), heterogeneity combines variation in random coefficients as well as heterogeneity from the "fixed" coefficients based on the observables from Table 3. Observations are weighted using Nielsen's projection factors in order to obtain a nationally representative sample. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Together, these results imply an average value of $\theta_{\tau,i}$ of 0.313, and a variance of $Var(\theta_{\tau,i}) = 0.051$, which is about 5 times larger than the variance estimate based on observable characteristics alone, and translates into a two-standard-deviation range around the mean salience parameter of 0.452. By comparison, in experimental settings, Taubinsky and Rees-Jones (2018) and Morrison and Taubinsky (forthcoming) report a lower-bound estimate of the variance of θ_{τ} around 0.1 and 0.8, respectively.⁴³

and price instruments, and between average taxes and tax instruments. To examine the validity of this assumption, we run similar mixed-effects models on the relevant first-stage residuals. Results are presented in Appendix Table A.12 and confirm that the variances of the random slope coefficients in first-stage relationships are very close to zero.

⁴³Several key differences across settings may explain why we obtain considerably lower estimates of $Var(\theta_{\tau,i})$. First,

Taken together, both empirical approaches to measure heterogeneity in consumer inattention strongly reject the null hypothesis of no heterogeneity in the tax salience parameter across households. Additionally, both approaches find much more variation across households in their responsiveness to taxes than prices. This implies that there is meaningful variation in the tax salience parameter across households, and this comes primarily from household-level heterogeneity in the reduced-form tax elasticity.

4 Calibrations

In this section, we calibrate the incidence and marginal excess formulas for ad valorem taxes using the estimates in the previous section. We then compute the difference between our marginal excess burden formula and the standard Harberger formula and decompose it into the deviation coming from salience effects and the deviation coming from imperfect competition. Lastly, we consider counterfactual scenarios that increase tax salience and change the market structure, taking into account the endogeneity of the output response to the tax and the pass-through rate with respect to tax salience and market structure. These scenarios reveal the various interactions between tax salience and imperfect competition in determining the pass-through of taxes into consumer prices, the effect of taxes on quantity demanded, and ultimately the incidence and marginal excess burden.

To begin, we recover the markup and the conduct parameter in several intermediate steps shown in Panel A of Table 5. We assume constant marginal costs and a constant price elasticity of demand throughout this calibration exercise. Using our estimate of ρ_{τ} from Table 2, column (3), and our estimate of $\mathbb{E}(\theta_{\tau,i})$ from Table 4, along with the pass-through expression, we recover an estimate of $v_q/(J\epsilon_{ms}) = 0.070$ by exploiting the fact that the elasticity of inverse marginal surplus is equal to the inverse of the price elasticity of demand under constant elasticity of demand; i.e., $\epsilon_{ms} = 1/\epsilon_D$. Next, in order to estimate the markup (p-mc)/p, we translate $v_q/(J\epsilon_{ms})$ into $v_q/(J\epsilon_D)$, and since the

our set of products include numerous goods that are tax-exempt in many jurisdictions, whereas the experiment in Morrison and Taubinsky (forthcoming) focuses on nine non-tax-exempt products. Second, the validity of their experiment hinges on ensuring participants understand the environment. This is accomplished by having participants answer comprehension questions about tax rates, which may prompt consumers to "think" about taxes, something they might not do during their usual grocery shopping experiences. In contrast, our inattention parameter also captures any lack of comprehension. Note that if $\theta_{\tau,i} \ge 0$, a variance greater than 0.25 is only possible if at least some consumers *overreact* to taxes (i.e. have $\theta_{\tau,i} > 1$). We conjecture that such a case is much less likely to arise in our observational setting.
latter determines the markup, we estimate (p-mc)/p = 0.037.⁴⁴ Our last intermediate step estimates $v_q/J = 0.051$.

With the estimated markup and conduct parameter in hand, we can calibrate the incidence and marginal excess burden formulas for ad valorem taxes using the estimates of price and tax elasticities in Table 4. The Appendix derives the following incidence formula for ad valorem taxes that allows for heterogeneity in θ_{τ} , which is analogous to the incidence formula in Proposition 1 above⁴⁵:

$$I = \frac{\rho_{\tau}(1+\tau) + (1 - \mathbb{E}(\theta_{\tau,i}))\tau\tilde{\epsilon}_{D\tau} + \tau(1+\tau)\tilde{\epsilon}_D(1/p)Var(\theta_{\tau})}{\left(1 - \frac{\nu_q}{J}\right)(1 - \rho_{\tau}) + \frac{\nu_q}{J}\mathbb{E}(\theta_{\tau,i})(1+\tau\rho_{\tau})}$$
(10)

In Panel B of Table 5, column (1) assumes no heterogeneity in θ_{τ} , while columns (2) and (3) illustrate sensitivity to heterogeneity in θ_{τ} . Column (2) uses our preferred estimate of $Var(\theta_{\tau}) = 0.051$ which comes from the mixed-effects model reported in Table 4. Column (3) considers a more conservative special case where $\theta_{\tau} \in \{0, 1\}$; i.e., some consumers fully optimize, while others are completely inattentive to taxes.⁴⁶ In column (1), we calculate I = 21.088, which suggests that essentially all of the incidence of sales taxes falls on consumers. In column (2), we allow for heterogeneity in tax salience, and we find this further increases the incidence on consumers to I = 21.126.

Turning to the marginal excess burden, we use the following formula that allows for heterogeneity in θ_{τ} , and we scale the formula so that it represents the change in welfare as a percentage of total revenue:

$$\frac{d\widetilde{W}}{d\tau} \equiv \frac{(1+\tau)}{pQ} \frac{dW}{d\tau} = \left(\frac{p-mc}{p} + \mathbb{E}(\theta_{\tau,i})\tau\right) \tilde{\epsilon}_{D\tau} + \tau(1+\tau)\tilde{\epsilon}_D(1/p)Var(\theta_{\tau})$$
(11)

Using the sample average tax rate of 2.4 percent for τ and assuming that $Var(\theta_{\tau}) = 0$, we find $d\widetilde{W}/d\tau = -0.018$ (column 1). This implies that the marginal excess burden is about 1.8 percent of total revenue. Allowing for heterogeneity in θ_{τ} across consumers increases the welfare cost of taxation to $d\widetilde{W}/d\tau = -0.019$ if $Var(\theta_{\tau}) = 0.051$, and to $d\widetilde{W}/d\tau = -0.025$ if $Var(\theta_{\tau}) = 0.215$.

⁴⁴Grocery stores operate on relatively low profit margins; industry analyst Jeff Cohen recently said that "It's a very competitive industry ... grocery stores can only slightly mark up the prices for their products." https://www.marketplace.org/2013/09/12/groceries-low-margin-business-still-highly-desirable/.

⁴⁵Throughout this section, we use $Var(\theta_{\tau})$ to denote the variance of the inattention parameter for ad valorem taxes.

⁴⁶In this case, since θ_{τ} is binary, an average θ_{τ} of 0.313 (i.e., the share of consumers fully optimizing) implies a variance of $0.313 \times (1 - 0.313) = 0.215$. Also note that the incidence formula requires a value for $(1/p)Var(\theta_{\tau})$, which normalizes the consumer heterogeneity in θ_{τ} by price. The values of $\log p$ in our data are centered around zero, implying an average price index p of 1.

	(1)	(2)	(3)
Panel A: Inputs and Intermediate Estimates Needed in Cali	bration		
Inputs:			
Average tax rate, τ		0.024	
Price elasticity, $\tilde{\epsilon}_D \equiv \partial \log(Q) / \partial \log(p(1+\tau))$		-1.375	
Tax pass-through, $\rho_{\tau} \equiv d \log(p (1+\tau))/d \log(1+\tau)$		0.968	
Tax elasticity, $\tilde{\epsilon}_{D\tau} \equiv d\log(Q)/d\log(1+\tau)$		-0.396	
Intermediate estimates:			
Implied estimate of $v_q/(J\epsilon_{ms})$		0.070	
Implied markup $(p - mc)/p$		0.037	
Implied estimate of v_q/J		0.051	
$(v_q/J = 0 \text{ is perfect competition}, v_q/J = 1 \text{ is monopoly})$			
Tax salience:			
Tax salience parameter, θ_{τ}		0.313	
Heterogeneity in θ_{τ} , $(1/p)$ Var (θ_{τ})	0.000	0.062	0.215
Panel B: Incidence and Marginal Excess Burden Form	ılas		
Incidence (I)			
$\overline{I = (dCS/d\tau)/(dPS/d\tau)}$	21.088	21.134	21.247
$= \left(\rho_{\tau}(1+\tau) + (1-\theta_{\tau})\tau\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau})\right) / $			
$((1-\nu/J)(1-\rho_{\tau})+(\nu/J)\theta_{\tau}(1+\tau\rho_{\tau}))$			
Marginal Excess Burden $(d\tilde{W}/d\tau)$			
$\overline{d\tilde{W}/d\tau} = ((p-mc)/p + \theta_{\tau}\tau)\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau})$	-0.018	-0.020	-0.025
Panel C: Decomposition of the Deviation Between General Formula and	l Harberge	r Formula	
Harberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{\epsilon}_{D_{\tau}}$	-0.009	-0.009	-0.009
	0.002	0.005	0.010
Imperfect salience only, $dW/d\tau = \theta_{\tau}\tau\epsilon_{D\tau} - \tau(1+\tau)\epsilon_D(1/p) Var(\theta_{\tau})$	-0.003	-0.005	-0.010
Decomposition as % of difference b/w Harberger and general formula	-80%	-43%	3%
Imperfect competition only, $d\tilde{W}/d\tau = ((p-mc)/p + \tau)\tilde{\epsilon}_{D\tau}$	-0.024	-0.024	-0.024
Decomposition as % of difference b/w Harberger and general formula	180%	143%	95%

 Table 5

 Calibration of Incidence and Marginal Excess Burden Formulas

<u>Notes:</u> This table reports calibrations of the tax incidence and marginal excess burden formulas. The results of these calibrations are shown in Panel B. Panel A presents the value of the input parameters taken from Tables 2 through 4, as well as estimates of intermediate parameters (see main text for details). Panel C presents a decomposition of the deviation between the general formula calibrated in Panel B. In column (1), we assume no heterogeneity in salience across consumers; in column (2) we allow for heterogeneity in the salience parameter by calibrating the variance of θ_{τ} using the estimate reported in Table 4. In column (3), we consider the special case of consumers being either fully attentive or fully inattentive to taxes. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

The final panel of Table 5 (Panel C) reports the excess burden calculation if one instead calibrated the standard Harberger formula (which assumes perfect competition and full optimization) using our empirical estimate for the tax elasticity. The standard Harberger formula is given by the following:

$$\frac{d\widetilde{W}^{Harberger}}{d\tau} \equiv \tau \widetilde{\epsilon}_{D\tau} \tag{12}$$

The objective of this exercise is to quantify the discrepancy if one "naively" computed the welfare cost of taxation ignoring salience effects and imperfect competition. In this case, we find an estimate of $\frac{d\widetilde{W}^{Harberger}}{d\tau} = -0.009$. To understand the sources of the difference between excess burden according to formula (11) (-0.019) and excess burden according to formula (12) (-0.009), we decompose the difference into the change from accounting for tax salience (while assuming perfect competition) and the change from accounting for imperfect competition (while assuming full tax salience).

Accounting for salience effects but assuming perfect competition leads to the marginal excess burden formulas in Chetty, Looney, and Kroft (2009) and Taubinsky and Rees-Jones (2018), depending on whether or not we allow for heterogeneity in salience effects. These excess burden formulas are given respectively as:

$$\frac{d\widetilde{W}^{CLK}}{d\tau} \equiv \theta_{\tau} \tau \widetilde{\epsilon}_{D\tau} \tag{13}$$

$$\frac{d\widetilde{W}^{TRJ}}{d\tau} \equiv \theta_{\tau} \tau \widetilde{\epsilon}_{D\tau} + \tau (1+\tau) \widetilde{\epsilon}_D (1/p) Var(\theta_{\tau})$$
(14)

Assuming no heterogeneity gives an estimate of $\frac{d\tilde{W}^{CLK}}{d\tau} = -0.003$ (column 1), which is smaller in magnitude than the excess burden according to the standard Harberger formula assuming full optimization (-0.009). Allowing for heterogeneity in θ_{τ} gives an estimate of $\frac{d\tilde{W}^{TRJ}}{d\tau} = -0.005$ (column 2), which is still smaller than but closer to the Harberger benchmark which ignores tax salience. In the special case where consumers either fully optimize or are fully inattentive (column 3), $\frac{d\tilde{W}^{TRJ}}{d\tau} = -0.010$, which is very similar to the Harberger benchmark. Thus, allowing for salience effects leads to either smaller or fairly similar estimates of the marginal excess burden calculated using the standard Harberger formula (depending on the amount of heterogeneity in salience effects).

Next, we account for imperfect competition but assume full optimization so that taxes are fully salient. In this case, we calibrate the excess burden according to the formula in Auerbach and Hines

(2001):

$$\frac{d\widetilde{W}^{AH}}{d\tau} \equiv \left(\frac{p-mc}{p} + \tau\right)\widetilde{\epsilon}_{D\tau}$$
(15)

Accounting for imperfect competition but assuming full optimization gives an estimate of $\frac{d\widetilde{W}^{AH}}{d\tau} = -0.024$. This is larger than the marginal excess burden estimate in column (1) and fairly similar to the estimate in column (3).

We thus find that tax salience accounts for a smaller percentage of the deviation between excess burden calculated using formula (11) and excess burden calculated using formula (12) in both columns. Numerically, our findings in column (1) indicate that imperfect competition accounts for 180 percent of the difference between excess burden according to our new formula and excess burden according to the Harberger formula, while imperfect salience accounts for -80 percent of the difference. In column (2) the corresponding percentages are 149 percent and -49 percent, respectively. Therefore, that naively applying the standard Harberger formula to calculate the welfare cost of taxation will lead one to understate the marginal excess burden, and our decomposition indicates that this is almost entirely due to accounting for imperfect competition.

We assess the robustness of these results in a number of dimensions. Appendix Tables A.13 and A.14 report all of the results in Table 5 using the unweighted store-level estimates instead of those based on households (for the full sample and the county border pair sample, respectively). The incidence continues to essentially all fall on consumers, and the excess burden is increased somewhat (from 1.9 percent in column (2), Table 5, to -3.6 and -2.4 percent in Tables A.13 and A.14, respectively). In Appendix Table A.15, we show sensitivity to alternative values of the elasticity of inverse marginal surplus. Since we do not have sufficient data to estimate the elasticity of inverse marginal surplus directly, we show sensitivity to different values of this parameter. Varying this parameter by roughly 50 percent in either direction does not change our main results qualitatively. Lastly, in Appendix Table A.16, we reproduce the decomposition using the sample average tax rates on taxed products of $\tau = 0.052$, excluding tax-exempt product modules from the calibration. This produces very slightly lower estimates of θ_{τ} and $Var(\theta_{\tau})$. More importantly, a higher initial tax rate raises the marginal excess burden, but narrows the gap between our formula and the Harberger benchmark since

the latter scales one-for-one with the initial tax rate.

Overall, even though we estimate a fairly small markup and a fairly large departure from full salience, we robustly find that imperfect competition "matters more" than salience in terms of accounting for the deviation from the standard Harberger analysis. Mathematically, this comes from the fact that the markup – while fairly small in absolute terms – is nevertheless larger than the product of the average tax rate and the salience "gap", or the difference between full salience and the tax salience parameter $(1 - \theta_{\tau})$.

4.1 Counterfactual Scenarios

The prior exercise sheds light on the discrepancy between our excess burden estimate and the estimate one would "naively" compute using the standard Harberger approach which ignores salience effects and imperfect competition. A different question one can ask is what are the welfare consequences of taxation under different market structures and under salient and non-salient taxes. This counterfactual analysis is more appropriate if one wants to compare the excess burden of taxation under different assumptions on the degree of market power and degree of inattention to taxes.

This section reports additional calibration exercises that estimate how the incidence and marginal excess burden would counterfactually be affected by changes to either tax salience or market structure (or both). The key difference between these calibrations and the calibrations in the prior section is that here we take into account the endogeneity of the pass-through rate and the output response to taxes to changes in tax salience and market structure. This allows us to capture the fact that when taxes become more salient consumers are expected to respond more, which leads to an increase in the tax elasticity of demand. Additionally, changes in either tax salience or market structure will change the pass-through of taxes onto consumer prices, and we can use the analytical pass-through expression to re-calculate the counterfactual pass-through of taxes into consumer prices in these different scenarios.

