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Modelling Tax-Consumption Relationship: An Empirical Evidence from Asia

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ABSTRACT

This study examines the impact of taxation on consumption behaviour by focusing on selected countries from Asia. The study adopts panel fixed effect and random estimators to gauge the influence of tax on consumption expenditures. Findings of the study support negative influence of tax on household consumption. The finding is parallel with the absolute income hypothesis that high volume of tax collected from the public results in falling households' disposable incomes, hence downwardly affecting households' consumption levels. The study's finding implies the importance of carefully observing an appropriate tax policy that suit the country's level of development in order to promote high rates of economic growth and consumption.

Keywords: Tax revenue; Fiscal policy; Government revenues; Household consumption; Public Economics

INTRODUCTION

Over the past decades, household consumption expenditure remained the largest contributor to GDP for many countries in Asia. According to the World Bank (2017), household consumption expenditures of most selected Asian countries have contributed to more than 50% of GDP from 2012 to 2016. There is a high percentage of contribution of consumption to GDP although some of the countries like Japan and Thailand recorded a decreasing trend in household consumption expenditure. According to the World Bank (2018), consumption expenditure forms the largest component of the aggregate demand for some Asian countries. Consumption plays an important role in the economy since it has a significant effect on economic growth of a country (Kim, 2017). Therefore, this study is carried out to further investigate the nexus between tax revenue and households' consumption patterns in the Asian's region.

The significant contribution of consumption expenditure to GDP in Asia has motivated this study to examine the impact of tax on consumption level since most Asian countries rely heavily on income taxes as the main source of government revenue for decades (The World Bank, 2018). According to Keynes (1936), the propensity to consume is a fairly stable function where the aggregate consumption depends on aggregate income of the household. The consumption expenditures of households rise as their income levels increase. Tax may affect the disposable incomes of households and their purchasing power, thus negatively affecting their aggregate consumption level. A lower tax rate increases the disposable income and spending power of consumers, thus stimulating consumption expenditure as consumers have more money to spend and vice versa. With a lower tax rate, consumption expenditure of household would rise, resulting in an increase in the aggregate demand which promotes a higher economic growth and increases social welfare of a country (Pettinger, 2017).

In recent years, the relationship between tax and consumption expenditure had received growing attention among researchers. Some of the studies were highlighted by Ajibola and Segun (2017), Leka (2015), and Eusebio and Franchesca (2013) who suggested a positive impact of tax on households' consumption expenditure. Other group of researchers namely Varlamova and Larionova (2015), Tamasauskiene and Opulskyte (2012), Baker and Kueng (2016), and Kolahi *et al.* (2016) emphasised on negative relationships between tax and consumption expenditure. These mixed