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Price increasing tax reductions for electronic newspapers: Implications for State aid policy

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Outline

- January 2016: ESA declared a zero VAT rate for electronic news services in Norway to be aid that is compatible
- A crucial assumption: following a decrease of the VAT rate on electronic newspapers, prices would decrease
- This would lead to a higher consumption of news, and thus promoting media pluralism as a prerequisite for freedom of expression and democracy (aim of aid)
- Yet, an emerging economics literature on the impacts of taxation in two-sided markets suggests that reader prices might actually increase if the VAT rate falls
- That questions the ESA's decision on compatibility
- "Action Plan on VAT": consequences for the new VAT Directive?

Norway, EU and the VAT Directive

- Norway is a Contracting Party to the EEA Agreement, but not a Member of the EU
- The competition (and State aid) policy regime is substantially equivalent to that of the EU
- EFTA Surveillance Authority (ESA) ≈ the European Commission
- In the EU, the 2006 VAT Directive - harmonization
- Norway is not restrained by the VAT Directive, but its VAT system is largely based on the same principles
- In Europe printed newspaper prices often benefit from zero (or at least lower) VAT ratings, BUT NOT ELECTRONIC
- Books v e-books…

Media policy objectives in Norway

- The so-called "infrastructure requirement" in the Norwegian Constitution (section 100, paragraph 6):

"It is incumbent upon the state government to create conditions that facilitate an open and enlightened public discourse".

- The current government:

"The main responsibility of the state on the media field is to **promote freedom of speech and democracy** by **facilitating an open and enlightened public debate**, cf. section 100 of the Norwegian Constitution. The main goal of the Government's media policy for editorial media is therefore to **promote good news production** and a **broad and enlightened public discourse in the digital media society of the future**. This shall be achieved by **stimulating an innovative and competitive media industry** and a **diversity of news- and current affairs media** characterized by **high quality and independent journalism, including a strong public service broadcaster**."

Media policy in Norway

Current schemes of direct grants for Norwegian news and current affairs media:

(the new budget proposal reduces state aid to the media sector)

- The production grant for news and current affairs media 308 NOK mill
- The production grant for Sami newspapers 25 mill NOK
- The production grant for weekly and monthly niche publications 14.6 mill NOK
- Distribution aid for newspapers in Finnmark 2 mill NOK
- The project grant for local broadcasting 13.5 mill NOK
- The license fee for the public service broadcaster (NRK) is NOK 2.552 per household

Zero-rated VAT on newspapers

- The general VAT rate is 25 percent of the net price (taxable base)
- Certain goods and services are levied at a reduced rate
- Zero rate on newspapers since the VAT introduced to Norway (1970)
- It applies only to news on paper (newsprint), i.e. **electronic news is not entitled to zero rating**
- Justification: Norwegian is a small language, **promoting media pluralism as a prerequisite for freedom of expression and democracy**.

Zero-rated VAT on newspapers - conditions

- Published at least once a week
- Informs the public about news and current affairs home or abroad
- Has a responsible editor
- Charges payment for the paper.

Media sector in change

- **Newspaper circulations have fallen** while the digitization of the news media services has increased
- Thus, a larger share of the news consumption falls **outside of the scope of the zero rated VAT**
- Reduced demand and use of news services with **negative effects on public debate and democracy**
- **Distortion of competition** between different distribution platforms
- **Obstacles for development** of digital news media services
- **Non-news competitors** and global actors like **Google** and **Facebook** take an increasing share of total ad spending

Solution?

- October 2009, the Norwegian Ministry of Culture appointed the Media Grant Committee, which was given the mandate to review the use of financial support instruments for the media
- The Committee submitted its recommendation in December 2010
- The Committee therefore recommended adapting government instruments, including the production grant for newspapers and the VAT system, to the emerging digital media landscape
- Norway notified the measure with ESA
- ESA approved it as compatible aid

ESA's decision on the zero VAT rate

The "electronic news services" – eligible criteria:

1. mainly include news and current affairs content from different areas of society;
2. have the general public as target audience;
3. have an editor in chief;
4. are published at least once a week.

State aid rules in a nutshell (1)

A state measure qualifies as aid if the following **five cumulative conditions** are met (Article 107(1) TFEU/Article 61(1) EEA)

1) transfer of public resources,
2) grant of an economic advantage,
3) **selectivity**,
4) **distortion, or a threat of distortion of competition**, and
5) an effect on trade between the Member States (Contracting Parties).

- Only **undertakings** may benefit from aid

State aid rules in a nutshell (2)

7 Common and cumulative conditions to declare aid compatible:

1. contribution to a well-defined objective of common interest;
2. need for state intervention;
3. appropriateness of State aid as a policy instrument;
4. **existence of an incentive effect**;
5. proportionality of the aid amount (aid limited to minimum necessary);
6. avoidance of undue negative effects on competition and trade;
7. transparency.

an incentive effect

- Aid **beneficiary** must **change its behaviour** in line with the objective sought
- **Beneficiaries** in the VAT case:

❑ the direct beneficiaries - the consumers of electronic news service, mostly private individuals

❑ potential aid to undertakings that purchase electronic news services - any undertaking would be able to benefit

❑ **The only beneficiary that may be identified - media companies that sell electronic news services.** ESA stated that they might benefit indirectly from the zero VAT rate due to an increase in demand for their services, which results in higher revenues.

