

Does Demographic Profile Affect Tax Setting Across Regions?: The Indian Case

A K Seth and Ankur Bhatnagar*

This paper attempts to provide conclusive evidence of variations in demand behaviour across regions using National Sample Survey Organisation (NSSO) data for India. India is well-suited for such an exercise as it provides a ready segregation of vast geographical area in the form of different states. The importance of household composition is brought out clearly via its influence on optimal commodity taxes. This is done by recognizing each of the chosen 16 Indian states separately and estimating tax rates for them, while incorporating demographic variables specific to each. The results show considerable variations in not only the estimated tax rates, but also in the demand behavior as revealed by response of tax rates to changes in revenue requirements and changes in a social planner's aversion to inequality. In other words, the estimated tax rates are extremely sensitive to the degree of aversion to inequality and the required revenue; the response of each state to these changing parameters is also non-uniform. Our results reveal that indirect taxes are ineffective in redistributing income in the majority of the states under consideration.

I Introduction

Most recent studies on consumer demand behaviour have outlined the importance of demographic variables and regional effects in shaping demand behaviour. Since the 1980s (see Pollack and Wales, 1980, 1981) considerable literature has been devoted to attempts to specifically capture the role of demographic variables in influencing demand behavior. Such literature has focused on variables like size of a household, age and number of kids in a household, optimal tax rates, formulation of child benefits, optimal government grants, besides other issues. Most of these issues are of importance and relevance in developed nations where subsidies and grants are used by the government as an easy and convenient tool of income redistribution. However, due to a variety of

* Reader, Department of Commerce, Delhi School of Economics, University of Delhi, Delhi 110 007 and Lecturer, Department of Economics, Satyawati College (M), Ashok Vihar, University of Delhi, Delhi 110 052 respectively.