Counterfact	ual Scenarios Adjust	ting Tax Saliend	ce and Market St	tructure		
	Imperfect		Cou	interfactual scena	arios	
Tax salience parameter, θ_r :	salience, $\theta_r = 0.313$	Imperfec $\theta_r =$	st salience, 0.313		Full salience, $\theta_r = 1.00$	
	$Var(\theta_\tau) = 0.062$	$\operatorname{Var}(\theta_{\tau})$) = 0.062		$\operatorname{Var}(\theta_{\tau}) = 0$	
	Imperfect	Perfect	Imperfect	Imperfect	Perfect	Imperfect
Market structure (conduct parameter, v_q /J):	competition, $v_q / J = 0.051$	competition, $v_q/J = 0$	competition, $v_q/J = 0.102$	competition, $v_q / J = 0.051$	competition, $v_q/J = 0$	competition, $v_q / J = 0.102$
	(1)	(2)	(3)	(4)	(2)	(9)
Panel A: Inp	uts and Intermediate	Estimates Need	ed to Calibrate F	ormulas		
<u>Inputs:</u> [constant parameters]						
Average tax rate, $ au$	0.024	0.	024		0.024	
Price Elasticity, $\tilde{\epsilon}_D \equiv \partial \log(Q)/\partial \log(p)$	-1.375	-1-	.375		-1.375	
Intermediate estimates:						
Implied estimate of $v_q/(J \epsilon_{ms})$	0.0.0	0.000	0.140	0/0.0	0.000	0.140
Implied markup $(p - mc)/p$	0.037	0.000	0.074	0.037	0.000	0.074
Panel B: Counterfactu	al Tax Responses and	d Implied Incid	ence and Margin	al Excess Burde	ц	
Counterfactual reponses:	Baseline estimates		Cou	interfactual respo	onses	
Tax Pass-Through, $\rho_{\tau} \equiv d\log(p(1+\tau))/d\log(1+\tau)$	0.968	1.000	0.940	0.898	1.000	0.809
Tax Elasticity, $\tilde{\epsilon}_{D\tau} \equiv d\log(Q)/d\log(1+\tau)$	-0.396	-0.437	-0.352	-1.232	-1.375	-1.106
$= \tilde{\epsilon}_D(\rho_\tau - 1 + \theta_r/(1 + \tau \theta_r))(1 + \tau)$						
Incidence (I)						
$I \equiv (dCS/d\tau)/(dPS/d\tau)$	21.134	8	11.080	6.184	8	3.010
$= \left(\rho_{\tau}(1+\tau) + (1-\sigma_{\tau})\tau \epsilon_{D\tau} - \tau(1+\tau) \epsilon_{D}(1/P) \vee \operatorname{arl}(\sigma_{\tau})\right) / ((1-\nu/J)(1-\rho_{\tau}) + (\nu/J)\theta_{\tau}(1+\tau)\rho_{\tau})$						
<u>Marginal Excess Burden (<i>d</i> Ŵ/<i>dt</i>)</u>						
$d\tilde{W}/d\tau = ((p-mc)/p + \theta_{\tau}\tau)\tilde{e}_{D\tau} - \tau(1+\tau)\tilde{e}_D(1/p)\operatorname{Var}(\theta_{\tau})$	-0.020	-0.005	-0.031	-0.075	-0.033	-0.109
<u>Notes:</u> This table reports calibrations of the tax incic	dence and marginal e	xcess burden for	ormulas for diffe	rent counterfact	ual assumptions	s about tax
parameters that are held constant across scenarios as	w tot includently to s well as the implied t	markup (given	assumed market	structure that de	termines the de	gree of
competition). Panel B shows the counterfactual resp column 1 (based on Table 4). Lastly. Panel B report	oonses to tax changes ts the incidence and r	for each scenar marginal excess	rio, which can be burden. Columr	e compared to th 1 (1) reports resu	e empirical esti- alts using the ba	mates ın seline
estimates of salience and conduct parameter from T	able 5, and the remai	ining columns r	eport counterfac	tual results assur	ming different v	values of the
tax salience parameter and the conduct parameter. (Columns (1)-(3) use t	the baseline esti-	mate of the tax s	alience paramete	er, and columns	: (4)-(6) +hot is double
the baseline estimate from Table 5. Data on sales tax	assume period from a v	variety of sourc	es listed in Appe	ndix Table A.2.	uuct parameter	utat is uouble nditure data
from Nielsen RMS and HMS.			- J.J		- Jos non said	

Table 6

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Our main results are summarized in Table 6, which report results from five different counterfactual scenarios that explore the consequences of moving to full salience and either moving to perfect competition or decreasing the amount of competition (relative to the baseline). Panel A of Table 6 shows that the underlying price elasticity of demand elasticity is always held constant across the scenarios. When varying the market structure, the markup and conduct parameter are either counterfactually set to zero (under perfect competition), or the conduct parameter is doubled (from the empirical estimate in Table 5) to decrease the amount of competition. In each scenario, we re-calculate the pass-through and the tax elasticity (shown in the top of Panel B), and we then use these estimates to re-calibrate the incidence and marginal excess burden formulas (bottom of Panel B).

The first column reports the baseline calibration from Table 5. Column (2) holds constant the tax salience parameter (θ_{τ}) but moves to perfect competition by setting the conduct parameter is 0. This leads to full pass-through, which in turn leads to a slightly larger tax elasticity (as consumers now face slightly higher prices for the same change in taxes). The remaining rows in Panel B show full incidence on consumers and a lower marginal excess burden under perfect competition (as compared to column (1)). Column (3) continues to hold constant the tax salience parameter but doubles the conduct parameter from 0.051 to 0.102 so that there is less competition in the market. This leads to a lower pass-through, which, in turn, leads to a smaller tax elasticity of demand. In turn, there is a lower incidence of taxation on consumers and a larger marginal excess burden.

Next, column (4) holds constant the markup and conduct parameter and considers the scenario where taxes are fully salient. In this case, the tax elasticity is much larger since consumers respond much more to tax changes as compared to columns (1)-(3). However, the pass-through rate is actually lower than in column (1), reflecting the fact that under imperfect competition, firms will choose lower pass-through when salience is higher. This reveals another interaction between tax salience and imperfect competition: we find that pass-through does not depend on the tax salience parameter under perfect competition given our calibration assumptions, but under imperfect competition, we find that increasing salience parameter leads to lower pass-through, a lower incidence on consumers, and a

larger marginal excess burden.47

Lastly, the scenarios in columns (5) and (6) continue to assume that taxes are fully salient but vary the degree of competition as in columns (2) and (3). In column (5), the tax elasticity is now the same as the price elasticity of demand since there is full pass-through under perfect competition. Interestingly, this leads to a larger marginal excess burden compared to our baseline calibration in column (1). In other words, "fixing" the misoptimization of consumers and reducing distortions from imperfect competition lead to a larger marginal excess burden than the status quo. While moving to perfect competition reduces the marginal excess burden in each "pair" scenarios (i.e., moving from (1) to (2) and from (4) to (5)), increasing the tax salience parameter increases marginal excess burden (going from (1) to (4), (2) to (5), and (3) to (6)). Additionally, the marginal excess burden from increasing the tax salience parameter increases even more under imperfect competition (as compared to perfect competition).⁴⁸ This highlights an additional interaction between tax salience and imperfect competition, ranging from the pass-through of taxes into prices to the incidence and marginal excess burden of taxation.

5 Conclusion

This paper develops new formulas for the welfare effects of commodity taxation in a model with heterogeneous consumers featuring imperfect competition and tax salience. We find important interactions between salience and the degree of competition for incidence and the efficiency cost of taxation. We also show that heterogeneity in inattention matters for incidence under all market structures, including perfect competition.

⁴⁷Our theoretical analysis shows that pass-through can increase with salience even under perfect competition if supply is less than perfectly elastic. Additionally, under imperfect competition pass-through can either increase or decrease with the salience parameter depending on the elasticity of inverse marginal surplus. Given our assumptions about supply elasticity and elasticity of inverse marginal surplus and our estimates of the other model parameters, we find that pass-through is generally increasing in the conduct parameter and decreasing with the salience parameter as long as the market is not perfectly competitive.

⁴⁸Specifically, the marginal excess burden increases from 3.1 percent of revenue to 10.9 percent across columns (3) and (6) under imperfect competition (going to full salience), compared to an increase of 0.5 percent to 3.3 percent under perfect competition comparing columns (2) and (5).

We estimate the inputs into the formulas using Nielsen Retail Scanner data, Nielsen Consumer Panel data, and detailed sales tax data. We find nearly-complete pass-through of sales taxes onto prices and meaningful effects of taxes on quantity. We also find that consumers substantially "underreact" to taxes, with a tax elasticity of about 30 percent of the price elasticity. Lastly, we estimate a large amount of heterogeneity in tax salience; the mean tax salience parameter is about 30 percent, but a two-standard-deviation range around that mean is 45 percentage points.

We use our formulas to estimate other model parameters. For example, we estimate a markup around 3.7 percent, which is consistent with grocery stores operating with fairly low profit margins. We then use these model-based estimates to calibrate our new incidence and efficiency formulas. We find essentially all of the incidence falls on consumers, regardless of whether or not we account for imperfect competition and tax salience. Turning to welfare, we find that the standard marginal excess burden formula substantially understates the welfare costs of commodity taxation, even after accounting for consumers' underreaction due to salience effects. While we estimate substantial underreaction to taxes alongside a fairly small markup (and thus a fairly small departure from perfect competition), our calibration results suggest that both are important for welfare analysis. Ignoring imperfect competition but allowing for salience effects but allowing for imperfect competition leads to an overestimate of the marginal excess burden, although by a somewhat smaller magnitude.

It is perhaps a surprising result that imperfect competition "matters more" than salience effects in our welfare analysis (relative to the benchmark case of perfect competition with full optimization), since we find a fairly small departure from perfect competition alongside a large departure from fully-optimizing behavior. Our new welfare formula shows why this is the case: the marginal excess burden scales one-for-one with the estimated markup while the tax salience parameter scales with the tax rate. Nevertheless, we conclude that both imperfect competition and tax salience are important factors to consider together when analyzing the incidence and efficiency consequences of commodity taxation. Focusing on either one in isolation will generally lead to misleading estimates, and accounting for one (but not the other) will – in some circumstances – lead to conclusions that are even less accurate

than a standard Harberger analysis that ignores both imperfect competition and salience effects.

Our general finding that tax salience and imperfect competition interact when considering the welfare cost of taxation may have broader lessons for policy. Since imperfect competition is one type of a pre-existing distortion in the market, we conjecture that our formulas may be useful for analyzing how tax salience affects the welfare cost of taxation under other pre-existing distortions such as externalities. Our counterfactual scenarios showed that increases in tax salience lead to larger welfare effects of taxes under imperfect competition compared to perfect competition. This implies that policies such as carbon taxes and sugar taxes may be more effective "corrective taxes" if they are incorporated into posted prices to increase salience since tax salience presumably scales linearly with the marginal damage from the externality in the welfare cost formula.

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Appendix

Assumptions

Here are the formal statements of the two assumptions discussed in Section 2 in the main text:

Assumption 1. Taxes affect utility only through their effects on the chosen consumption bundle. Indirect utility is given by:

$$V^{i}(p_{1},\ldots,p_{J},t,Z_{i}) = u^{i}(q_{1}^{i}(p_{1},\ldots,p_{J},t),\ldots,q_{J}^{i}(p_{1},\ldots,p_{J},t)) + Z^{i} - (p_{1}+t)q_{1}^{i} - \cdots - (p_{J}+t)q_{J}^{i}$$

Assumption 2. When tax-inclusive prices are fully salient, the agent chooses the same allocation as a fully-optimizing agent.

$$(q_1^i, \dots, q_J^i)(p_1 + t, \dots, p_J + t, 0) = \arg\max_{(q_1, \dots, q_J)} u^i(q_1, \dots, q_J) + Z^i - (p_1 + t)q_1 - \dots - (p_J + t)q_J$$

Proofs

Proof of Lemma 1

Proof. Note that

$$\begin{aligned} \epsilon_{Dt} &= \frac{dQ(p(t),t)}{dt} \frac{p+t}{Q(t)} \\ &= \frac{p+t}{Q(t)} \int \frac{\partial Q_i}{\partial p}(p(t),t) \left(\frac{dp}{dt} + \theta_i\right) di \\ &= \frac{p+t}{Q(t)} \left((\rho-1) \frac{\partial Q}{\partial p} + \int \frac{\partial Q_i}{\partial p}(p(t),t) \theta_i di\right) \\ &= \frac{p+t}{Q(t)} \left((\rho-1 + \mathbb{E}(\theta_i)) \frac{\partial Q}{\partial p} + Cov \left(\theta_i, \frac{\partial Q_i(p,t)}{\partial p}\right)\right) \\ &= -(\mathbb{E}(\theta_i) + \rho - 1)\epsilon_D + \frac{p+t}{Q(t)}Cov \left(\theta_i, \frac{\partial Q_i(p,t)}{\partial p}\right) \end{aligned}$$

Finally, under assumption 3, $\frac{\partial Q_i}{\partial p}(p(t), t)$ is constant in *i* and so $Cov\left(\theta_i, \frac{\partial Q_i(p,t)}{\partial p}\right) = 0$

Proof of Proposition 1

Proof. Let the market be symmetric imperfect competition with J products j = 1, ..., J and the market conduct parameter $\nu_p = \frac{\partial p_k}{\partial p_j} \ (k \neq j)$.

$$CS_i = \int_0^{Q^i} wt p^i(s) ds - (p+t)Q^i$$

Given $\rho \equiv 1 + \frac{dp}{dt},$ we have

$$\begin{aligned} \frac{dCS^{i}}{dt} &= wtp^{i}(Q^{i})\frac{dQ^{i}(p(t),t)}{dt} - \rho Q^{i} - (p+t)\frac{dQ^{i}(p(t),t)}{dt} \\ &= (p+\theta_{i}t)\frac{dQ^{i}(p(t),t)}{dt} - \rho Q^{i} - (p+t)\frac{dQ^{i}(p(t),t)}{dt} \\ &= -\rho Q^{i} - (1-\theta_{i})t\frac{dQ^{i}(p(t),t)}{dt} \end{aligned}$$

where the second equality follows from the fact that $wtp^i(Q^i)=p+\theta_i(p,t)t,$ then

$$\begin{aligned} \frac{dCS}{dt} &= \int \frac{dCS^i}{dt} di \\ &= -\rho \mathbb{E}(Q^i) - t \mathbb{E}\left((1-\theta_i)\frac{dQ^i(p(t),t)}{dt}\right) \\ &= -\rho Q - (1-\mathbb{E}(\theta_i))t\frac{dQ(p(t),t)}{dt} + tCov\left(\theta_i,\frac{dQ^i(p(t),t)}{dt}\right) \end{aligned}$$

For the tax revenue, we have

$$\frac{dR}{dt} = Q + t \frac{dQ(p(t), t)}{dt}$$

For producer surplus, taking the derivative of PS = pQ - Jc(q) with respect to t, we have

$$\begin{split} \frac{dPS}{dt} &= (\rho - 1)Q + J(p - mc(q))\frac{dq}{dt} \\ &= (\rho - 1)Q + \frac{\nu_q}{J\epsilon_D}\frac{dQ(p(t), t)}{dt}p \\ &= (\rho - 1)Q - \frac{\nu_q}{J}Q\frac{dQ(p(t), t)}{dt}\frac{1}{\frac{\partial Q}{\partial p}} \\ &= (\rho - 1)Q - \frac{\nu_q}{J}Q\frac{\int \frac{dQ_i(p(t), t)}{dt}di}{\frac{\partial Q}{\partial p}} \\ &= (\rho - 1)Q - \frac{\nu_q}{J}Q\frac{\int \frac{\partial Q^i}{\partial p}\left(\frac{dp}{dt} + \theta_i\right)di}{\frac{\partial Q}{\partial p}} \\ &= (\rho - 1)Q - \frac{\nu_q}{J}Q\left[\frac{dp}{dt} + \frac{\int \theta_i\frac{\partial Q^i}{\partial p}di}{\frac{\partial Q}{\partial p}}\right] \\ &= -\left(1 - \frac{\nu_q}{J}\right)[Q(1 - \rho)] - \frac{\nu_q}{J}\left[Q\left(\mathbb{E}(\theta_i) + \frac{Cov\left(\theta_i,\frac{\partial Q^i}{\partial p}\right)}{\frac{\partial Q}{\partial p}}\right)\right] \end{split}$$

The second equality comes from the Lerner condition $\frac{p-mc(q)}{p} = \frac{\nu_q}{J\epsilon_D}$, and the fifth equation comes from $\frac{dQ^i(p(t),t)}{dt} = \frac{\partial Q^i}{\partial p} \left(\frac{dp}{dt} + \theta_i\right)$.

Also note that

$$\begin{aligned} \frac{dQ(p(t),t)}{dt} &= \int \frac{dQ^{i}(p(t),t)}{dt} di \\ &= \int \frac{\partial Q^{i}}{\partial p} \left(\frac{dp}{dt} + \theta_{i}\right) di \\ &= \mathbb{E}\left(\frac{\partial Q^{i}}{\partial p}\right) \left(\rho - 1 + \mathbb{E}(\theta_{i})\right) + Cov\left(\theta_{i}, \frac{\partial Q^{i}}{\partial p}\right) \end{aligned}$$

Now, to obtain the formula for pass-through, from Lerner condition we have

$$p - mc(q) = -\frac{\nu_q}{J} \frac{Q}{\frac{\partial Q}{\partial p}}$$

Recall that marginal surplus is ms(Q) = -mwtp(Q)Q. Furthermore, define $MS(Q, t) \equiv -\frac{Q}{\frac{\partial Q}{\partial p}(p(t),t)} = \frac{ms(Q)}{mwtp(Q(t))*\frac{\partial Q}{\partial p}(p(t),t)}$, then MS(Q, 0) = ms(Q). Let $MS_t = \frac{\partial MS}{\partial t}$, and let $\epsilon_{ms} = \frac{MS}{MS_QQ}$, we have $p - mc(q) = \frac{\nu_q}{J}MS(Q, t)$

Therefore

$$\frac{dp}{dt} = \left(\frac{\nu_q}{J}MS_Q(Q,t) + \frac{mc'(q)}{J}\right)\frac{dQ(p(t),t)}{dt} + \frac{\nu_q}{J}MS_t$$

$$= \left(\frac{\nu_q}{J}MS_Q(Q,t) + \frac{mc'(q)}{J}\right)\left(\frac{\partial Q}{\partial p}\left(\frac{dp}{dt} + \mathbb{E}(\theta_i)\right) + Cov\left(\theta_i,\frac{\partial Q^i}{\partial p}\right)\right) + \frac{\nu_q}{J}MS_t$$

and

$$\frac{dp}{dt} \left[1 - \frac{\partial Q}{\partial p} \left(\frac{\nu_q}{J} M S_Q(Q, t) + mc'(Q) \right) \right] = \left(\frac{\nu_q}{J} M S_Q(Q, t) + \frac{mc'(q)}{J} \right) \left(\frac{\partial Q}{\partial p} \left(\mathbb{E}(\theta_i) \right) + Cov \left(\theta_i, \frac{\partial Q^i}{\partial p} \right) \right) + \frac{\nu_q}{J} M S_t$$