ESA's conclusions

- The **support of consumption of news media** (to increase the demand for news services, political debate, media pluralism) is the **objective** of the measure
- **Lower prices of electronic news** would lead to **higher consumption**
- **Higher prices would decrease the consumption**
- It relied on the arguments and reasoning as they were presented by the Norwegian authorities

while

Economics literature on the impacts of taxation in two-sided markets suggests that …

reader prices might actually increase if the VAT rate falls.

?

Theory vs a stark example

- Economic theory on the impact of indirect taxes on prices in "normal" markets has been pretty clear cut for hundreds of years
  - Tax increases lead to price increases, although
  - Precise amounts depend on market conditions, but
  - The higher the tax – the higher the price

- So what's so different now?
  - Our understanding of two-sided markets
  - Digitisation

A two-sided market

- Media firms are a prominent or typical example of **a two-sided market**
- They sell content to readers and advertising space to advertisers
- The demand for ads in a newspaper is increasing in the number of readers – a key aspect of two-sided markets

With very low marginal costs

1. Electronic newspapers have an **extremely low marginal cost**. Thus, unlike printed newspapers, the **cost of reaching an extra online reader is essentially zero.**

A stark example

- Two-sided platforms have a valuable possibility to respond to asymmetric ad valorem tax changes
- If a platform firm faces an increased VAT on readers, it **"can reduce its tax burden by shifting revenue to the side of the market where the tax rate is unchanged"** (Kind and Moen, 2014)
- Advertisers will pay more for an advert when it is seen by more readers
- What if there was a really large VAT increase on readers?
- An electronic newspaper may set its price to zero and, make no profit on its readers, but make profit from adverts

3 steps to understand the intuition

1. Imagine a price setting electronic newspaper is prohibited from placing adverts.
   - This newspaper will maximise his profit by setting the reader price such that marginal revenue (MR) equals marginal cost (MC)
   - Marginal revenue has two components - an inframarginal effect and a quantity effect
   - Its marginal cost is zero
   - So the firm will set price such that the inframarginal effect of any price change will exactly be offset by the quantity effect

   - At this price – a very small price decrease would have no impact on profit. The negative effect on revenues from infra-marginal readers would exactly offset the increased (reader market) revenue from new readers

3 steps to understand the intuition

2. Now imagine that the prohibition on ads is lifted.

- Advertisers want their ad to be seen as many readers as possible.
- They will pay more for an ad seen by more readers
- What does this mean for the newspapers optimal price?
  - The two previous effects are still there
  - But there is an additional new quantity effect – not only do new readers generate additional reader market revenues they also generate additional advertising market revenues
  - Consider a very small price reduction from the level which maximises reader market profit.
  - We know that the reduction of revenues from inframarginal readers will be exactly offset by the increased reader market revenues from new readers. But the price decrease will also increase ad revenues, as there are now more readers. So this price decrease is profitable

3 steps to understand the intuition

- So introducing the ad market led to the newspaper sacrificing some reader market profit in order to achieve a larger gain in advertising profit

- The more valuable the advertising market the less important reader market profits are for the firm and the lower the price will be

3 steps to understand the intuition

3. Now imagine that a VAT on reader market prices is introduced

   - A fraction of the reader price now goes to the Govt. not the newspaper
   - This makes the reader market less attractive than before – and the ad market is unaffected.
   - The opportunity cost of advertising profits is now reduced so it will further reduce the reader price.

Further reading…

- This mechanism is now an established part of the economics literature

	M	PC	HD	VD	dU/da	Multi	Asym
Kind, Koethenbuerger, Schjelderup (J. Pub. Econ 2008)	✓	✓			✓		
Kind, Koethenbuerger, Schjelderup (Oxford Econ Papers 2010)	✓		✓		✓		
Kind, Schjelderup, Stahler (Economica 2012)			✓	✓			
Foros, Kind, Wyndham (In progress)			~	~		✓	✓

- Marginal costs matter – ambiguous findings for printed newspapers

Additional issues we raise…

- Media publishers as **indirect beneficiaries**?
- Will the reduction in VAT primarily benefit the **consumer**?
- Has the measure contributed to removing (at least partially) **competition distortion**?
- Wider implications for European policymakers

European VAT rates for newspapers

VAT rates 1/8/2016	BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV
printed books	6	20	10	25	7	9	0	6	4	5.5	5	4	5	12
e-books	21	20	21	25	19	20	23	23	21	5.5	25	4	19	21
VAT rate differential (percentage points)	15	0	11	0	12	11	23	17	17	0	20	0	14	9
	BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV
printed newspapers	0	20	15	0	7	9	9	6	4	2.1	5	4	5	12
e-newspapers	21	20	21	25	19	20	23	23	21	2.1	25	4	19	21
VAT rate differential (percentage points)	21	0	6	25	12	11	14	17	17	0	20	0	14	9

VAT rates 1/8/2016	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	UK
printed books	9	3	5	5	6	10	5	6	5	9.5	10	10	6	0
e-books	21	17	27	18	21	20	23	23	20	22	20	24	25	20
VAT rate differential (percentage points)	12	14	22	13	15	10	18	17	15	12.5	10	14	19	20
	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	UK
printed newspapers	9	3	5	5	6	10	8	6	5	9.5	20	10	6	0
e-newspapers	21	17	27	18	21	20	23	23	20	22	20	24	25	20
VAT rate differential (percentage points)	12	14	22	13	15	10	15	17	15	12.5	0	14	19	20

Thank you for your attention