

Box A: Transitional Effects on Demand of the GST: the Canadian, Japanese and New Zealand Experiences

Canada, Japan and New Zealand are three countries that have relatively recently introduced GST-type taxes as part of a broad-ranging reform of the taxation system.¹ In all of these countries, as in Australia, the introduction of the GST coincided with a reduction in other indirect tax rates, so the prices of some goods were expected to rise, while others were expected to fall. In each case, however, these reforms were expected to lead to a once-off rise in the aggregate price level. Economic conditions at the time these tax changes were introduced varied across the three countries; conditions were very buoyant in Japan, quite soft in New Zealand and very weak in Canada. In each case, however, there is clear evidence that the introduction of the GST had significant transitional effects on some components of domestic demand. These transitional effects were concentrated in the couple of months immediately before and after the introduction of the new tax.

Although it is often difficult, even with hindsight, to disentangle GST-related effects from underlying trends, these effects appear to be fairly clear in the available data on consumer expenditure for each of these countries. In each case, the aggregate level of retail sales, for example, was significantly boosted in the month or two before the GST was introduced, and was correspondingly weaker in the subsequent two or three months (Graph A1). This effect was particularly pronounced in New Zealand, where the once-off rise in the aggregate price level was expected to be greater than in Canada or Japan because the New Zealand reforms involved the most significant change in taxation arrangements.

This shifting in expenditure was primarily confined to spending on goods; the consumption of services was largely unaffected by the tax changes because it is quite difficult to shift the timing of much of this expenditure. An analysis of retail trade

Table A1: Retail Trade by Store Type
Per cent deviation from moving-average, current prices, monthly data

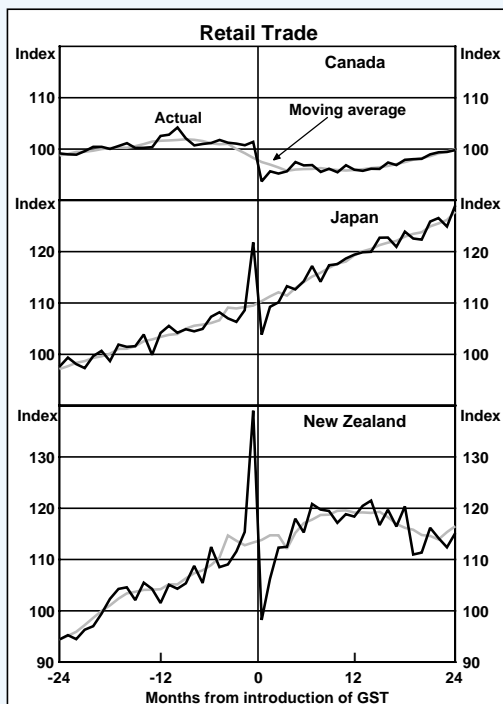
	Japan		Canada		New Zealand	
	Pre-tax Mar 89	Post-tax Apr 89	Pre-tax Dec 90	Post-tax Jan 91	Pre-tax Sep 86	Post-tax Oct 86
Food	2.7	-2.3	0.0	-0.7	8.3	-5.1
Clothing	14.5	-7.6	6.2	-12.3	28.3	-10.3
Furniture and household appliances	21.4	-9.9	18.7	-20.3	54.7	-31.1
Motor vehicles	-3.5 ^(a)	3.5 ^(a)	2.1	-1.4	27.1	-20.1
Other	3.1	-5.4	18.1	-7.4
Total	11.2^(b)	-6.0^(b)	3.0	-4.0	22.9	-13.5

(a) Motor vehicle registrations

(b) Excludes motor vehicle registrations

1. In Canada a 7 per cent goods and services tax (GST) was introduced in January 1991, in Japan a 3 per cent value added tax (VAT) was introduced in April 1989, and in New Zealand a 10 per cent GST was introduced in October 1986.

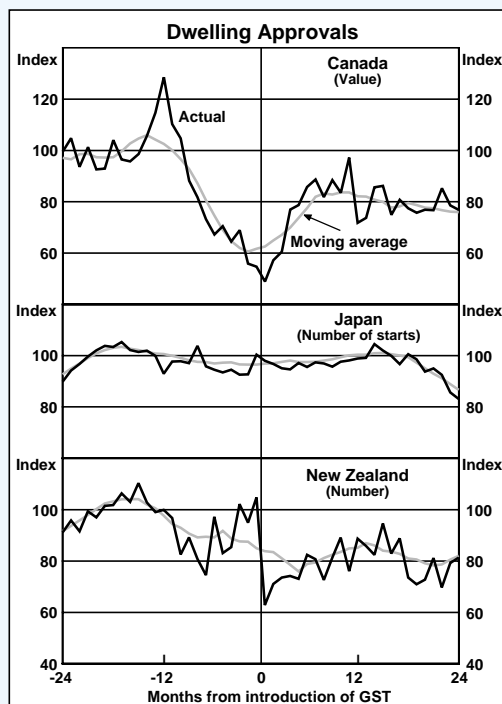
Graph A1



by store type indicates that across types of goods, the shifting of expenditure was greatest for big-ticket durable items such as furniture and household appliances, and most limited for food (Table A1). Interestingly, although motor vehicle prices were expected to remain unchanged in New Zealand on account of the tax changes, spending on motor vehicles was significantly boosted in the month before the GST was introduced. This suggests that consumers may have been confused about the effect the reforms were to have on some prices. In Japan, by contrast, motor vehicle prices were expected to fall and some spending on motor vehicles was postponed.

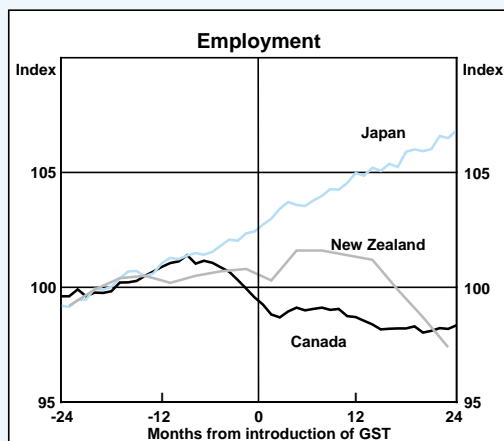
The effect of the introduction of the GST on the timing of dwelling construction activity is more difficult to discern from the available data, in part because these data are inherently more volatile (Graph A2). In Canada and Japan it is hard to establish whether housing-related activity was affected at all by the introduction of the GST. In New Zealand, the number of

Graph A2



dwelling approvals does appear to have been boosted significantly in the six months before the introduction of the GST, with approvals in the following six months being correspondingly weaker. Approvals of alterations and additions behaved in a similar fashion to those of new houses, as did approvals of medium-density dwellings. This bunching of approvals resulted in a significant increase in construction activity in New Zealand in the quarter before the GST was introduced, while activity was weaker than otherwise in the following quarter.

It is difficult to find evidence of the introduction of the GST having a significant effect on the timing of expenditure on most other components of domestic demand or on the aggregate level of employment in these countries. The employment data, in particular, do not appear to have been more volatile than usual around these periods (Graph A3), suggesting that it was widely appreciated that the observed effects on demand were likely to be temporary.

Graph A3

In summary, all of these countries experienced a boost to consumption expenditure in the quarter immediately prior to implementation of the tax, with the effect being broadly reversed in the following quarter. The overall effect on GDP varied quite widely across countries, and depended on the details of the tax reform package being implemented amongst other factors. Employment data, however, were little affected by these tax changes and throughout these transitional periods provided a better guide to the underlying strength of these economies. ✎