Define $\epsilon_s \equiv \frac{mc(Q)}{mc'(Q)Q}$, then we have

$$\begin{split} \rho &= \frac{dp}{dt} + 1 \\ &= 1 + \frac{\left(\frac{\nu_q}{J}ms'(Q) + \frac{mc'(q)}{J}\right)\left(\frac{\partial Q}{\partial p}\mathbb{E}(\theta_i) + Cov\left(\theta_i, \frac{\partial Q^i}{\partial p}\right)\right) + \frac{\nu_q}{J}MS_t}{1 - \frac{\partial Q}{\partial p}\left(\frac{\nu_q}{J}ms'(Q) + mc'(Q)\right)} \\ &= 1 + \left(\frac{1}{1 - \frac{\partial Q}{\partial p}\left(\frac{\nu_q}{J}ms'(Q) + \frac{mc'(q)}{J}\right)} - 1\right)\left(\mathbb{E}(\theta_i) + \frac{Cov\left(\theta_i, \frac{\partial Q^i}{\partial p}\right)}{\frac{\partial Q}{\partial p}}\right) \\ &+ \frac{\frac{\nu_q}{J}MS_t}{1 - \frac{\partial Q}{\partial p}\left(\frac{\nu_q}{J}ms'(Q) + \frac{mc'(q)}{J}\right)} \\ &= 1 - \left(1 - \frac{1}{1 + \frac{\epsilon_D\frac{p}{p+t} - \frac{\nu_q}{J}}{\epsilon_S} + \frac{\frac{\nu_q}{J}}{\epsilon_{ms}}}\right)\left(\mathbb{E}(\theta_i) + \frac{Cov\left(\theta_i, \frac{\partial Q^i}{\partial p}\right)}{\frac{\partial Q}{\partial p}}\right) \\ &+ \frac{\frac{\nu_q}{J}MS_t}{1 - \frac{\partial Q}{\partial p}\left(\frac{\nu_q}{J}ms'(Q) + \frac{mc'(q)}{J}\right)} \\ &= 1 - (1 - \omega)\left(\mathbb{E}(\theta_i) + \frac{Cov\left(\theta_i, \frac{\partial Q^i}{\partial p}\right)}{\frac{\partial Q}{\partial p}}\right) + \omega\frac{\nu_q}{J}MS_t \end{split}$$

where $\omega = \frac{1}{1 + \frac{\epsilon_D \frac{p}{p+t} - \frac{\nu_q}{J}}{\epsilon_S} + \frac{\nu_q}{\epsilon_{ms}}}$. Then we use

$$mc'(q)\frac{\partial Q}{\partial p} = \frac{J\epsilon_D - \nu_q}{\epsilon_S}$$

We have the incidence of the tax:

$$I = \frac{-\rho Q - (1 - \mathbb{E}(\theta_i))t\frac{dQ}{dt} + tCov\left(\theta_i, \frac{dQ^i(p(t),t)}{dt}\right)}{-\left(1 - \frac{\nu_q}{J}\right)\left[Q(1 - \rho)\right] - \frac{\nu_q}{J}\left[Q\left(\mathbb{E}(\theta_i) + \frac{Cov\left(\theta_i, \frac{\partial Q^i}{\partial p}\right)}{\frac{\partial Q}{\partial p}}\right)\right]}{\frac{Q}{D}}$$
$$= \frac{\rho + (1 - \mathbb{E}(\theta_i))\frac{t}{p+t}\epsilon_{Dt} - \frac{t}{Q}Cov\left(\theta_i, \frac{dQ^i(p(t),t)}{dt}\right)}{(1 - \rho)\left(1 - \frac{\nu_q}{J}\right) + \frac{\nu_q}{J}\frac{\mathbb{E}\left(\theta_i\frac{\partial Q^i}{\partial p}\right)}{\mathbb{E}\left(\frac{\partial Q^i}{\partial p}\right)}}$$

The marginal excess burden of the tax is calculated by summing up the incidence on consumers, producers, and government. $\hfill \Box$

Derivation of Marginal Surplus Remark

Let $MS(Q, t) = \frac{ms(Q)}{mwtp(Q(t))*\frac{\partial Q}{\partial p}(p(t),t)}$, then MS(Q, 0) = ms(Q), and $MS(Q(t), t) = \frac{-mwtp(Q(t))Q(t)}{mwtp(Q(t))*\frac{\partial Q}{\partial p}(p(t),t)} = -\frac{Q(t)}{\frac{\partial Q}{\partial p}(p(t),t)}$. If $MS_t = \frac{\partial MS}{\partial t}$ then:

$$\begin{split} MS_t &= \frac{-ms(Q)}{\left(mwtp(Q(t)) * \frac{\partial Q}{\partial p}(p(t),t)\right)^2} \left(wtp''(Q(t))Q'(t) * \frac{\partial Q}{\partial p}(p(t),t) + wtp'(Q(t)) * \frac{\partial}{\partial t} \left(\frac{\partial Q}{\partial p}(p(t),t)\right)\right) \\ &= \frac{-ms(Q)}{\left(mwtp(Q(t)) * \frac{\partial Q}{\partial p}(p(t),t)\right)^2} \left(wtp''(Q(t))Q'(t) * \frac{\partial Q}{\partial p}(p(t),t) + wtp'(Q(t)) * \int \frac{\partial}{\partial t} \left(\frac{\partial Q_i}{\partial p}(p(t) + \theta_i t, 0)\right) di\right) \\ &= \frac{-ms(Q)}{\left(mwtp(Q(t)) * \frac{\partial Q}{\partial p}(p(t),t)\right)^2} * \\ \left(wtp''(Q(t))Q'(t) * \frac{\partial Q}{\partial p}(p(t),t) + wtp'(Q(t)) * \int \frac{\partial^2 Q_i}{\partial p^2}(p(t) + \theta_i t, 0) * \left(\frac{dp}{dt} + \theta_i\right) di\right) \\ &= \frac{-Q}{mwtp(Q) \left(\frac{\partial Q}{\partial p}\right)^2} \left(wtp''(Q) \frac{\partial Q}{\partial p} \frac{dQ}{dt} + mwtp(Q) \left[\frac{dp}{dt} \int \frac{\partial^2 Q_i}{\partial p^2} di + \int \left(\frac{\partial^2 Q_i}{\partial p^2} * \theta_i\right) di\right]\right) \\ &= \frac{-Q}{mwtp(Q) \left(\frac{\partial Q}{\partial p}\right)^2} \left(wtp''(Q) \frac{\partial Q}{\partial p} \frac{dQ}{dt} + mwtp(q) \left[\frac{\partial^2 Q}{\partial p^2} \left(\frac{dp}{dt} + \bar{\theta}\right) + Cov \left(\frac{\partial^2 Q_i}{\partial p^2}, \theta_i\right)\right]\right) \\ &\approx \frac{-Q}{\left(\frac{\partial Q}{\partial p}\right)^2} Cov \left(\frac{\partial^2 Q_i}{\partial p^2}, \theta_i\right) \end{split}$$

Note that under Assumption 3 the second derivatives are 0 and so $MS_t = 0$. Also for the model with fixed θ it is easy to show that $wtp' = \left(\frac{\partial Q}{\partial p}\right)^{-1}$ implies $wtp''(Q)\frac{dQ}{dt} = -\frac{mwtp(Q)}{\frac{\partial Q}{\partial p}}\frac{\partial^2 Q}{\partial p^2}\left(\frac{dp}{dt} + \bar{\theta}\right)$ so $MS_t = 0$.

General model featuring both ad valorem and unit taxes

It is well known that ad valorem and unit taxes are not equivalent in imperfectly competitive markets (Delipalla and Keen 1992, Anderson, de Palma and Kreider 2001a, Adachi and Fabinger 2019). This section extends our results on incidence and excess burden in Proposition 3 to ad valorem taxes in the presence of salience effects. We consider the model of imperfect competition with both unit taxes and ad valorem taxes. The purpose of the model is to compare the incidence and welfare effects of these taxes and to forge a link with the empirical section which considers ad valorem taxes. For ease of exposition, we assume identical consumers and present the general expressions for ad valorem taxes in the presence of heterogeneous consumers that we calibrate in Section 6.

Let p denote the producer price and let $p(1 + \tau) + t$ denote the price paid by consumers where τ is the ad valorem tax and t is the unit tax. Demand is given by $D(p, t, \tau)$ and assume that for $\tau > 0$ and t > 0, $D(p, 0, 0) > D(p, t, \tau) > D(p(1 + \tau) + t, 0, 0)$. For any triple (p, t, τ) there exists $\theta_{\tau}(p, t, \tau)$ and $\theta_{t}(p, t, \tau)$ to be such that: $D(p, t, \tau) = D(p(1 + \theta_{\tau}\tau) + \theta_{t}t, 0, 0)$. However following the literature and to simplify the setup assume θ_{τ} and θ_{t} are independent of the level of prices and tax rates. Equivalently we could define $\theta_{\tau} \equiv \frac{\partial D}{\partial p} \times \frac{1}{p}$ and $\theta_{t} \equiv \frac{\partial D}{\partial p}$ and assume they are constant with respect to prices and taxes.⁴⁹ Following the prior section, we extend the definition of willingness to pay to accommodate the ad valorem tax so that $wtp(Q) = p(1 + \theta_{\tau}\tau) + \theta_{t}t$.

Let $\epsilon_D \equiv -\frac{\partial Q}{\partial p} \frac{p(1+\tau)+t}{Q}$, $\epsilon_D^* = \epsilon_D \frac{p}{p(1+\tau)+t}$ and define the pass-through rates for ad valorem and unit taxes respectively, as $\rho_\tau \equiv \frac{1}{p} \frac{\partial(p(1+\tau)+t)}{\partial \tau}$ and $\rho_t \equiv \frac{\partial(p(1+\tau)+t)}{\partial t}$. The following lemma shows how to identify θ_τ with commonly observable objects.

⁴⁹Note that in the denominator of θ_{τ} and θ_t , the derivative is with respect to the first argument of D.

Lemma. A1. Let $\epsilon_{D\tau} \equiv \frac{dQ}{d\tau} \frac{p(1+\tau)+t}{Q}$. The following relationship holds:

$$\epsilon_{D\tau} = -\epsilon_D * \frac{p}{1+\tau} \left(\left(1 + \theta_\tau \tau \right) \rho_\tau + \theta_\tau - 1 \right)$$

and

$$\theta_{\tau} = \frac{(1 - \rho_{\tau}) p \epsilon_D - \epsilon_{D\tau} (1 + \tau)}{(1 + \tau \rho_{\tau}) p \epsilon_D}$$

Proof. See below.

With Lemma 2 in hand, we can now state our main proposition for ad valorem taxes. Following the literature, we compare the pass-through rates and the marginal cost of public funds. A lower marginal cost of public funds indicates greater efficiency. We begin with the characterization of pass-through rates.

Proposition. *A1.* In the symmetric model of imperfect competition, the pass-through rates for ad valorem and unit taxes are given respectively as:

$$\rho_{\tau} = 1 - \frac{(1+\tau)\theta_{\tau}}{1+\theta_{\tau}\tau} \left(1 - \omega \frac{mc(q)}{p}\right)$$
$$\rho_{t} = 1 - \frac{(1+\tau)\theta_{t}}{1+\theta_{\tau}\tau} (1-\omega)$$

where $\omega = \frac{1}{1 + \frac{(1+\theta_{\tau}\tau)\epsilon_D^* - \frac{\nu_q}{J}}{\epsilon_S} + \frac{\nu_q}{J} \frac{1}{\epsilon_{ms}}}$.

This implies that the two pass-through rates can be ranked based on the following:

$$\frac{\rho_{\tau} - 1}{\rho_t - 1} = \frac{\theta_{\tau}}{\theta_t} \frac{\omega \frac{mc}{p} - 1}{\omega - 1} = \frac{\theta_{\tau}}{\theta_t} \left(1 - \frac{\omega}{\omega - 1} \frac{\nu_q}{J\epsilon_D^*} \right)$$

Proof. See below.

A first observation is that when $\theta_{\tau} = \theta_t$, if mc < p then $\rho_{\tau} < \rho_t$ which is consistent with the literature (Delipalla and Keen 1992; Adachi and Fabinger 2019). Thus, if consumers underreact to ad valorem and unit taxes similarly, the pass-through rate is lower for ad valorem taxes. A new observation is that even under perfect competition starting from p = mc, ad valorem taxes imply a higher pass-through than unit taxes $\rho_t < \rho_{\tau}$ if and only if the consumers are more responsive to ad valorem taxes than unit taxes $\theta_{\tau} > \theta_t$.⁵⁰ Most of the available empirical evidence in the literature applies to sales taxes and thus, θ_{τ} . Our results stress the need for additional evidence on θ_t .

Next, we derive the marginal cost of public funds for an ad valorem tax and a unit tax which are defined as $MC_{\tau} \equiv -\frac{dW/d\tau}{dR/d\tau}$ and $MC_t \equiv -\frac{dW/dt}{dR/dt}$, respectively.

Proposition. A2. Denote $wtp = p(1 + \theta_{\tau}\tau) + \theta_t t$ the perceived price by the consumer and $\epsilon_D^* = \epsilon_D \frac{p}{p(1+\tau)+t}$. The marginal cost of public funds for an ad valorem tax, τ , and a unit tax, t, may be expressed as:

$$MC_{\tau} = \epsilon_D^* \frac{\frac{wtp - mc}{p}}{\frac{1 + \tau\rho_{\tau}}{(1 + \theta_{\tau}\tau)\rho_{\tau} + \theta_{\tau} - 1} - \epsilon_D^*(\tau + \frac{t}{p})}$$
$$MC_t = \epsilon_D^* \frac{\frac{wtp - mc}{p}}{\frac{1 + \tau\rho_t}{(1 + \theta_{\tau}\tau)\rho_t + \theta_t - 1} - \epsilon_D^*(\tau + \frac{t}{p})}$$

This implies the following:

$$\frac{MC_t}{MC_\tau} = \frac{\frac{1+\tau\rho_\tau}{(1+\theta_\tau\tau)\rho_\tau+\theta_\tau-1} - \epsilon_D^*(\tau+\frac{t}{p})}{\frac{1+\tau\rho_t}{(1+\theta_\tau\tau)\rho_t+\theta_t-1} - \epsilon_D^*(\tau+\frac{t}{p})}$$

In other words, the cost of ad-valorem taxes is lower than the cost of unit taxes ($MC_{\tau} < MC_{t}$) if and only if

$$\theta_{\tau} \left[1 - \frac{1 + \tau (1 + \theta_{\tau} - \theta_t)}{1 + \theta_{\tau} \tau} \left(1 - \omega \frac{mc}{p} \right) \right] < \theta_t \left[1 - \frac{1 + \tau}{1 + \theta_{\tau} \tau} \left(1 - \omega \right) \right]$$

Proof. See below.

It is instructive to consider the benchmark case where $\theta_{\tau} = \theta_t$. In this case, $MC_{\tau} < MC_t$ if and only if p > mc. Thus, as long as consumers respond symmetrically to ad valorem and unit taxes, then salience does not affect the well-known result that ad valorem taxes are more efficient than unit taxes under imperfect competition. Of course, if consumers are sufficiently more attentive to ad valorem taxes than unit taxes, then this result shows that ad valorem taxes can be more distortionary than unit tax.

⁵⁰As a basic matter of tax administration, this is relatively unlikely. Indeed, it has been suggested to us that the relative saliency of unit taxes appears to have played an important role in dictating the implementation details of recently-adopted beverage taxes.

Proof of Lemma A1

Proof. Observe

$$\epsilon_{D\tau} = \frac{dQ}{d\tau} \frac{p(1+\tau)+t}{Q}$$

$$= -\epsilon_D * \left((1+\tau) \frac{dp}{d\tau} + p \right)$$

$$= -\epsilon_D * \frac{p}{1+\tau} \left((1+\theta_\tau \tau) \left(\frac{1}{p} (1+\tau) \frac{\partial p}{\partial \tau} + 1 \right) + \theta_\tau - 1 \right)$$

$$= -\epsilon_D * \frac{p}{1+\tau} \left((1+\theta_\tau \tau) \rho_\tau + \theta_\tau - 1 \right)$$

Solving for θ_{τ} we obtain:

$$\theta_{\tau} = \frac{(1 - \rho_{\tau}) p\epsilon_D - \epsilon_{D\tau}(1 + \tau)}{(1 + \tau\rho_{\tau}) p\epsilon_D}$$

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Proof of Proposition A1

Proof. Note that

$$\frac{dp}{d\tau} = \frac{1}{1 + \theta_{\tau}\tau} (mwtp(q)\frac{dq}{d\tau} - p\theta_{\tau})$$
(16)

The first order condition with J symmetric products and conduct parameter ν_q is $p - mc(q) = -\frac{\nu_q}{J}\frac{mwtp(q)q}{1+\theta_\tau\tau}$, substitute $p = \frac{wtp(q)-\theta_t t}{1+\theta_\tau\tau}$ so we get $\frac{wtp(q)-\theta_t t}{1+\theta_\tau\tau} - mc(q) = -\frac{\nu_q}{J}\frac{mwtp(q)q}{1+\theta_\tau\tau}$ or $wtp(q) - \theta_t t - mc(q) (1 + \theta_\tau\tau) = -\frac{\nu_q}{J}mwtp(q)q$. Taking the derivative with respect to τ , we have

$$mwtp(q)\frac{dq}{d\tau} - (1 + \theta_{\tau}\tau)mc'(q)\frac{dq}{d\tau} - mc(q)\theta_{\tau} = -\frac{\nu_q}{J}\left(mwtp'(q)\frac{dq}{d\tau}q + mwtp(q)\frac{dq}{d\tau}\right)$$

Rearrange terms, we have

$$\left((1+\frac{\nu_q}{J})mwtp(q) - (1+\theta_\tau\tau)mc'(q) + \frac{\nu_q}{J}mwtp'(q)q\right)\frac{dq}{d\tau} = mc(q)\theta_\tau$$

