Abstract:

Increases in consumption tax rates are a major political issue in New Zealand and around the world. While economic theory is generally favorable towards consumption taxation, increases in the rate of consumption tax have the potential to induce short-term macroeconomic disruptions as a result of intertemporal substitution, as well as depress household consumption over the long-run. In this paper, I examine the impact of increases in New Zealand's Goods and Services Tax (GST) on retail sales. I find that the October 1986 GST implementation and July 1989 GST rate increase induced significant amounts of intertemporal substitution, while the intertemporal substitution response for the recent October 2010 GST rate increase was muted, despite the fact that the rate increase was comparable in size to the July 1989 rate increase. I also provide evidence that the July 1989 rate increase, which was uncompensated, reduced quarterly retail sales by over two percent, while the 1986 GST implementation and October 2010 rate increase, which were compensated, had no long-run impact on sales. I conclude with a discussion of possible explanations for the muted intertemporal substitution response prior to the October 2010 rate increase.