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The Effect of Tax Structure on Consumption Expenditure in Iran's Economy

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Abstract

In Iran's economy, taxes are the most important and highest source of government income from public sources in the public budget, so that about two-thirds of the government's general income from the public budget are taxes. The structure of taxes consists of five types of taxes, which are collected in the form of direct taxes and indirect taxes, and its amount is predicted and approved in the annual budget laws. In this article, based on the time series in the last 50 years from 1971-2020, the effect of each type of tax on consumption expenditure has been investigated using the dynamic model Auto-Regressive Distributed Lag (ARDL) in Iran. The results of the research indicate that in the short term, each unit change in the tax on consumption of goods and services and imports reduces the consumption expenditure by -1.38 and -2.9 units with an immediate negative effect. Also, in the short term, each unit of personal income tax will reduce consumption expenses by more than -7 units. However, income tax of legal persons and wealth tax have a positive effect on consumption in both time periods. In addition, gross domestic product and gross fixed capital formation also have a positive effect on consumption and consumer spending in the short and long term, Also, consumption has a positive effect during its first lag, but it has a negative effect in the second and third lag. In addition, it shows the ecm pattern or error correction coefficient. If in each period moving towards balance is followed by the error of 100, the imbalance error is adjusted to -/26 in the next period and tends to its equilibrium value in a spiral manner by correcting the error. Also, consumption has a positive effect from the first break.

Keywords: Tax Structure, Consumption Expenditure, ARDL, ECM.

JEL Classification: H20, H30, E21, C22.

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1. Introduction

Tax is one of the most important sources of government income in the annual public budget, which is collected from the society for public services provided by the government to cover public expenses such as education, health, public security, national defense, etc. In fact, tax is a part of income, wealth, sales or part of any type of tax base that is collected by the government from natural and legal persons. Taxes have income, distribution, stabilization and allocation goals. Public decision-making rules describe a set of requirements, taxes and transfers to guide the market system towards the optimum and inevitably affect other variables such as consumption expenditures. The tax structure consists of types of direct taxes, including income tax of natural persons, legal and wealth tax, and indirect tax on the sale of goods and services and imports. Consumption is one of the most important components of the gross domestic product in any country, any change in the components of the gross domestic product affects the income of households through induced consumption expenditures. In 1936, Keynes considered the consumption function as the basic element of income-expenditure to determine national income. Keynes introduced the short-term consumption function. Simon Kuznets showed in 1946 that long-run consumption is a straight line through the origin. In later theories of consumption (Dusenberry, Friedman and Ando Modigliani), consumer behavior is the result of his rational effort to maximize his utility. Consumption tax has an effect on household consumption expenses and thus reduces demand.

2. Research objectives and Methodology

The purpose of this research is to estimate and examine the effect of each component of tax on consumption expenditure during the period of 2010-2019 and seeks to answer and evaluate the hypothesis that the effect of each component of tax on consumption expenditure is positive and Meaningful? And has improved consumption? In order to estimate and analyze the short-term and long-term effects simultaneously, the specification of the model in a linear form and using the dynamic model of Auto - regression Distributed Lag Model (ARDL) is used in econometrics.

The variables used in the model include 8 variables: consumption expenditures (dependent variable), five tax variables, gross domestic product (GDP) and gross fixed capital formation (i). The variables have been checked for stationary using the augmented Dickey-Fuller test and they are all “I(1)”.

3. Conclusion

In the estimation of the model, the number of Lag using the criteria of choosing the Lag, the AIC with maximum of three Lag has been selected. The results show that all the variables have a meaningful effect on the dependent variable (consumption function) in the short term. Consumption expenditure has a positive and meaningful effect from its first Lag and shows that consumption is a function of the consumption of the previous period, as well as GDP and i have a positive effect and They have meaningful on the consumption function, each unit of change in GDP16/. and each unit of change in i in the first Lag 33/. and in the third Lag 65/. The unit improves the consumption function. The increase of tax on consumer goods and services (tc)) and import tax (tm) have an immediate negative effect on consumption 1.38 and 2.9, respectively.the income tax on natural persons in the third Lag has a negative effect of 7.7 units on consumption has it. Also for each unit of income tax on legal persons, the consumption expenditure increases with an immediate positive effect of 1.8 units and in the second Lag 2.2 units. There will be a significant increase in the for of each unit of wealth tax on consumption expenditure.

In the long term, with the exception of tax on the consumption of goods and services (not meaningful), the rest of the explanatory variables have a meaningful effect on consumption and consumption expenditures, so that each unit of change in GDP improves consumption expenditures and consumption by 12.6 percent. Also, each unit of gross fixed capital formation has an effect on improving consumption. Income tax and import have a negative and meaningful impact on consumption and cause a decrease in consumer spending. Income tax of legal persons has a positive effect of 2.7 units on consumption expenditure, and the effect of wealth tax is also positive. Based on the results obtained from -ECM model - errors correction model- in a zigzag manner and a long-term balance is achieved. Therefore, the correctness of the hypothesis in these two tax components is confirmed and accepted.

4. Policy suggestions

-Taxes on goods and services, which have an immediate negative effect on consumer spending in the short term, and import taxes and income of natural persons which have a negative effect on the dependent variable in both time periods, should be reduced. The basis of the research that determines its threshold will be formed.

-The income tax of legal entities and the wealth tax should be increased to the point of balance with the level of consumption and the absence of negative reactions from economic actors.

-The formation of gross fixed capital and its increase means an increase in investment and the prosperity of economic activities and business of the non-governmental sector. Therefore, governmental should provide the necessary platform for the development of the activity of this sector.

5. Ethical Considerations

5.1. Acknowledgments

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5.2. Conflict of interest

The author declares that there is no conflict of interest while observing the publication ethics in referencing.