And so

$$\frac{dq}{d\tau} = \frac{mc(q)\theta_{\tau}}{(1+\frac{\nu_q}{J})mwtp(q) - (1+\theta_{\tau}\tau)mc'(q) + \frac{\nu_q}{J}mwtp'(q)q}$$
$$= \frac{\frac{mc(q)\theta_{\tau}}{mwtp(q)}}{(1+\frac{\nu_q}{J}) - \frac{mc'(q)q}{mc(q)}\frac{mc(q)(1+\theta_{\tau}\tau)}{mwtp(q)q} + \frac{\nu_q}{J}\frac{mwtp'(q)q}{mwtp(q)q}q}$$

Thus,

$$\frac{dq}{d\tau} = \frac{\theta_{\tau} \frac{mc(q)}{mwtp(q)}}{1 + \frac{(1+\theta_{\tau})\epsilon_{D}^{*} - \frac{\nu_{q}}{J}}{\epsilon_{S}} + \frac{\frac{\nu_{q}}{J}}{\epsilon_{ms}}}$$

Therefore,

$$\frac{dp}{d\tau} = \frac{\theta_{\tau}}{1 + \theta_{\tau}\tau} \left(\frac{\frac{mc(q)}{p}}{1 + \frac{(1 + \theta_{\tau})\epsilon_D^* - \frac{\nu_q}{J}}{\epsilon_S} + \frac{\frac{\nu_q}{J}}{\epsilon_{ms}}} - 1 \right)$$

And

$$\rho_{\tau} = \frac{\theta_{\tau}(1+\tau)}{1+\theta_{\tau}\tau} \left(\frac{\frac{mc(q)}{p}}{1+\frac{(1+\theta_{\tau})\epsilon_D^* - \frac{\nu_q}{J}}{\epsilon_S} + \frac{\frac{\nu_q}{J}}{\epsilon_{ms}}} - 1 \right) + 1$$

Similarly, we have

$$\frac{dp}{dt} = \frac{1}{1 + \theta_{\tau}\tau} (mwtp(q)\frac{dq}{dt} - \theta_t)$$

The first order condition of monopoly is $p - mc(q) = -\frac{\nu_q}{J} \frac{mwtp(q)q}{1+\theta_\tau \tau}$, or $wtp(q) - \theta_t t - mc(q) (1 + \theta_\tau \tau) = -\frac{\nu_q}{J} mwtp(q)q$. Taking the derivative w.r.t t we get:

$$\left(mwtp(q) - mc'(q)\left(1 + \theta_{\tau}\tau\right) + \frac{\nu_q}{J}mwtp'(q)q + \frac{\nu_q}{J}mwtp(q)\right)\frac{dq}{dt} = \theta_t$$

And so

$$\begin{aligned} \frac{dq}{dt} &= \frac{\theta_t}{mwtp(q) - mc'(q)\left(1 + \theta_\tau \tau\right) + \frac{\nu_q}{J}mwtp'(q)q + \frac{\nu_q}{J}mwtp(q)} \\ &= \frac{\frac{\theta_t}{mwtp(q)}}{1 - \frac{mc'(q)q}{mc(q)}\frac{(1 + \theta_\tau \tau)mc(q)}{mwtp(q)q} + \frac{\frac{\nu_q}{J}\left(mwtp'(q)q + mwtp(q)\right)}{mwtp(q)}} \end{aligned}$$

Thus,

$$\frac{dq}{dt} = \frac{\frac{\theta_t}{mwtp(q)}}{1 + \frac{(1+\theta_\tau)\epsilon_D^* - \frac{\nu_q}{J}}{\epsilon_S} + \frac{\frac{\nu_q}{J}}{\epsilon_{ms}}}$$

Therefore,

$$\frac{dp}{dt} = \frac{\theta_t}{1 + \theta_\tau \tau} \left(\frac{1}{1 + \frac{(1 + \theta_\tau)\epsilon_D^* - \frac{\nu_q}{J}}{\epsilon_S} + \frac{\nu_q}{\epsilon_{ms}}} - 1 \right)$$

consumer price is

$$\rho_t = 1 + \frac{dp}{dt} \left(1 + \tau \right) = 1 + \frac{(1+\tau)\theta_t}{1+\theta_\tau \tau} \left(\frac{1}{1 + \frac{(1+\theta_\tau)\epsilon_D^* - \frac{\nu_q}{J}}{\epsilon_S} + \frac{\nu_q}{\epsilon_{ms}}} - 1 \right)$$

Proof of Proposition A2

Proof. Denote $wtp = p(1 + \theta_{\tau}\tau) + \theta_t t$ the perceived price by the consumer and $\epsilon_D^* = \epsilon_D \frac{p}{p(1+\tau)+t}$. We have

$$\frac{dCS}{d\tau} = wtp(Q)\frac{dQ}{d\tau} - Q\frac{d(p(1+\tau)+t)}{d\tau} - (p(1+\tau)+t)\frac{dQ}{d\tau}$$
$$= -Q\frac{d(p(1+\tau)+t)}{d\tau} - \frac{dQ}{d\tau}\left((1-\theta_{\tau})p\tau + (1-\theta_{t})t\right)$$

$$\frac{dCS}{dt} = wtp(Q)\frac{dQ}{dt} - Q\frac{d(p(1+\tau)+t)}{dt} - (p(1+\tau)+t)\frac{dQ}{dt} = -Q\frac{d(p(1+\tau)+t)}{dt} - \frac{dQ}{dt}\left((1-\theta_{\tau})p\tau + (1-\theta_{t})t\right)$$

$$\frac{dPS}{d\tau} = \frac{d\left((p - mc(q))q\right)}{d\tau}$$
$$= \frac{dp}{d\tau}q + \left(p - mc(q)\right)\frac{dq}{d\tau}$$

$$\frac{dPS}{dt} = \frac{d\left((p - mc(q))q\right)}{dt}$$
$$= \frac{dp}{dt}q + \left(p - mc(q)\right)\frac{dq}{dt}$$

$$\begin{aligned} \frac{dR}{d\tau} &= (\tau p + t)\frac{dQ}{d\tau} + Q\frac{d(\tau p + t)}{d\tau} \\ &= (\tau p + t)\frac{dQ}{d\tau} - \frac{p\tau}{\epsilon_D}\frac{dQ}{d\tau} - (1 + \tau)\frac{p}{\epsilon_D\rho_\tau}\frac{dQ}{d\tau} \end{aligned}$$

$$\begin{aligned} \frac{dR}{dt} &= (\tau p + t) \frac{dQ}{dt} + Q \frac{d(\tau p + t)}{dt} \\ &= (\tau p + t) \frac{dQ}{dt} - \frac{p\tau}{\epsilon_D} \frac{dQ}{dt} - \frac{p}{\epsilon_D \rho_t} \frac{dQ}{d\tau} \end{aligned}$$

Therefore, we have

$$\begin{aligned} \frac{dW}{d\tau} &= \frac{dCS}{d\tau} + \frac{dPS}{d\tau} + \frac{dR}{d\tau} \\ &= \left(p(1+\theta_{\tau}\tau) + \theta_{t}t - mc(q)\right)\frac{dQ}{d\tau} \\ \frac{dW}{dt} &= \left(p(1+\theta_{\tau}\tau) + \theta_{t}t - mc(q)\right)\frac{dQ}{dt} \end{aligned}$$

We also have

$$MC_{\tau} = -\frac{\frac{dW}{d\tau}}{\frac{dR}{d\tau}}$$
$$= -\frac{p(1+\theta_{\tau}\tau) + \theta_{t}t - mc(q)}{(\tau p+t) - \frac{p\tau}{\epsilon_{D}} - (1+\tau)\frac{p}{\epsilon_{D}\rho_{\tau}}}$$
$$= \epsilon_{D}^{*} \frac{\frac{wtp - mc}{p}}{\frac{1+\tau\rho_{\tau}}{(1+\theta_{\tau}\tau)\rho_{\tau} + \theta_{\tau} - 1} - \epsilon_{D}^{*}(\tau + \frac{t}{p})}$$

And

$$MC_{t} = -\frac{\frac{dW}{dt}}{\frac{dR}{dt}}$$
$$= -\frac{p(1+\theta_{\tau}\tau) + \theta_{t}t - mc(q)}{(\tau p+t) - \frac{p\tau}{\epsilon_{D}} - \frac{p}{\epsilon_{D}\rho_{t}}}$$
$$= \epsilon_{D}^{*} \frac{\frac{wtp-mc}{p}}{\frac{1+\tau\rho_{\tau}}{(1+\theta_{\tau}\tau)\rho_{\tau}+\theta_{\tau}-1} - \epsilon_{D}^{*}(\tau + \frac{t}{p})}$$

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Derivations for ad valorem tax with heterogeneous consumers used in the calibrations

For reference, we add the formulas to calculate the effect of increasing an ad-valorem tax on consumer surplus, and producer surplus in the presence of heterogenous consumers. We also derive the marginal excess burden and incidence formulas that we take to the data. Recall $\rho_{\tau} \equiv \frac{1}{p} \frac{\partial(p(1+\tau)+t)}{\partial \tau}$ and $D(p, t, \tau) = D(p(1 + \theta_{\tau}\tau) + \theta_t t, 0, 0)$. Then

$$\frac{dCS}{d\tau} = -pQ\rho_{\tau} - \frac{dQ}{d\tau} \left((1 - \mathbb{E}(\theta_{\tau}))p\tau + (1 - \mathbb{E}(\theta_{t}))t \right) + p\tau * Cov \left(\theta_{i\tau}, \frac{dQ_{i}}{dt}\right) + t * Cov \left(\theta_{it}, \frac{dQ_{i}}{dt}\right)$$
$$\frac{dPS}{d\tau} = -pQ * \left[\left(1 - \frac{\nu_{q}}{J}\right) \left(\frac{1}{1 + \tau}\right) [1 - \rho_{\tau}] + \frac{\nu_{q}}{J} * \left(1 - \frac{\tau}{1 + \tau} (1 - \rho_{\tau})\right) \left[\mathbb{E}(\theta_{i\tau}) + \frac{Cov \left(\theta_{i\tau}, \frac{\partial Q_{i}}{\partial p}\right)}{\frac{\partial Q}{\partial p}} \right] \right]$$

If only there is no unit tax, then $\theta_t = t = 0$ and so:

$$\frac{dCS}{d\tau} = -pQ\rho_{\tau} - \frac{dQ}{d\tau} \left((1 - \mathbb{E}(\theta_{\tau}))p\tau \right) + p\tau * Cov \left(\theta_{i\tau}, \frac{dQ_{i}}{dt}\right)$$
$$\frac{dPS}{d\tau} = -pQ* \left[\left(1 - \frac{\nu_{q}}{J}\right) \left(\frac{1}{1 + \tau}\right) [1 - \rho_{\tau}] + \frac{\nu_{q}}{J} * \left(1 - \frac{\tau}{1 + \tau} (1 - \rho_{\tau})\right) \left[\mathbb{E}(\theta_{i\tau}) + \frac{Cov \left(\theta_{i\tau}, \frac{\partial Q_{i}}{\partial p}\right)}{\frac{\partial Q}{\partial p}} \right] \right]$$

Furthermore, under assumption 1:

$$\frac{dCS}{d\tau} = -pQ\rho_{\tau} - \frac{dQ}{d\tau} \left((1 - \mathbb{E}(\theta_{i\tau}))p\tau \right) + p\tau * \frac{\partial Q}{\partial p} Var\left(\theta_{i\tau}\right)$$

$$\frac{dPS}{d\tau} = -pQ * \left[\left(1 - \frac{\nu_q}{J} \right) \left(\frac{1}{1+\tau} \right) \left[1 - \rho_\tau \right] + \frac{\nu_q}{J} * \left(1 - \frac{\tau}{1+\tau} \left(1 - \rho_\tau \right) \right) \left[\mathbb{E}(\theta_{i\tau}) \right] \right]$$

From where, we can derive a formula for incidence:

$$I = \frac{\rho_{\tau} + (1 - \mathbb{E}(\theta_{i\tau}))\frac{\tau}{Q}\frac{dQ}{d\tau} - \frac{\tau}{Q} * \frac{\partial Q}{\partial p} Var\left(\theta_{i\tau}\right)}{\left(1 - \frac{\nu_q}{J}\right)\left(\frac{1}{1+\tau}\right)\left[1 - \rho_{\tau}\right] + \frac{\nu_q}{J} * \left(1 - \frac{\tau}{1+\tau}\left(1 - \rho_{\tau}\right)\right)\mathbb{E}(\theta_{i\tau})}$$

And so:

$$\frac{dW}{d\tau} = \left(p(1 + \mathbb{E}(\theta_{i\tau})\tau) - mc(q)\right)\frac{dQ}{d\tau} + p\tau * \frac{\partial Q}{\partial p}Var\left(\theta_{i\tau}\right)$$

Finally, for the empirical implementation we use the following variations:

$$I = \frac{\rho_{\tau} + (1 - \mathbb{E}(\theta_{i\tau}))\frac{\tau}{1+\tau}\frac{dlog(Q)}{dlog(1+\tau)} - \frac{\tau}{p} * \frac{\partial log(Q)}{\partial log(p)} Var(\theta_{i\tau})}{\left(1 - \frac{\nu_q}{J}\right)\left(\frac{1}{1+\tau}\right)\left[1 - \rho_{\tau}\right] + \frac{\nu_q}{J} * \left(1 - \frac{\tau}{1+\tau}\left(1 - \rho_{\tau}\right)\right)\mathbb{E}(\theta_{i\tau})}$$
$$\frac{dW}{d\tau}\frac{1+\tau}{Q} = \left(p(1 + \mathbb{E}(\theta_{i\tau})\tau) - mc(q)\right)\frac{dlog(Q)}{dlog(1+\tau)} + \tau(1+\tau) * \frac{\partial log(Q)}{\partial log(p)} Var(\theta_{i\tau})$$

We also have from previous sections:

$$\frac{dq}{d\tau} = \frac{\frac{(1+\theta\tau)(\rho\tau-1)}{1+\tau} + p\theta}{mwtp(q)}$$
$$= \frac{\frac{(1+\theta\tau)(\rho\tau-1)}{1+\tau} + p\theta}{(1+\theta\tau)\frac{dp}{dq}}$$
$$= \frac{\frac{(1+\theta\tau)(\rho\tau-1)}{p(1+\tau)} + \theta}{(1+\theta\tau)\frac{dp}{dq}\frac{1}{p}}$$
$$= q(\frac{\rho\tau-1}{p(1+\tau)} + \frac{\theta}{1+\theta\tau})\epsilon_D$$

The generalized Lerner condition for ad valorem tax:

$$\frac{p - mc(q)}{p(1 + \tau)} = \frac{\nu_q}{J\epsilon_D}$$

where $\epsilon_D \equiv -\frac{\partial D(p,\tau)}{\partial p} \frac{p(1+\tau)}{D}$.

	Appendix Table A	.1: Examples of Univ					
	Madala Decenintian		Department	Brand Description	M14:	C:	TI
UPC Description	Module Description	Group Description	Description	Description	Multi	Size	Units
M&M PLN DK CH HDY-M HDY	CANDY-CHOCOLATE- SPECIAL	CANDY	DRY GROCERY	M&M MARS M&M PLAIN	1	12.6	ΟZ
M&M PLN CH/TY SHREK 2 HL	CANDY-CHOCOLATE- SPECIAL	CANDY	DRY GROCERY	M&M MARS M&M PLAIN	1	1.75	OZ
M&M PLN CH DSP STAR WARS	CANDY-CHOCOLATE- SPECIAL	CANDY	DRY GROCERY	M&M MARS M&M PLAIN	1	1.06	OZ
R SSY E-C MSE AP CHFN	COSMETICS-EYE SHADOWS	COSMETICS	HEALTH & BEAUTY CARE	REVLON STAR STYLE	1	0.17	OZ
R SSY E-S PWD SQN	COSMETICS-EYE SHADOWS	COSMETICS	HEALTH & BEAUTY CARE	REVLON STAR STYLE	1	0.05	OZ
AXE AR R TWIST	DEODORANTS - COLOGNE TYPE	DEODORANT	HEALTH & BEAUTY CARE	AXE	1	4	OZ
CTL BR EGGS A LG	EGGS-FRESH	EGGS	DAIRY	CTL BR	1	12	СТ
CTL BR B-E JMB	EGGS-FRESH	EGGS	DAIRY	CTL BR	1	12	СТ
COKE CLS R CL NB 6P	SOFT DRINKS - CARBONATED	CARBONATED BEVERAGES	DRY GROCERY	COCA-COLA CLASSIC R	6	8	OZ
COKE CLS R CL CN &	SOFT DRINKS - CARBONATED	CARBONATED BEVERAGES	DRY GROCERY	COCA-COLA CLASSIC R	1	12	OZ
GPC 2 UL L M F UT 85 P30	CIGARETTES	TOBACCO & ACCESSORIES	NON-FOOD GROCERY	GPC	1	20	СТ
GPC 2 UL L M F UT 85 C -2.00	CIGARETTES	TOBACCO & ACCESSORIES	NON-FOOD GROCERY	GPC	10	20	СТ

Source: Nielsen's Retail Scanner Data.

