Consumption and Saving Response to a Tax-Subsidized Saving Policy

Date: March 20 (Wednesday), 2019  
Time: 2 – 3:30 pm  
Venue: WLB 918  
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Convener: Weiqiang Tan, Dept of FDS

Abstract

To incentivize households to increase private savings, the Indian government implemented in July 2014 a new tax-subsidized saving policy that allowed homeowners to exempt an additional 50,000 INR ($833) of the mortgage principal and interest payments from taxable income. We exploit the exogenous policy change and assess the extent to which households reduce their consumption in order to finance a tax-favored saving instrument using a unique administrative panel data of consumer debit card and credit card spending transactions. We find that about 31% of households with a mortgage increase the principal repayment amount after the policy change; the median annual increase in principal repayment is about US$307, which is about 36.8% of the higher tax exemption limit. We estimate that households with a mortgage reduce their consumption by US$25 (5.2%) per month on average in order to finance the tax-favored saving account. For a one dollar increase in the income tax exemption limit on long-term savings, private saving increases by $0.23 for the treatment group. Relative to annual income, private savings for the treatment group increase by about 1.87% on average.