

Menu Costs and Information Rigidity: Evidence from the Consumption Tax Hike in Japan

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Abstract

Feldstein (2002) argues that raising consumption taxes generates inflation, based on the assumption that consumption tax hikes are immediately passed through to prices. To test this assumption, I examine firms' price-setting behavior after Japan's consumption tax hike in 2014. I find that tax-excluded prices became less sticky after the tax hike. This finding suggests that firms paid menu costs when changing tax-included prices, which contradicts Feldstein's assumption. This finding is similar to the finding of Hobijn, Ravenna, and Tambalotti (2006) that prices became more flexible after the introduction of the euro. Moreover, I provide evidence for information rigidity.

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Keywords: Unconventional fiscal policy, price stickiness, tax-included and tax-excluded prices, consumption tax pass-through

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