Appendix Table A.2: Sources of sales tax exemption information

State	URLs	Type of Document
AL	http://revenue.alabama.gov/salestax/rules/810-6-502.pdf	Laws and Regulations
AL	http://www.alabamaadministrativecode.state.al.us/docs/rev/810-6-3.pdf	Laws and Regulations
AL	http://revenue.alabama.gov/publications/business-taxes/sales/Sales TaxSales Tax Brochure.pdf	Brochure
AZ	http://www.azleg.state.az.us/ArizonaRevisedStatutes.asp?Title=42	Laws and Regulations
AZ	http://www.azsos.gov/public services/Title 15/15-05.htm	Laws and Regulations
AZ	https://www.azdor.gov/Portals/0/TPTRates/08012016RateTable.pdf	Table
AZ	https://www.azdor.gov/Portals/0/Brochure/575.pdf	Brochure
AR*	http://www.lexisnexis.com/hottopics/arcode/Default.asp	Laws and Regulations
AR*	http://www.dfa.arkansas.gov/offices/policyAndLegal/Documents/et2008_3.pdf	Laws and Regulations
AR*	http://www.dfa.arkansas.gov/offices/policyAndLegal/Documents/et2007_3.ndf	Laws and Regulations
AR*	http://www.dfa.arkansas.gov/offices/exciseTax/salesanduse/Documents/SalesTaxExemptionsFY2011.ndf	Brochure
1110		Dischare
CA	http://www.boe.ca.gov/lawguides/business/current/btlg/business-taxes-law-guide.html	Laws and Regulations
CA	https://www.boe.ca.gov/pdf/pub31.pdf	Brochure
CA	https://www.boe.ca.gov/pdf/pub27.pdf	Brochure
CA	https://www.boe.ca.gov/pdf/pub61.pdf	Brochure
CO	https://www.sos.state.co.us/CCR/GenerateRulePdf.do?ruleVersionId=4753	Laws and Regulations
CO	http://codes findlaw.com/co/title-39-taxation/co-rev-st-sect-39-26-707 html	Laws and Regulations
0	https://euclorado.gov/nacific/sites/default/files/DR1002.pdf	Brochure
0	https://www.colorado.gov/pacific/sites/default/files/Sales04.pdf	Brochure
CT	http://www.cga.ct.gov/2011/nub/chap219.htm	Laws and Regulations
СТ	https://www.cga.ct.gov/2011/rpt/2011_ R -0238 htm	Brochure
СТ	http://www.ct.gov/dts//wwn/view.asp2 $a = 1514\&O = 563394$	Brochure
СТ	http://www.ct.gov/drs/cwp/view.asp? r 1514 α Q 505554	Brochure
DE	http://revenue.delaware.gov/cervices/current.ht/taytins/grocerv.ndf	Brochure
FI	http://www.leg.state.gov/services/current_ob/taxups/grocery.pdf	Laws and Pagulations
ГL	0200/0212/0212ContentsIndex.html	Laws and Regulations
FI	https://www.flrules.org/gataway/ChantarHome.org/Chantar=12A_1	Laws and Pagulations
L EI	http://www.inutes.org/gateway/Chapterhome.aspichapterhome.aspi	Drochuro
	http://nondalevende.com/Forms_norary/curren/d40nt.pdf	Lawa and Degulations
GA*	http://www.texisitexis.com/notiopics/gacode/Default.asp	Laws and Regulations
GA*	http://demoscie.com/sites/demoscie.com/files/seleted_files/demoscie/LATD/Dulletin/20160/20List0/20	Das alura
GA.	nups://dor.georgia.gov/siles/dor.georgia.gov/nies/related_lies/document/LATP/Bulletin/2010%20List%20	Brochure
ID	of%20Sales%20and%20Ose%20Tax%20Exemptions.pdf	I
ID ID	http://adminrules.idano.gov/rules/current/35/0102.pdf	Laws and Regulations
ID ID	http://www.legislature.idano.gov/ldstat/11065/165CH56.ntm	Laws and Regulations
ID ID	https://tax.itaano.gov/pubs/EBK00012_0/-01-2001.pdf	Brochure
<u>ID</u>	https://tax.idano.gov/pubs/EBR00016_03-23-2015.pdf	Brochure
	ttp://www.liga.gov/JCAR/AdminCode/086/08600130sections.html	Laws and Regulations
	http://www.revenue.state.ii.us/publications/Bulletins/2010/FY-2010-01.PDF	Brochure
IL	http://www.revenue.state.il.us/Publications/Pubs/Pub-117.pdf	Brochure
IN*	http://codes.findlaw.com/in/title-6-taxation/	Laws and Regulations
IN*	http://www.in.gov/legislative/iac/2008082/-IR-045080658NRA.xml.pdf	Brochure
IA*	https://www.legis.iowa.gov/law/iowaCode/chapters?title=X	Laws and Regulations
IA*	http://law.justia.com/codes/iowa/2013/titlex/subtitle1/chapter423	Laws and Regulations
IA*	https://tax.iowa.gov/iowa-sales-tax-food	Brochure
KS*	http://kansasstatutes.lesterama.org/Chapter_79/	Laws and Regulations
KS*	http://rvpolicy.kdor.ks.gov/Pilots/Ntrntpil/IPILv1x0.NSF/\$\$ViewTemplate%20for%20Regulations%20Onl	Laws and Regulations
	y?OpenForm	
KS*	http://www.ksrevenue.org/pdf/pub1510.pdf	Brochure
KY*	http://www.lrc.ky.gov/Statutes/chapter.aspx?id=37663	Laws and Regulations
KY*	http://www.lrc.ky.gov/kar/TITLE103.HTM	Laws and Regulations
KY*	http://revenue.ky.gov/Documents/AppendixN_CandyProduct91114.pdf	Brochure
KY*	http://revenue.ky.gov/News/Publications/Pages/Sales-Tax-Facts.aspx	Brochure
LA	http://www.legis.state.la.us/lss/lss.asp?folder=121	Laws and Regulations
LA	http://www.doa.louisiana.gov/osr/lac/61v01/61v01.doc	Laws and Regulations
LA	http://www.rev.state.la.us/Miscellaneous/FoodExemptionFlyer.pdf	Brochure
LA	http://revenue.louisiana.gov/Publications/R-1002(01-17)%20FINAL.pdf	Brochure
ME	http://www.mainelegislature.org/legis/statutes/36/title36ch0sec0.html	Laws and Regulations
ME	http://www.maine.gov/revenue/salesuse/Bull1220160101v2.pdf	Brochure
ME	http://www.maine.gov/revenue/salesuse/Bull2720160101v2.pdf	Brochure

MD MD MD	http://www.lexisnexis.com/hottopics/mdcode/ http://www.dsd.state.md.us/COMAR/title_search/Title_List.aspx http://taxes_marylandtaxes_com/Resource_Library/Tax_Publications/Tax_Tips/Business_Tax_Tips/busin5_	Laws and Regulations Laws and Regulations Brochure
MD	pdf	Dioentite
MA	https://malegislature.gov/Laws/GeneralLaws/PartI/TitleIX/Chapter64H	Laws and Regulations
MA	http://www.mass.gov/dor/individuals/taxpayer-help-and-resources/tax-guides/salesuse-tax-guide.html	Brochure
MI*	http://w3.lara.state.mi.us/orrsearch/948_2010-012TY_AdminCode.pdf	Laws and Regulations
MI*	https://www.michigan.gov/documents/treasury/RAB_2009-	Brochure
	8 Food for Human Consumption Oct 09 299470 7.pdf	
MN*	https://www.revisor.mn.gov/statutes/?id=297A.67	Laws and Regulations
MN*	http://www.revenue.state.mn.us/businesses/sut/factsheets/FS102A.pdf	Brochure
MN*	http://www.revenue.state.mn.us/businesses/sut/factsheets/FS102B.pdf	Brochure
MN*	http://www.revenue.state.mn.us/businesses/sut/factsheets/FS102C.pdf	Brochure
MN*	http://www.revenue.state.mn.us/businesses/sut/factsheets/FS102D.pdf	Brochure
MN*	http://www.revenue.state.mn.us/businesses/sut/factsheets/FS117A.pdf	Brochure
MS	http://www.leviende.state.nin.us/businesses/sub/factsneets/FSTT/F.pdf	Laws and Regulations
MS	http://www.sos.ms.gov/admincodesearch/default.aspx	Laws and Regulations
MS	https://www.dor.ms.gov/Laws-	Laws and Regulations
1010	Rules/Documents/Part%20IV%20Sales%20and%20Use%20Tax%2092216.ndf	Laws and Regulations
MS	http://www.dor.ms.gov/Business/Pages/Sales-Tax-Exemptions.aspx	Brochure
MO	http://www.moga.mo.gov/mostatutes/stathtml/14400000301.html	Laws and Regulations
MT	https://revenue.mt.gov/home/individuals/businesses otherinformation#Sales%20Tax	Brochure
NE*	http://www.revenue.nebraska.gov/legal/regs/slstaxregs.html	Laws and Regulations
NE*	http://www.nebraskalegislature.gov/laws/browse-chapters.php?chapter=77	Laws and Regulations
NE*	http://www.revenue.nebraska.gov/info/6-432.pdf	Brochure
NE*	http://www.revenue.nebraska.gov/info/6-437.pdf	Brochure
NV*	http://www.leg.state.nv.us/NRS/NRS-372.html	Laws and Regulations
NV*	http://www.leg.state.nv.us/NAC/NAC-372.html	Laws and Regulations
NV*	https://tax.nv.gov/FAQs/Sales Tax Information FAQ s/	Brochure
NH	https://www.revenue.nh.gov/assistance/tax-overview.htm	Brochure
NJ*	http://law.justia.com/codes/new-jersey/2009/title-54/54-32b	Laws and Regulations
NJ*	http://www.state.nj.us/treasury/taxation/pdf/pubs/sales/su4.pdf	Brochure
NJ*	http://www.state.nj.us/treasury/taxation/pdf/ssutfood.pdf	Brochure
NM	http://www.nmcpr.state.nm.us/nmac/ title03/T03C002.htm	Laws and Regulations
NM	http://public.nmcompcomm.us/nmpublic/gateway.dll/?t=templates&tn=default.htm	Laws and Regulations
INIM	$\frac{1}{100} \frac{1}{100} \frac{1}$	Brochure
NM	%20Gross%20Receipts%20&%20Compensating%20Taxes%20-%20An%20Overview.pdf	Prochuro
NV	http://www.zimonioinis.com/2010/F008403004.FDF	Laws and Pagulations
NY	https://govt.westlaw.com/ny/my/my/my/my/my/my/my/my/my/my/my/my/my	Laws and Regulations
111	riginationContext=documenttoc&transitionType=CategoryPageItem&contextData=(sc Default)	Laws and Regulations
NY	https://www.tax.nv.gov/ndf/nublications/sales/nub840.ndf	Brochure
NY	https://www.tax.nv.gov/pdf/publications/sales/pub750.pdf	Brochure
NY	https://www.tax.nv.gov/pdf/memos/sales/m11_3s.pdf	Brochure
NY	https://www.tax.ny.gov/pdf/memos/sales/m06_6s.pdf	Brochure
NY	https://www.tax.ny.gov/pdf/tg_bulletins/sales/b11_525s.pdf	Brochure
NY	https://www.tax.ny.gov/pdf/tg_bulletins/sales/b14_103s.pdf	Brochure
NY	https://www.tax.ny.gov/pdf/tg_bulletins/sales/b11_160s.pdf	Brochure
NY	https://www.ny.gov/sites/ny.gov/files/atoms/files/GuideForTaxableandExemptPropertyandServices.pdf	Brochure
NC*	http://www.ncga.state.nc.us/gascripts/Statutes/StatutesTOC.pl?Chapter=0105	Laws and Regulations
NC*	http://www.dornc.com/practitioner/sales/bulletins/toc.html	Laws and Regulations
NC*	http://www.dornc.com/taxes/sales/foodnotice6-06.pdf	Brochure
ND*	http://law.justia.com/codes/north-dakota/2013/title-57/chapter-57-39.2	Laws and Regulations
ND*	https://www.nd.gov/tax/data/upfiles/media/gl-22062.pdf?20170414121353	Brochure
OH*	http://codes.ohio.gov/orc/5/39	Laws and Regulations
OK*	nttp://www.tax.ohio.gov/portals/0/sales and use/information releases/st200401.pdf	Brochure
OK* OV*	https://www.ok.gov/tov/documents/w166500.ndf	Laws and Regulations
OK"	https://www.ok.gov/tax/documents/fue0509.pdf	Laws and Regulations
OR OR	http://landru.leg.state.or.us/ors/	Laws and Regulations
OR	http://arcweb.sos.state.or.us/pages/rules/oars 100/oar 150/150 tofc.html	Laws and Regulations

PA	http://www.pacode.com/secure/data/061/061 toc.html	Laws and Regulations
PA	http://www.revenue.pa.gov/FormsandPublications/FormsforBusinesses/Documents/Sales-Use%20Tax/rev-	Brochure
	_717.pdf	
RI*	http://www.tax.ri.gov/regulations/FINAL%20REGS%202009/FoodandFoodIngredientsRegFinal%20v2%2	Laws and Regulations
	002122010.pdf	
RI*	http://law.justia.com/codes/rhode-island/2010/title44/chapter44-18/	Laws and Regulations
RI*	http://www.tax.ri.gov/regulations/salestax/11-60.pdf	Laws and Regulations
RI*	http://www.tax.state.ri.us/streamlined/candy_soft_diet.php	Brochure
SC	http://www.scstatehouse.gov/code/t12c036.php	Laws and Regulations
SC	http://www.scstatehouse.gov/coderegs/c117.php	Laws and Regulations
SC	https://dor.sc.gov/resources-site/lawandpolicy/Advisory%20Opinions/RR06-5.pdf	Laws and Regulations
SC	https://dor.sc.gov/resources-	Brochure
	site/publications/Publications/Sales%20and%20Use%20Tax%20Manual%202015%20Edition-Web.pdf	
SC	http://media.clemson.edu/procurement/2011SalesTaxSeminarManual May.pdf	Brochure
SD*	http://legis.sd.gov/Statutes/Codified_Laws/DisplayStatute.aspx?Type=Statute&Statute=10-45	Laws and Regulations
SD*	http://dor.sd.gov/taxes/business_taxes/publications/pdfs/stguide2014.pdf	Brochure
SD*	$http://dor.sd.gov/Publications/2013_Session_Presentations/PDFs/Summary of StateSalesTaxExemptions0113$	Brochure
	.pdf	
TN*	http://www.lexisnexis.com/hottopics/tncode/	Laws and Regulations
TN*	https://www.tnumc.org/wp-content/uploads/2016/04/TN-Sales-Tax-booklet-2013.pdf	Brochure
TN*	https://revenue.support.tn.gov/hc/en-us/article attachments/202401125/Notice 13-05.pdf	Brochure
ΤX	http://www.statutes.legis.state.tx.us/	Laws and Regulations
ΤX	https://comptroller.texas.gov/taxes/publications/96-280.pdf	Brochure
ΤX	https://comptroller.texas.gov/taxes/publications/94-155.pdf	Brochure
ΤХ	https://comptroller.texas.gov/taxes/audit/docs/convenience-manual.pdf	Brochure
UT*	http://le.utah.gov/UtahCode/chapter.jsp?code=59	Laws and Regulations
UT*	http://www.tax.utah.gov/sales/food-rate	Brochure
UT*	http://www.tax.utah.gov/forms/pubs/pub-25.pdf	Brochure
VT*	http://www.leg.state.vt.us/statutes/sections.cfm?Title=32&Chapter=233	Laws and Regulations
VT*	http://www.state.vt.us/tax/pdf.word.excel/legal/regs/SU.finals.11012010.pdf	Laws and Regulations
VT*	http://tax.vermont.gov/sites/tax/files/documents/SalesTaxTaxable%26ExemptFS.pdf	Brochure
VA	http://law.lis.virginia.gov/vacode/title58.1/chapter6/	Laws and Regulations
VA	http://lis.virginia.gov/000/reg/TOC23010.HTM#C0210	Laws and Regulations
VA	https://www.tax.virginia.gov/laws-rules-decisions/rulings-tax-commissioner/05-78	Brochure
VA	https://www.tax.virginia.gov/sites/default/files/inline-files/TB%2013-5%20Nonprescription%20Drugs.pdf	Brochure
WA*	http://apps.leg.wa.gov/rcw/default.aspx?cite=82.08	Laws and Regulations
WA*	http://apps.leg.wa.gov/WAC/default.aspx?cite=458-20	Laws and Regulations
WA*	http://dor.wa.gov/Docs/Pubs/SpecialNotices/2012/sn_12_SoftDrinks.pdf	Brochure
WA*	http://dor.wa.gov/Docs/Pubs/SpecialNotices/2010/sn_10_WaterCandyGumTaxRepeal.pdf	Brochure
WA*	http://dor.wa.gov/content/aboutus/statisticsandreports/stats ExemptionStudy.aspx	Brochure
WV*	http://www.legis.state.wv.us/wvcode/Code.cfm?chap=11&art=1	Laws and Regulations
WV*	http://tax.wv.gov/Documents/TSD/tsd300.pdf	Brochure
WV*	http://tax.wv.gov/Documents/TSD/tsd419.pdf	Brochure
WV*	http://tax.wv.gov/Documents/TSD/tsd420.pdf	Brochure
WI*	https://docs.legis.wisconsin.gov/statutes/statutes/77/III/51	Laws and Regulations
WI*	https://www.revenue.wi.gov/DOR%20Publications/pb220.pdf	Brochure
WY*	http://www.lexisnexis.com/hottopics/wystatutes/	Laws and Regulations
WY*	http://revenue.wyo.gov/home/rules-and-regulations-by-chapter	Laws and Regulations
WY*	http://revenue.wyo.gov/FoodExemption.pdf?attredirects=0	Brochure

* States indexed participate in the Streamlined Sales Tax Project (SSTP): http://www.streamlinedsalestax.org/

Appendix Table A.3 Variance Decomposition of Tax Rates

Sample:	Full Sample	County Border Pair Subsample	Full Sample
Weights:	Unweighted	Inverse of number of border-pairs	HMS-based weights
	(1)	(2)	(3)
Variance of $log(1+\tau)$	0.0011	0.0010	0.0009
Standard deviation of $log(1+\tau)$	0.0327	0.0313	0.0304
Standard deviation within:			
Store × Module cells	0.0041	0.0049	0.0041
Module × State × Year-Quarter cells	0.0041		0.0040
Module × Border Pair × Year-Quarter cells		0.0113	
Fraction of variance within:			
Store × Module cells	1.5%	2.5%	1.8%
Module × State × Year-Quarter cells	1.6%		1.7%
Module × Border Pair × Year-Quarter cells		13.0%	

<u>Notes:</u> This table reports variance decomposition of the tax rate variable in the Nielsen RMS data. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2.

Sample:	County Borde [OLS Estimate	er Pair Sample s from Table 2]	County Borde [Instrumental Va	er Pair Sample riables Estimates]	
Dependent variable:	Price	Quantity	Price	Quantity	
	(1)	(2)	(3)	(4)	
$\log(1+ au_{mcn})$	0.980	-0.649	0.952	-0.574	
	(0.016)	(0.084)	(0.017)	(0.090)	
First-stage coefficient for $log(1 + \tau_{msn})$			0.988 (0.001)		
First stage F-statistic			486	,509	
Specification:					
Store × Module fixed effects	У	У	У	У	
Module \times Border Pair \times Year-Quarter fixed effects	У	У	У	У	
N (observations)	33,749,257	33,749,257	33,749,208	33,749,208	

Appendix Table A.4 OLS and Instrumental Variables Estimates of the Effects of Sales Taxes on Prices and Quantity

<u>Notes:</u> Columns (1) and (2) replicate the estimates of the OLS effects of sales taxes on quantity and prices reported in Table 2, column (2) (Panel A and Panel B). In columns (3) and (4), we report 2SLS estimates from instrumenting the county-level module-specific sales tax rates with the associated average state-level sales tax rate. The independent variable is quarterly sales tax rate of module *m* in county *c* in state *s* and the instrument is is quarterly sales tax rate of module *m* in state *s*, with both measures available each quarter (*n*). One observation is a module in a store in a given quarter. Consumer prices $p(1+\tau)$ are tax inclusive. The Retail Scanner data is restricted to modules above the 80th percentile of the national distribution of sales. The sample is restricted to stores in border counties. Observations are weighted by the inverse of the number of times a store appears in the data. The regression model includes module-by-store and module-by-year-quarter-by-pair fixed effects, where pairs denote pairs of contiguous counties. All standard errors in this table are clustered at the state-module level and are reported in parentheses. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Dependent variable:	Consumer prices					
	(1)	(2)				
$\log(1 + \tau_{mcn})$	0.970	0.965				
	(0.046)	(0.046)				
$\log(1 + \tau_{mcn}) \times \text{normalized HHI}_{mcs}$		-0.045				
		(0.035)				
Specification:						
Store \times Module fixed effects	У	У				
Module × State × Year-Quarter fixed effects	У	У				
Ν	53,987,131	53,987,131				

Appendix Table A.5 Heterogeneous Pass-Through by Market Concentration

<u>Notes:</u> This table reports estimates of pass-through heterogeneity as a function of market concentration. The normalized HHI is defined at the module-by-county level as $nHHI_{mc} = (H_{mc} - 1/J_{mc})/(1-1/J_{mc})$, where J_{mc} is the number of UPCs in the module-county market mc, and H_{mc} is the sum of squared market shares over all UPCs in market mc. In the regression, the normalized HHI is standardized to be mean zero and unit variance. All standard errors in this table are clustered at the state-module level and are reported in parentheses. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Reduced-form O	LS Estir	nates of t	the Effect	ts of Cha	in Instru	ment on	Prices ar	ıd Quant	ity			
Sample:			Full S	Sample			County Border Pair Sample				mple	
Dependent variable:		Price			Quantity	,		Price			Quantity	7
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Leave-me-out chain average log(p)	0.970 (0.002)			-1.115 (0.026)			0.964 (0.003)			-1.128 (0.026)		
Leave-county-out chain average log(<i>p</i>)		0.952 (0.003)			-1.099 (0.026)			0.951 (0.003)			-1.104 (0.026)	
Index based on UPC-level leave-me-out chain average log(p)			0.983 (0.002)			-1.009 (0.024)			0.976 (0.003)			-1.032 (0.023)
Specification:												
Store × Module fixed effects	У	У	у	у	у	у	У	У	у	у	У	у
Module × State × Year-Quarter fixed effects	у	у	у	у	у	у						
Module × Border Pair × Year-Quarter fixed effect	s						У	У	у	у	У	у
Ν	53,987,430	53,982,244	53,984,835	53,987,430	53,982,244	53,984,835	33,749,257	33,739,322	33,746,805	33,749,257	33,739,322	33,746,805

Appendix Table A.6 educed-form OLS Estimates of the Effects of Chain Instrument on Prices and Ouant

<u>Notes:</u> This table reports estimates of the reduced-form effect of price instruments on consumer prices and quantity sold. One observation is a module in a store in a given quarter. Consumer prices are tax inclusive. The Retail Scanner data is restricted to modules above the 80th percentile of the national distribution of sales. All standard errors in this table are clustered at the state-module level and are reported in parentheses. In columns (1) to (6), the sample includes our full sample of stores and the regression model includes module-by-store and module-by-quarter-by-state fixed effects. In columns (7) to (12), the sample is restricted to stores in border counties, and observations are weighted by the inverse of the number of times a store appears in the data. In columns (7) to (12), the regression model includes module-by-store and module-by-quarter-by-pair fixed effects, where pairs denote pairs of contiguous counties. In columns (1), (4), (7) and (10) the independent variable is the chain average log price leaving all stores in county c out. In the remaining columns, the dependent variable is a regression-adjusted price index where each UPCs price is a leave-me-out chain average price. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Sample:	Low-price modules	High-price modules	
Weights:	Unweighted	Unweighted	
	(1)	(2)	
Panel A: Reduced-form OLS Estimates of the Effects of Sales Taxes on Consum	er Prices and Qu	antity	
$d \log(p(1+\tau))/d \log(1+\tau)$ [pass-through]	0.969	0.970	
	(0.065)	(0.064)	
$d \log(Q)/d \log(1 + \tau)$ [tax elasticity]	-0.829	-0.713	
	(0.218)	(0.314)	
Panel B: 2SLS Estimates of the Price Elasticity of Demand			
$d\log(Q)/d\log(p)$	-1.079	-1.221	
	(0.024)	(0.048)	
Panel C: "Plug-in" Estimate of Tax Salience Parameter			
$ heta_{ au}$	0.771	0.595	
Average tax rate, τ	0.038	0.034	
Average price (in \$)	3.14	6.84	
Specification:			
Store × Module fixed effects	У	У	
Module × State × Year-Quarter fixed effects	У	У	
Module × Border Pair × Year-Quarter fixed effects			
Ν	27,716,660	26,270,770	

	Appendix Table A.7
Store-level Estimates of Pass-Through,	, Tax Elasticity, Price Elasticity of Demand, and Tax Salienc

<u>Notes:</u> This table reports estimates of the effects of sales taxes, of the price elasticity of demand, and of the tax salience parameter. All standard errors in this table are clustered at the state-module level and are reported in parentheses. In column (1), the sample is restricted to modules for which the average, unconditional price is below the median, where the median is calculated separately for food and nonfood products. In column (2), the sample is restricted to modules with average prices above the median. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.
Reduced-form OLS Estimate	es of the Effe	ets of Sales Ta	xes on Quant	ity and Expen	diture	
Sample:		Full Sample		Count	y Border Pair S	Sample
Dependent variable:	Quantity	Pre-tax price	Expenditure	Quantity	Pre-tax price	Expenditure
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: Reduced	-form OLS E	stimates of the	Effects of Sal	es Taxes		
$\log(1+\tau_{mrn})$	-0.775	-0.030	-0.834	-0.649	-0.020	-0.669
	(0.187)	(0.046)	(0.186)	(0.084)	(0.016)	(0.083)
Implied effect on quantity		-0.8	304		-0.0	549
Danal D. Dadward for		tag of the Effe	ata of the Drie	. In stars out		
-					0.064	0.240
² mrn	-1.115	0.970	-0.333	-1.128	0.964	-0.340
T 1' 1 CC	(0.026)	(0.002)	(0.025)	(0.026)	(0.002)	(0.024)
Implied effect on quantity		-1.,	503		-1	504
Panel C: "Plu	ıg-in" Estimat	e of the Tax Sa	alience Parame	eter		
$\mathrm{E}[heta]$	0	0.6	525		0.5	01
Specification:						
Store × Module fixed effects	у	у	у	у	у	у
Module × State × Year-Quarter fixed effects	y	y	y	·	-	-
Module × Border Pair × Year-Quarter fixed effects		·		У	У	У
N (observations)	53.895.446	53,895,446	53,895,446	33,749,157	33,749,157	33.749.157
× ,	,,	.,,	,, ••	, , . ,	,, . ,	, , . ,
Notes: This table replicates the key parameters repo	orted in Table	2, but uses an	alternative me	asure of quan	tity. Here, we	report
separately the effects of sales taxes (Panel A) and the	ne effects of th	ne price instrur	nent (Panel B)	on total expe	nditures on mo	odule <i>m</i> in
store r at time n and on pre-tax prices. We then rep	port the differ	ence between	the effect on e	xpenditure an	d on prices as	an

Appendix Table A.8

alternative measure of the effect on quantity. Panel C reports the associated value of the tax salience parameter. The Retail Scanner data is restricted to modules above the 80th percentile of the national distribution of sales. All standard errors in this table are clustered at the state-module level and are reported in parentheses. In columns (1) to (3), the sample includes our full sample of stores and the regression model includes module-by-store and module-by-quarter-by-state fixed effects. In columns (4) to (6), the sample is restricted to stores in border counties. Observations are weighted by the inverse of the number of times a store appears in the data. The regression model includes module-by-store and module-by-quarter-by-pair fixed effects, where pairs denote pairs of contiguous counties. All standard errors in this table are clustered at the state-module level and are reported in parentheses. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Robustness to Local	Trends		
Sample:		Full Sample	
	(1)	(2)	(3)
Panel A: Reduced-form OLS Estimates of the Effects of S	ales Taxes on Consur	ner Prices and Qu	uantity
$d\log(p(1+\tau))/d\log(1+\tau)$	0.970	0.939	0.941
	(0.046)	(0.036)	(0.036)
$d\log(Q)/d\log(1+\tau)$	-0.775	-0.499	-0.328
	(0.187)	(0.165)	(0.164)
Panel B: 2SLS Estimates of the Price	e Elasticity of Deman	d	
$d\log(Q)/d\log(p)$	-1.150	-1.073	-1.007
	(0.027)	(0.030)	(0.030)
Panel C: "Plug-in" Estimate of the T	ax Salience Paramete	r	
$ heta_{ au}$	0.680	0.509	0.372
Specification:			
Store × Module fixed effects	у	у	У
Module × Year-Quarter fixed effects		у	У
Module × State × Year-Quarter fixed effects	у		
Module × County × Linear time trend		у	
Module × Store × Linear time trend			У
Ν	53,895,446	53,994,252	53,994,252

Appendix Table A.9

<u>Notes</u>: This table reports estimates of the effects of sales taxes, of the price elasticity of demand, and of the tax salience parameter. In Panel A, the independent variable is quarterly sales tax rate of module *m* in county *c* in state *s*. One observation is a module in a store in a given quarter. Consumer prices $p(1+\tau)$ are tax inclusive. The Retail Scanner data is restricted to modules above the 80th percentile of the national distribution of sales. In Panel B, the reported coefficients are 2SLS estimates of the effect of consumer prices on quantity sold, where prices are instrumented with leave-self-out chain-level average prices. In Panel C, we report the estimate of the tax salience parameter. All standard errors in this table are clustered at the state-module level and are reported in parentheses. The sample includes our full sample of stores. In columns (1), the regression model includes module-by-store and module-by-quarter-by-state fixed effects. In column (2), the regression model includes module-by-store and module-by-quarter fixed effects, as well as county-module specific time trends. In column (3), the regression model includes module-by-store and module-by-store and module-by-quarter fixed effects, as well as store-module specific time trends. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Store-level Estimates of Pass-Through, Tax Elasticity, Price Elasticity of Dema	and, and Tax Sal	ience
Sample:	Full Sample	Excluding alcohol and tobacco
Weights:	Unweighted	Unweighted
	(1)	(2)
Panel A: Reduced-form OLS Estimates of the Effects of Sales Taxes on Consume	er Prices and Qu	antity
$d \log(p(1+\tau))/d \log(1+\tau)$ [pass-through]	0.970	0.974
	(0.046)	(0.046)
$d \log(Q)/d \log(1 + \tau)$ [tax elasticity]	-0.775	-0.815
	(0.187)	(0.184)
Panel B: 2SLS Estimates of the Price Elasticity of Demand		
$d\log(Q)/d\log(p)$	-1.150	-1.136
	(0.027)	(0.027)
Panel C: "Plug-in" Estimate of Tax Salience Parameter		
$ heta_{ au}$	0.680	0.718
Average tax rate, τ	0.036	0.036
Specification:		
Store × Module fixed effects	У	У
Module × State × Year-Quarter fixed effects	у	у
Module × Border Pair × Year-Quarter fixed effects	-	-
Ν	53,987,430	52,404,504

Appendix Table A.10 Store-level Estimates of Pass-Through, Tax Elasticity, Price Elasticity of Demand, and Tax Salience

<u>Notes:</u> This table reports estimates of the effects of sales taxes, of the price elasticity of demand, and of the tax salience parameter. All standard errors in this table are clustered at the state-module level and are reported in parentheses. In column (1), the sample includes our full sample of stores and the regression model includes module-by-store and module-by-quarter-by-state fixed effects. In column (2), the sample excludes alcoholic beverages and tobacco products, which are subject to excise taxes. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Dependent variable:	Total quantity	Quantity at IV stores only	Total quantity	Quantity at IV stores only
	log	log	levels	levels
	(1)	(2)	(3)	(4)
Panel A: 2SLS Estimates of the	e Effects of Sales	s Taxes on Quant	ity	
$\log(1+\tau)$	-0.355	-0.598	-12.22	-19.97
	(0.231)	(0.248)	(6.606)	(4.603)
Panel B: 2SLS Estimates of	f the Price Elastic	city of Demand		
$\log(p)$	-1.113	-1.553	-15.28	-20.98
	(0.0101)	(0.0109)	(0.228)	(0.155)
Mean dependent variable			12.53	5.058
Specification:				
Household × Module fixed effects	у	У	У	У
Module × State × Year-Quarter fixed effects	у	У	У	У
Ν	27,957,026	27,957,026	51,346,211	51,346,211

Appendix Table A.11 Household-Level Estimates of Cross-Store Substitution

<u>Notes:</u> This table reports estimates of the effects of sales taxes and prices on quantity demanded. In columns (1) and (2), the sample is restricted to cells with non-zero purchases at RMS stores. In column (1) the dependent variable is the log of the total quantity purchased at any store, whereas in column (2) the dependent variable is the log of the total quantity purchased at RMS stores only. In columns (3) and (4), the sample is expanded to include all observations with any purchase, but the dependent variables are now in levels to keep zeros when examining purchases at RMS stores. All standard errors in this table are clustered at the state-module level and are reported in parentheses. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Independent variable (x):	Taxes	Prices
	(1)	(3)
Panel A: Variance of the Price and Tax Elasticities (Random	n Coefficients)	
Average coefficient	-0.396	-1.375
Sample variance of empirical Bayes predictions	0.099	0.002
Panel B: Variance of First-Stage Coefficients (Random C Average coefficient Sample variance of empirical Bayes predictions	oefficients) 0.564 0.000	0.218 0.002
Panel C: Variance of the Tax Salience Paramet	er	
$\operatorname{Var}(\theta_{\tau})$	0.0)51
Ν	51,346,211	51,346,211

Appendix Table A.12 Alternative Estimates of Tax and Price Elasticities, Mixed-Effects Model

<u>Notes:</u> This table reports estimates of the variance of random coefficients from mixed-effects models. Panel A reports the average price and tax elasticities as well as the sample variance of the associated empirical Bayes predictions of the random coefficients. Panel B reports the average first-stage coefficient for the price and tax instruments as well as the sample variance of the associated empirical Bayes predictions of the random coefficients. The mixed-effects models allow for random coefficients across household-year cells. Observations are weighted using Nielsen's projection factors in order to obtain national representativeness. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Appendix Table A.13 Calibration of Incidence and Marginal Excess Burden Formulas [Table 5 Using RMS Full Sample Estimates]

	(1)	(2)	(3)
Panel A: Inputs and Intermediate Estimates Needed in Cali	bration		
Inputs:			
Average tax rate, τ		0.036	
Price elasticity, $\tilde{\epsilon}_D \equiv \partial \log(Q) / \partial \log(p(1+\tau))$		-1.150	
Tax pass-through, $\rho_{\tau} \equiv d \log(p (1+\tau))/d \log(1+\tau)$		0.970	
Tax elasticity, $\tilde{\epsilon}_{D\tau} \equiv d\log(Q)/d\log(1+\tau)$		-0.775	
Intermediate estimates:			
Implied estimate of $v_q/(J_{\epsilon_{ms}})$		0.025	
Implied markup (p -mc)/p		0.019	
Implied estimate of v_q / J		0.022	
$(v_q/J = 0 \text{ is perfect competition}, v_q/J = 1 \text{ is perfect collusion})$			
Tax salience:			
Tax salience parameter, θ_{τ}		0.680	
Heterogeneity in θ_{τ} , $(1/p)$ Var (θ_{τ})	0.000	0.062	0.218
Panel B: Incidence and Marginal Excess Burden Form	ulas		
Incidence (1)			
$I \equiv (dCS/d\tau)/(dPS/d\tau)$	22.270	22.331	22.486
$= \left(\rho_{\tau}(1+\tau) + (1-\theta_{\tau})\tau\tilde{\epsilon}_{D\tau} + \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau})\right) / \left((1-\nu/J)(1-\rho_{\tau}) + (\nu/J)\theta_{\tau}(1+\tau\rho_{\tau})\right)$			
Marginal Excess Burden $(d\tilde{W}/d\tau)$			
$\overline{d\tilde{W}/d\tau} = ((p-mc)/p + \theta_{\tau}\tau)\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)\operatorname{Var}(\theta_{\tau})$	-0.034	-0.036	-0.043
Panel C: Decomposition of the Deviation Between General Formula and	l Harberger F	ormula	
Harberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{\epsilon}_{D\tau}$	-0.028	-0.028	-0.028
Imperfect salience only, $d\tilde{W}/d\tau = \theta_{\tau}\tilde{\epsilon}_{\rho_{\tau}} - \tau(1+\tau)\tilde{\epsilon}_{\rho}(1/p) Var(\theta_{\tau})$	-0.019	-0.022	-0.028
Decomposition of deviation (as % of difference b/w Harberger and general formula)	-154%	-74%	3%
	0.042	0.042	0.042
Imperfect competition only, $dW/d\tau = ((p-mc)/p + \tau)\epsilon_{D\tau}$	-0.043	-0.043	-0.043
Decomposition of deviation (as % of difference b/w Harberger and general formula)	254%	174%	97%

Notes: This table reports calibrations of the tax incidence and marginal excess burden formulas. The results of these calibrations are shown in Panel B. Panel A presents the value of the input parameters taken from Tables 2 through 4, as well as estimates of intermediate parameters (see main text for details). Panel C presents a decomposition of the deviation between the general formula calibrated in Panel B and a standard Harberger analysis. In column (1), we assume no heterogeneity in salience across consumers; in column (2) we allow for heterogeneity in the tax salience parameter by calibrating the variance of θ_{τ} using the estimate reported in Table 4. In column (3), we consider the special case of consumers being either fully attentive or fully inattentive to taxes. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Appendix Table A.14 Calibration of Incidence and Marginal Excess Burden Formulas [Table 5 Using RMS County Border Pair Sample Estimates]

	(1)	(2)	(3)
Panel A: Inputs and Intermediate Estimates Needed in Calibrat	ion		
Inputs:			
Average tax rate, τ		0.034	
Price elasticity, $\tilde{\epsilon}_D \equiv \partial \log(Q) / \partial \log(p(1+\tau))$		-1.170	
Tax pass-through, $\rho_{\tau} \equiv d \log(p (1+\tau))/d \log(1+\tau)$		0.980	
Tax elasticity, $\tilde{\epsilon}_{D\tau} \equiv d\log(Q)/d\log(1+\tau)$		-0.649	
Intermediate estimates:			
Implied estimate of $v_q/(J\epsilon_{ms})$		0.021	
Implied markup (p -mc)/p		0.015	
Implied estimate of v_q / J		0.018	
$(v_q/J = 0 \text{ is perfect competition}, v_q/J = 1 \text{ is perfect collusion})$			
Tax salience:			
Tax salience parameter, θ_{τ}		0.556	
Heterogeneity in θ_{τ} , $(1/p)$ Var (θ_{τ})	0.000	0.062	0.247
Panel B: Incidence and Marginal Excess Burden Formulas			
Incidence (1)			
$I \equiv (dCS/d\tau)/(dPS/d\tau)$	33.669	33.757	34.021
$= \left(\rho_{\tau}(1+\tau) + (1-\theta_{\tau})\tilde{\tau}\epsilon_{D\tau} + \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau})\right) / \left((1-\nu/J)(1-\rho_{\tau}) + (\nu/J)\theta_{\tau}(1+\tau\rho_{\tau})\right)$			
Marginal Excess Burden $(d\tilde{W}/d\tau)$			
$\overline{d\tilde{W}/d\tau} = ((p-mc)/p + \theta_{\tau}\tau)\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)\operatorname{Var}(\theta_{\tau})$	-0.022	-0.025	-0.032
Panel C: Decomposition of the Deviation Between General Formula and Ha	rberger Fo	rmula	
Harberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{\epsilon}_{D\tau}$	-0.022	-0.022	-0.022
Imperfect salience only, $d\tilde{W}/d\tau = \theta_{\tau}\tilde{\tau}_{\rho_{\tau}} - \tau(1+\tau)\tilde{\epsilon}_{\rho}(1/p) \operatorname{Var}(\theta_{\tau})$	-0.012	-0.015	-0.022
Decomposition of deviation (as % of difference b/w Harberger and general formula)	-	-283%	4%
Imperfect competition only, $d\tilde{W}/d\tau = ((p-mc)/p + \tau)\tilde{\epsilon}_{D\tau}$	-0.032	-0.032	-0.032
Decomposition of deviation (as % of difference b/w Harberger and general formula)	-	383%	96%

Notes: This table reports calibrations of the tax incidence and marginal excess burden formulas. The results of these calibrations are shown in Panel B. Panel A presents the value of the input parameters taken from Tables 2 through 4, as well as estimates of intermediate parameters (see main text for details). Panel C presents a decomposition of the deviation between the general formula calibrated in Panel B and a standard Harberger analysis. In column (1), we assume no heterogeneity in salience across consumers; in column (2) we allow for heterogeneity in the tax salience parameter by calibrating the variance of θ_{τ} using the estimate reported in Table 4. In column (3), we consider the special case of consumers being either fully attentive or fully inattentive to taxes. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Appendix Table A.15 Calibration of Incidence and Marginal Excess Burden Formulas [Sensitivity of Table 5 to Alternative Values of Elasticity of Inverse Marginal Surplus]

	(1)	(2)	(3)	(4)	(5)
Panel A: Inputs and Intermediate Estimates Needed i	n Calibratic	n			
Inputs:					
Average tax rate, τ			0.024		
Price elasticity, $\tilde{\epsilon}_D \equiv \partial \log(Q) / \partial \log(p(1+\tau))$			-1.375		
Tax pass-through, $\rho_{\tau} \equiv d\log(p(1+\tau))/d\log(1+\tau)$			0.968		
Tax elasticity, $\tilde{\epsilon}_{D\tau} \equiv d\log(Q)/d\log(1+\tau)$			-0.396		
ϵ_{ms} (assume $1/\epsilon_D$ in col (1), sensitivity analysis in (2)-(5))	0.727	0.400	0.600	1.000	1.200
Intermediate estimates:					
Implied estimate of $v_a/(J_{\epsilon_{mc}})$	0.070	0.084	0.075	0.062	0.057
Implied markup $(p - mc)/p$	0.037	0.024	0.033	0.045	0.049
Implied estimate of v_a/J	0.051	0.034	0.045	0.062	0.068
$(v_q/J = 0 \text{ is perfect competition}, v_q/J = 1 \text{ is perfect collusion})$					
Tax salience:					
Tax salience parameter, θ_{τ}			0.313		
Heterogeneity in θ_{τ} , $(1/p)$ Var (θ_{τ})			0.062		
Panel B: Incidence and Marginal Excess Burden	Formulas				
Incidence (1)					
$I \equiv (dCS/d\tau)/(dPS/d\tau)$	21.134	23.672	21.950	19.835	19.140
$= (\rho_{\tau}(1+\tau) + (1-\theta_{\tau})\tau\tilde{\epsilon}_{D\tau} + \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau}))/((1-\nu/J)(1-\rho_{\tau}) + (\nu/J)\theta_{\tau}(1+\tau\rho_{\tau}))$					
<u>Marginal Excess Burden $(d\tilde{W}/d\tau)$</u>					
$d\tilde{W}/d\tau = ((p-mc)/p + \theta_{\tau}\tau)\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau})$	-0.020	-0.015	-0.018	-0.023	-0.025
Panel C: Decomposition of the Deviation Between General Formu	la and Harb	berger For	mula		
Harberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{\epsilon}_{D\tau}$	-0.009	-0.009	-0.009	-0.009	-0.009
Imperfect salience only $d\tilde{W}/d\tau = \theta \tau \tilde{z}_{\rm D} - \tau (1+\tau) \tilde{z}_{\rm D} (1/n) \operatorname{Var}(\theta)$	-0.005	-0.014	-0.014	-0.014	-0.014
Decomposition of deviation (as % of difference b/w Harberger and general formula)	-43%	83%	51%	33%	29%
Imperfect competition only, $d\tilde{W}/d\tau = ((p-mc)/p + \tau)\tilde{\epsilon}_{0r}$	-0.024	-0.019	-0.022	-0.027	-0.029
Decomposition of deviation (as % of difference b/w Harberger and general formula)	143%	185%	152%	133%	129%

<u>Notes:</u> This table reports calibrations of the tax incidence and marginal excess burden formulas. The results of these calibrations are shown in Panel B. Panel A presents the value of the input parameters taken from Tables 2 through 4, as well as estimates of intermediate parameters (see main text for details). Panel C presents a decomposition of the deviation between the general formula calibrated in Panel B and a standard Harberger analysis. In all columns, we assume no heterogeneity in salience across consumers. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Appendix Table A.16 Calibration of Incidence and Marginal Excess Burden Formulas [Table 5 Using Alternative Calibration of τ]

(1) (2) (3)		(1)	(2)	(3)
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Panel A: Inputs and Intermediate Estimates Needed in Calibration

Average tax rate, τ 0.052Price clasticity, $\tilde{c}_D \equiv clog(Q)/clog(p(1+\tau))$ -1.375Tax pass-through, $\rho_r \equiv d \log(p(1+\tau))/d \log(1+\tau)$ 0.968Tax elasticity, $\tilde{c}_{DT} \equiv d \log(Q)/d \log(1+\tau)$ -0.396Intermediate estimates:0.070Implied estimate of $v_q/(J\epsilon_{ms})$ 0.037Implied estimate of v_q/J 0.031Implied estimate of v_q/J 0.051 $(v_q/J = 0 \text{ is perfect competition, v_q/J = 1 is perfect collusion)0.000Tax salience:Tax salience parameter, \theta_r0.305Heterogeneity in \theta_{\tau,\tau}(1/p) \operatorname{Var}(\theta_{\tau})0.0000.062Panel B: Incidence and Marginal Excess Burden FormulasIncidence (I)I \equiv (d \operatorname{CS}/d \tau)/(d \operatorname{PS}/d \tau)21.48321.588= (\rho_r(1+\tau) + (1-\theta_r)\tilde{c}_{Dr} - \tau(1+\tau)\tilde{c}_{D}(1/p) \operatorname{Var}(\theta_r)-0.021-0.026Marginal Excess Burden (d \tilde{W}/d \tau)-0.021-0.021-0.021Marginal Excess formula (assuming perfect composition of the Deviation Between General Formula and Harberger FormulaHarberger formula (assuming perfect competition and full salience), d \tilde{W}/d \tau = \tilde{\pi}_{Dr}-0.021-0.021Implied estimate only, d \tilde{W}/d \tau = d_r \tilde{x}_{Dr} - \tau(1+\tau) \tilde{c}_D(1/p) \operatorname{Var}(\theta_r)-0.021-0.021-0.021$	Inputs:			
Price elasticity, $\tilde{c}_D \equiv \tilde{c}\log(Q)/\tilde{c}\log(p(1+\tau))$ -1.375 Tax pass-through, $p_t \equiv d\log(p(1+\tau))/d\log(1+\tau)$ 0.968 Tax elasticity, $\tilde{c}_{D_t} \equiv d\log(Q)/d\log(1+\tau)$ -0.396 Intermediate estimates: Implied estimate of $v_q/(Je_{mt})$ 0.070 Implied estimate of $v_q/(Je_{mt})$ 0.037 Implied estimate of v_q/J 0.051 $(v_q/J = 0$ is perfect competition, $v_q/J = 1$ is perfect collusion) Tax salience: Tax salience parameter, θ_τ 0.305 Heterogeneity in θ_τ , $(1/p) \operatorname{Var}(\theta_\tau)$ 0.000 0.062 0.212 Panel B: Incidence and Marginal Excess Burden Formulas Incidence (I) $I \equiv (dCS/d\tau)/(dPS/d\tau)$ 21.483 21.588 21.842 $\equiv (\rho_t(1+\tau) + (1-\theta_t)\tilde{\alpha}_{D_t} - \tau(1+\tau)\tilde{c}_D(1/p)\operatorname{Var}(\theta_t)) / ((1-v/J)(1-\rho_t)+(v/J)\theta_t(1+\tau\rho_t))$ Marginal Excess Burden $(d\tilde{W}/d\tau)$ $d\tilde{W}/d\tau = ((p-mc)/p + \theta_t \tau)\tilde{c}_{D_t} - \tau(1+\tau)\tilde{c}_D(1/p)\operatorname{Var}(\theta_t)$ -0.021 -0.026 -0.037 Panel C: Decomposition of the Deviation Between General Formula and Harberger Formula Harberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tilde{\alpha}_{DT}$ -0.021 -0.021 -0.021 Imperfect salience only, $d\tilde{W}/dt = \theta_t \tilde{\alpha}_{DT} - \tau(1+\tau)\tilde{c}_D(1/p)\operatorname{Var}(\theta_t)$ -0.021 -0.021 -0.021	Average tax rate, $ au$		0.052	
Tax pass-through, $\rho_{\tau} \equiv d \log(p (1+\tau))/d \log(1+\tau)$ 0.968Tax elasticity, $\tilde{\epsilon}_{D\tau} \equiv d \log(Q)/d \log(1+\tau)$ -0.396Intermediate estimates:0.070Implied estimate of $v_q/(J\epsilon_{min})$ 0.037Implied markup $(p - mc)/p$ 0.037Implied estimate of v_q/J 0.051 $(v_q/J = 0$ is perfect competition, $v_q/J = 1$ is perfect collusion)0.000Tax salience:0.000Tax salience parameter, θ_{τ} 0.305Heterogeneity in θ_{τ} , $(1/p) \operatorname{Var}(\theta_{\tau})$ 0.000 $I = (dCS/d\tau)/(dPS/d\tau)$ 21.483 $I = (dCS/d\tau)/(dPS/d\tau)$ 21.588 $I = (\rho_{\tau}(1+\tau) + (1-\theta_{\tau})\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau})) / ((1-v_{t}))(1-\rho_{\tau})+(v_{t}/)\theta_{t}(1+\tau\rho_{\tau}))$ 21.483Marginal Excess Burden $(d\tilde{W}/d\tau)$ $d\tilde{W}/d\tau = \tilde{\pi}_{D\tau}$ -0.021 $d\tilde{W}/d\tau = ((p-mc)/p + \theta_{\tau}\tilde{v}\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau})$ -0.021 -0.021Panel C: Decomposition of the Deviation Between General Formula and Harberger FormulaHarberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tilde{\pi}_{D\tau}$ -0.021-0.021Imperfect salience only, $d\tilde{W}/d\tau = \theta_{\tau}\tilde{\kappa}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau})$ -0.006-0.011-0.022	Price elasticity, $\tilde{\epsilon}_D \equiv \partial \log(Q) / \partial \log(p(1+\tau))$		-1.375	
Tax elasticity, $\tilde{\mathfrak{e}}_{p_{\tau}} \equiv d\log(Q)/d\log(1+\tau)$ -0.396Intermediate estimates: Implied estimate of $v_q/(J \mathfrak{e}_{q_0})$ 0.070Implied estimate of $v_q/(J \mathfrak{e}_{q_0})$ 0.037Implied estimate of v_q/J 0.051 $(v_q/J = 0$ is perfect competition, $v_q/J = 1$ is perfect collusion)0.051Tax salience parameter, θ_{τ} 0.305Heterogeneity in θ_{τ} , $(1/p) \operatorname{Var}(\theta_{\tau})$ 0.0000.0000.0620.212Panel B: Incidence and Marginal Excess Burden FormulasIncidence (1) $I = (\alpha \operatorname{CS}/d\tau)/(d\operatorname{PS}/d\tau)$ 21.48321.58821.842 $= (\rho_t(1+\tau) + (1-\theta_t)\tilde{\kappa}_{D_t} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)\operatorname{Var}(\theta_t)) / ((1-\nu/J)(1-\rho_t)+(\nu/J)\theta_t(1+\tau\rho_t))$ 21.48321.588Data Excess Burden ($d\tilde{W}/d\tau$) $d\tilde{W}/d\tau = ((p-mc)/p + \theta_t \tau)\tilde{\epsilon}_{D_t} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)\operatorname{Var}(\theta_t)$ -0.021 -0.026 -0.037 Panel C: Decomposition of the Deviation Between General Formula and Harberger FormulaHarberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{\epsilon}_{D\tau}$ -0.021 -0.021 -0.021 Harberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{\epsilon}_{D\tau}$ -0.021 -0.021 -0.021	Tax pass-through, $\rho_{\tau} \equiv d \log(p (1+\tau))/d \log(1+\tau)$		0.968	
Intermediate estimates:0.070Implied estimate of $v_q/(J\epsilon_{mx})$ 0.037Implied estimate of v_q/J 0.037Implied estimate of v_q/J 0.051 $(v_q/J = 0$ is perfect competition, $v_q/J = 1$ is perfect collusion)0.051Tax salience: Tax salience parameter, θ_r 0.305Heterogeneity in θ_τ , $(1/p) \operatorname{Var}(\theta_\tau)$ 0.0000.062Panel B: Incidence and Marginal Excess Burden FormulasIncidence (I) $I = (\rho_c(S/d\tau))(dPS/d\tau)$ $I = (\rho_c(S/d\tau))(dPS/d\tau)$ 21.483 21.588 21.842 Marginal Excess Burden formulasIncidence (I) $I = (\rho_c(S/d\tau))(dPS/d\tau)$ 0.021 -0.021	Tax elasticity, $\tilde{\epsilon}_{D\tau} \equiv d\log(Q)/d\log(1+\tau)$		-0.396	
Implied estimate of $v_q/(J\varepsilon_{ms})$ 0.070Implied markup $(p - mc)/p$ 0.037Implied estimate of v_q/J 0.051 $(v_q/J = 0$ is perfect competition, $v_q/J = 1$ is perfect collusion)0.051Tax salience: Tax salience parameter, θ_τ 0.305Heterogeneity in θ_τ , $(1/p) \operatorname{Var}(\theta_\tau)$ Danel B: Incidence and Marginal Excess Burden FormulasIncidence (I) $I = (dCS/d\tau)/(dPS/d\tau)$ 21.48321.48321.48321.58821.842Marginal Excess Burden $(d\tilde{W}/d\tau)$ $d\tilde{W}/d\tau = ((p - mc)/p + \theta_t \tau)\tilde{e}_D(1/p) \operatorname{Var}(\theta_t)) / ((1 - v/J)(1 - \rho_t) + (v/J)\theta_t(1 + \tau \rho_t))$ Panel C: Decomposition of the Deviation Between General Formula and Harberger FormulaHarberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{e}_{D\tau}$ -0.021 $-$	Intermediate estimates:			
Implied markup $(p - mc)/p$ 0.037Implied estimate of v_q/J 0.051 $(v_q/J = 0$ is perfect competition, $v_q/J = 1$ is perfect collusion)0.051Tax salience: Tax salience parameter, θ_τ Tax salience parameter, θ_τ 0.305Heterogeneity in θ_τ , $(1/p) \operatorname{Var}(\theta_\tau)$ 0.0000.0620.212Panel B: Incidence and Marginal Excess Burden FormulasIncidence (I) $I = (dCS'd\tau)/(dPS/d\tau)$ 21.48321.58821.842equation (dW/dt) $dW/d\tau = ((p-mc)/p + \theta_t \tau)\tilde{\epsilon}_D(1/p)\operatorname{Var}(\theta_t)) / ((1-v/J)(1-\rho_t)+(v/J)\theta_t(1+\tau\rho_t))$ -0.021-0.026-0.037Panel C: Decomposition of the Deviation Between General Formula and Harberger FormulaHarberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{\epsilon}_{Dt}$ -0.021-0.021-0.021-0.021-0.021-0.021-0.021Implicit colspan="2">Implicit colspan="2">-0.021 <td>Implied estimate of $v_q/(J\epsilon_{ms})$</td> <td></td> <td>0.070</td> <td></td>	Implied estimate of $v_q/(J\epsilon_{ms})$		0.070	
Implied estimate of v_q/J 0.051 $(v_q/J = 0$ is perfect competition, $v_q/J = 1$ is perfect collusion)0.051 $\frac{\text{Tax salience:}}{\text{Tax salience parameter, } \theta_{\tau}}$ 0.305 $\text{Tax salience parameter, } \theta_{\tau}$ 0.305Heterogeneity in θ_{τ} , $(1/p) \operatorname{Var}(\theta_{\tau})$ 0.0000.062Panel B: Incidence and Marginal Excess Burden FormulasIncidence (1) $I = (dCS/d\tau)/(dPS/d\tau)$ 21.48321.58821.842 $= (\rho_t(1+\tau) + (1-\theta_t)\tau\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)\operatorname{Var}(\theta_t)) / ((1-\nu/J)(1-\rho_t)+(\nu/J)\theta_t(1+\tau\rho_t))$ 21.48321.58821.842Marginal Excess Burden $(d\tilde{W}/d\tau)$ $d\tilde{W}/d\tau = ((p-mc)/p + \theta_t\tau)\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)\operatorname{Var}(\theta_t)$ -0.021 -0.026 -0.037 Panel C: Decomposition of the Deviation Between General Formula and Harberger FormulaHarberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau\tilde{\epsilon}_{D\tau}$ -0.021 -0.021 -0.021 Imperfect salience only, $d\tilde{W}/d\tau = \theta_t \tilde{\pi}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)\operatorname{Var}(\theta_t)$	Implied markup (<i>p</i> - <i>mc</i>)/ <i>p</i>		0.037	
$(v_q/J = 0 \text{ is perfect competition}, v_q/J = 1 \text{ is perfect collusion})$ $\frac{\text{Tax salience:}}{\text{Tax salience parameter}, \theta_{\tau}} 0.305$ $\text{Heterogeneity in } \theta_{\tau}, (1/p) \text{Var}(\theta_{\tau}) 0.000 0.062 0.212$ $\text{Panel B: Incidence and Marginal Excess Burden Formulas}$ $\frac{\text{Incidence (I)}}{I = (d\text{CS}/d\tau)/(d\text{PS}/d\tau)} 21.483 21.588 21.842$ $= (\rho_t(1+\tau) + (1-\theta_t)\tau\tilde{\epsilon}_{D_t} - \tau(1+\tau)\tilde{\epsilon}_D(1/p) \text{Var}(\theta_t)) / ((1-\nu/J)(1-\rho_t) + (\nu/J)\theta_t(1+\tau\rho_t))$ $\frac{\text{Marginal Excess Burden (d\tilde{W}/d\tau)}}{d\tilde{W}/d\tau = ((p-mc)/p + \theta_t\tau)\tilde{\epsilon}_{D_t} - \tau(1+\tau)\tilde{\epsilon}_D(1/p) \text{Var}(\theta_t)} - 0.021 - 0.026 - 0.037$ $\text{Panel C: Decomposition of the Deviation Between General Formula and Harberger Formula}$ $\text{Harberger formula (assuming perfect competition and full salience), } d\tilde{W}/d\tau = \tau\tilde{\epsilon}_{D\tau} - 0.021 - 0.021 - 0.021 - 0.021$ $\text{Imperfect salience only, } d\tilde{W}/d\tau = \theta_t\tau\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p) \text{Var}(\theta_t) - 0.026$	Implied estimate of v_q / J		0.051	
Tax salience:Tax salience parameter, θ_{τ} 0.305Heterogeneity in θ_{τ} , $(1/p) Var(\theta_{\tau})$ 0.0000.0620.212Panel B: Incidence and Marginal Excess Burden FormulasIncidence (I) $I = (dCS/d\tau)/(dPS/d\tau)$ 21.483 21.588 21.842 $= (\rho_{\tau}(1+\tau) + (1-\theta_{\tau})\tau\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p) Var(\theta_{\tau})) / ((1-\nu/J)(1-\rho_{\tau})+(\nu/J)\theta_{\tau}(1+\tau\rho_{\tau}))$ 21.483 21.588 21.842 Marginal Excess Burden $(d\tilde{W}/d\tau)$ $d\tilde{W}/d\tau = ((p-mc)/p + \theta_{\tau}\tau)\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p) Var(\theta_{\tau})$ -0.021 -0.026 -0.037 Panel C: Decomposition of the Deviation Between General Formula and Harberger FormulaHarberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau\tilde{\epsilon}_{D\tau}$ -0.021 -0.021 -0.021 Imperfect salience only, $d\tilde{W}/d\tau = \theta_{\tau}\tilde{\tau}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p) Var(\theta_{\tau})$	$(v_q/J = 0 \text{ is perfect competition}, v_q/J = 1 \text{ is perfect collusion})$			
Tax salience parameter, θ_{τ} 0.305Heterogeneity in θ_{τ} , $(1/p) Var(\theta_{\tau})$ 0.0000.0620.212Panel B: Incidence and Marginal Excess Burden FormulasIncidence (I) $I \equiv (dCS/d\tau)/(dPS/d\tau)$ 21.48321.58821.842 $= (\rho_{\tau}(1+\tau) + (1-\theta_{\tau})\tilde{\tau}\epsilon_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p) Var(\theta_{\tau})) / ((1-\nu/J)(1-\rho_{\tau})+(\nu/J)\theta_{\tau}(1+\tau\rho_{\tau}))$ 21.48321.58821.842Marginal Excess Burden $(d\tilde{W}/d\tau)$ $d\tilde{W}/d\tau = ((p-mc)/p + \theta_{\tau}\tau)\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p) Var(\theta_{\tau})$ -0.021 -0.026 -0.037 Panel C: Decomposition of the Deviation Between General Formula and Harberger FormulaHarberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{\epsilon}_{D\tau}$ -0.021 -0.021 -0.021 Imperfect salience only, $d\tilde{W}/d\tau = \theta_{\tau} \tilde{\tau} \tilde{\epsilon}_{D\tau} - \tau(1+\tau) \tilde{\epsilon}_D(1/p) Var(\theta_{\tau})$ -0.006 -0.011 -0.022	Tax salience:			
Heterogeneity in θ_{τ} , $(1/p) \operatorname{Var}(\theta_{\tau})$ 0.000 0.062 0.212 Panel B: Incidence and Marginal Excess Burden Formulas $\frac{\operatorname{Incidence}(I)}{I \equiv (d\operatorname{CS}/d\tau)/(d\operatorname{PS}/d\tau)} 21.483 21.588 21.842$ $= (\rho_t(1+\tau) + (1-\theta_t)\tilde{\epsilon}_{D_t} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p) \operatorname{Var}(\theta_t)) / ((1-\nu/J)(1-\rho_t) + (\nu/J)\theta_t(1+\tau\rho_t))$ $\frac{\operatorname{Marginal Excess Burden}(d\tilde{W}/d\tau)}{d\tilde{W}/d\tau} = ((p-mc)/p + \theta_t\tau)\tilde{\epsilon}_{D_t} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p) \operatorname{Var}(\theta_t)$ $-0.021 - 0.026 - 0.037$ Panel C: Decomposition of the Deviation Between General Formula and Harberger Formula Harberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{\epsilon}_{D\tau}$ $-0.021 - 0.021 - 0.021 - 0.021$ Imperfect salience only, $d\tilde{W}/d\tau = \theta_t \tau \tilde{\epsilon}_{D\tau} - \tau(1+\tau) \tilde{\epsilon}_{D}(1/p) \operatorname{Var}(\theta_t)$ $-0.006 - 0.011 - 0.022$	Tax salience parameter, θ_{τ}		0.305	
Panel B: Incidence and Marginal Excess Burden FormulasIncidence (I) $I \equiv (dCS/d\tau)/(dPS/d\tau)$ 21.483 21.588 21.842 $= (\rho_t(1+\tau) + (1-\theta_t)\tau\tilde{\epsilon}_{D_t} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)Var(\theta_t)) / ((1-\nu/J)(1-\rho_t)+(\nu/J)\theta_t(1+\tau\rho_t))$ 21.483 21.588 21.842 Marginal Excess Burden $(d\tilde{W}/d\tau)$ $d\tilde{W}/d\tau = ((p-mc)/p + \theta_t\tau)\tilde{\epsilon}_D\tau - \tau(1+\tau)\tilde{\epsilon}_D(1/p)Var(\theta_t)$ -0.021 -0.026 -0.037 Panel C: Decomposition of the Deviation Between General Formula and Harberger FormulaHarberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau\tilde{\epsilon}_{D\tau}$ -0.021 -0.021 -0.021 Imperfect salience only, $d\tilde{W}/d\tau = \theta_t \tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)Var(\theta_t)$ Output	Heterogeneity in θ_{τ} , $(1/p)$ Var (θ_{τ})	0.000	0.062	0.212
$\frac{\text{Incidence }(I)}{I = (d\text{CS}/d\tau)/(d\text{PS}/d\tau)} 21.483 21.588 21.842$ $= (\rho_{t}(1+\tau) + (1-\theta_{t})\tilde{\epsilon}_{D_{t}} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\text{Var}(\theta_{t})) / ((1-\nu/J)(1-\rho_{t})+(\nu/J)\theta_{t}(1+\tau\rho_{t}))$ $\frac{\text{Marginal Excess Burden }(d\tilde{W}/d\tau)}{d\tilde{W}/d\tau = ((p-mc)/p + \theta_{\tau}\tau)\tilde{\epsilon}_{D_{\tau}} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\text{Var}(\theta_{\tau})} - 0.021 - 0.026 - 0.037$ $\text{Panel C: Decomposition of the Deviation Between General Formula and Harberger Formula}$ $\text{Harberger formula (assuming perfect competition and full salience), } d\tilde{W}/d\tau = \tilde{\tau}\tilde{\epsilon}_{D\tau} - 0.021 - 0.021 - 0.021 - 0.021 - 0.021$ $\text{Imperfect salience only, } d\tilde{W}/d\tau = \theta_{\tau}\tilde{\tau}\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\text{Var}(\theta_{\tau}) - 0.006 - 0.011 - 0.022$	Panel B: Incidence and Marginal Excess Burden Formu	las		
$\frac{\operatorname{Interdence}(T)}{I \equiv (d\operatorname{CS}/d\tau)/(d\operatorname{PS}/d\tau)} = \frac{21.483}{21.588} = 21.842$ $= (\rho_{\tau}(1+\tau) + (1-\theta_{\tau})\tau\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau})) / ((1-\nu/J)(1-\rho_{\tau}) + (\nu/J)\theta_{\tau}(1+\tau\rho_{\tau}))$ $\frac{\operatorname{Marginal}\operatorname{Excess}\operatorname{Burden}(d\tilde{W}/d\tau)}{d\tilde{W}/d\tau} = ((p-mc)/p + \theta_{\tau}\tau)\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau}) - 0.021 - 0.026 - 0.037$ $\operatorname{Panel} \operatorname{C:} \operatorname{Decomposition} \operatorname{of} \operatorname{the} \operatorname{Deviation} \operatorname{Between} \operatorname{General} \operatorname{Formula} \operatorname{and} \operatorname{Harberger} \operatorname{Formula}$ $\operatorname{Harberger} \operatorname{formula}(\operatorname{assuming} \operatorname{perfect} \operatorname{competition} \operatorname{and} \operatorname{full} \operatorname{salience}), d\tilde{W}/d\tau = \tau\tilde{\epsilon}_{D\tau} - 0.021 - 0.021 - 0.021 - 0.021$ $\operatorname{Imperfect} \operatorname{salience} \operatorname{only}, d\tilde{W}/d\tau = \theta_{\tau}\tau\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau}) - 0.026 - 0.011 - 0.022$	Incidence (I)			
$= (\mu c) dt(f) (dt b) dt(f) = 21.0000 = 21.00000 = 21.00000 = 21.000000 = 21.0000 = 21$	$I = (dCS/d\tau)/(dPS/d\tau)$	21 483	21 588	21 842
Marginal Excess Burden $(d\tilde{W}/d\tau)$ $d\tilde{W}/d\tau = ((p-mc)/p + \theta_{\tau}\tau)\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)$ Var (θ_{τ}) Panel C: Decomposition of the Deviation Between General Formula and Harberger FormulaHarberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau\tilde{\epsilon}_{D\tau}$ -0.021-0.022	$= (\rho_{\tau}(1+\tau) + (1-\theta_{\tau})\tau\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau})) / ((1-\nu/J)(1-\rho_{\tau}) + (\nu/J)\theta_{\tau}(1+\tau\rho_{\tau}))$	21.105	21.500	21.012
$d\tilde{W}/d\tau = ((p-mc)/p + \theta_{\tau}\tau)\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p) \operatorname{Var}(\theta_{\tau}) -0.021 -0.026 -0.037$ Panel C: Decomposition of the Deviation Between General Formula and Harberger Formula Harberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau\tilde{\epsilon}_{D\tau}$ -0.021 -0.021 -0.021 -0.021 Imperfect salience only, $d\tilde{W}/d\tau = \theta_{\tau}\tau\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p) \operatorname{Var}(\theta_{\tau})$ -0.006 -0.011 -0.022	<u>Marginal Excess Burden $(d\tilde{W}/d\tau)$</u>			
Panel C: Decomposition of the Deviation Between General Formula and Harberger Formula Harberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{\epsilon}_{D\tau}$ -0.021 -0.021 -0.021 -0.021 Imperfect salience only, $d\tilde{W}/d\tau = \theta_{\tau} \tau \tilde{\epsilon}_{D\tau} - \tau (1+\tau) \tilde{\epsilon}_D (1/p) \operatorname{Var}(\theta_{\tau})$ -0.006 -0.011 -0.022	$d\tilde{W}/d\tau = ((p-mc)/p + \theta_{\tau}\tau)\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_{D}(1/p)\operatorname{Var}(\theta_{\tau})$	-0.021	-0.026	-0.037
Harberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tilde{\tau}\epsilon_{D\tau}$ -0.021 -0.021 -0.021 Imperfect salience only, $d\tilde{W}/d\tau = \theta_{\tau}\tilde{\tau}\epsilon_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)$ Var (θ_{τ}) -0.006 -0.011 -0.022	Panel C: Decomposition of the Deviation Between General Formula and	Harberger F	ormula	
Imperfect salience only, $d\tilde{W}/d\tau = \theta_{\tau}\tilde{\tau}\epsilon_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)\operatorname{Var}(\theta_{\tau})$ -0.006 -0.011 -0.022	Harberger formula (assuming perfect competition and full salience), $d\tilde{W}/d\tau = \tau \tilde{\epsilon}_{D\tau}$	-0.021	-0.021	-0.021
	Imperfect salience only, $d\tilde{W}/d\tau = \theta_{\tau}\tilde{\epsilon}_{D\tau} - \tau(1+\tau)\tilde{\epsilon}_D(1/p)\operatorname{Var}(\theta_{\tau})$	-0.006	-0.011	-0.022
Decomposition of deviation (as % of difference b/w Harberger and general formula)191% 10%	Decomposition of deviation (as % of difference b/w Harberger and general formula)	-	-191%	10%
Imperfect competition only, $d\tilde{W}/d\tau = ((p-mc)/p + \tau)\tilde{\epsilon}_{D\tau}$ -0.035 -0.035 -0.035	Imperfect competition only, $d\tilde{W}/d\tau = ((p-mc)/p + \tau)\tilde{\epsilon}_{D\tau}$	-0.035	-0.035	-0.035
Decomposition of deviation (as % of difference b/w Harberger and general formula) - 291% 90%	Decomposition of deviation (as % of difference b/w Harberger and general formula)	-	291%	90%

<u>Notes:</u> This table reports calibrations of the tax incidence and marginal excess burden formulas. The results of these calibrations are shown in Panel B. Panel A presents the value of the input parameters taken from Tables 2 through 4, as well as estimates of intermediate parameters (see main text for details). The average tax rate is based on taxable products alone. Panel C presents a decomposition of the deviation between the general formula calibrated in Panel B and a standard Harberger analysis. In column (1), we assume no heterogeneity in salience across consumers; in column (2) we allow for heterogeneity in the tax salience parameter by calibrating the variance of $\theta \tau$ using the estimate reported in Table 4. In column (3), we consider the special case of consumers being either fully attentive or fully inattentive to taxes. Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.

Appendix Figures



Figure A.1: Pass-Through and Tax Salience in Monopoly

<u>Notes</u>: This self-made figure shows that if the Marginal Revenue (MR) curve is flatter than the inverse demand curve, such as when $P(Q) = Q^{-1/\epsilon}$ for $\epsilon > 1$, then for $\theta_1 > \theta_0$, we have that $\theta_1 \Delta t > \theta_0 \Delta t$, which implies that $\Delta p/\Delta t$ will be higher if taxes are more salient.



Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.



Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.





Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.



Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.



Figure A.6: Number of Changes in Sales Tax Rates Number of Sales Tax Rate Changes (State+County), 2006 Q1 to 2014 Q4

Data on sales taxes collected from a variety of sources listed in Appendix Table A.2, price and expenditure data from Nielsen RMS and HMS.