

# Household consumption analysis in rawalpindi



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## 1. Introduction:

Consumption and production generate economic activities in an economy. Consumption and production go side by side. Consumption creates demand for further production of goods and services. It is not wrong to say that if there is no consumption there is no economic activity in the country. Only the final purchase of goods and services is known as consumption, and every commercial activity is for production purpose. Consumption can be expressed in two ways. In nominal, means the money spent on the purchase of goods and services, and in real, means the deriving of the utility of goods and services for the satisfaction of wants e. g. using up of consumer goods both durables and non durables. Consumption amounts to the biggest part of Pakistan which accounts for 81% of Gross Domestic product in 2013 according to World Bank statistics.

Consumption is also termed as the total spending on goods and services in an economy. The consumption function is used to estimate the proportion of total consumption in an economy. In social sciences, the consumption function is a used to express trend of consumer spending as income of people rising and falling. Consumption function provides an excellent illustration of a typical sequence in the development of the country and standard of living of the people. Bentham (1748) also considered production and its usage as important determinants of an economy. The process of consumption was vital for any system to sustain. Keynes (1936) addresses the theory of consumption, which showed the relationship between consumer income and consumption. According to Keynes, “ People on <https://assignbuster.com/household-consumption-analysis-in-rawalpindi/>

average, have behavior that when their income increase, they spend more, but not as much as their income raises. It is made up of autonomous consumption that was not influenced by current income and induced consumption that was influenced by the economy's income level.

Chow et al. (2001) did a research about the Chinese economy and Chinese entrepreneurs who had grown along with the Chinese economy. This research paper compares and contrasts the consumption habits of low and high income business class and concluded that small businesses incomes are transitory and more unstable hence their consumption is less and they tend to save more on the other hand entrepreneurs who earn more and largely spend on meals, moving from one place to other, private formal education and expensive items as their incomes were permanent and stable over a period of time. Socio-demographic factors, geographic locations of household have significant effects on the tastes and preferences. Similarly, gathering and socializing activities of consumers that were carried out are the second largest expense in their budgets as they need a lot of networking to succeed the business. But low income class spends a larger amount of their income on health issues, education of their masses.

Tai and Tam (1997) discussed the consumption behavior of females that was changing due to the different socio economic factors such as delayed marriage, smaller family size and single parents have lead to changing dynamics of consumer market as a result the consumer preference were changing and consumption pattern of the families.

Siddiquie (1982) analyzed the consumption patterns based on the Engle law in terms of income, household size and number of earners. The study showed that the consumption of food and non-food items was strongly affected by the changes in total expenditures and size of households.

Consumption patterns in Pakistan have been estimated by Burki (1997) using time series data.

By using Almost Ideal Demand System (AIDS) technique and data from 1972-1992 there was an exogenous growth in non durable food items demand irrespective of the movements in their prices and growth. Study focused that the policy makers should focus on own price elasticity to predict impact of taxes.

This study will be developed on the basis of Household Consumption in Rawalpindi. The study will include both cross-sectional and time series data of consumer behavior. Questionnaire will also be developed to address the study beside secondary sources. In this study econometric model will be developed by taking income, age, family size, consumer price index as independent variable and household consumption as dependent variable. Expenditure on food items will be used as a proxy variable.

#### 1. Objective of the study:

The objectives of the study are as follows:

1. To analyze the significance of demographic factors (family size, age) on household consumption expenditure in Rawalpindi.

2. To study empirically the impact of economic factors (income, consumer price index and household consumption expenditure in Rawalpindi)

1. 2Significance of the study:

Consumption is the sole cause and biggest reason due to which all economic activities begins ranging from hiring of services of factors, investing money, constructing factory or building and many more. As if there is no consumption in any society there is no need for activities of any type ranging from running a business or employing somewhere in any capacity. In short it is the consumption so that economies lively exist otherwise not.

Consumption is an important function of income but there are many other factors that influence the consumption pattern there are incidence when two households with same income level may have different consumption pattern due to lifestyle, preference and the stage of life cycle they are in as a household greatly affects the consumption patterns. All these researches try to explore the behavior patterns that are crucial for molding the consumption pattern all these researches have added different key reasons and not a single research as been able to come up with any common behavior traits in the different societies of the world this phenomena indicate that the consumption patterns changing according to society the house hold resides in.

Income is the main component on which the consumption depends. The study will incorporate the causal relationship between household consumption to income and household consumption to consumer price index which is the important and new in this study as compared to the work done

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earlier. This study will be a bird's eye view about every citizen consumption pattern which is affected by macro economic variables and demographic factors.

### 3. Review of Literature:

Thomas (1993). In this paper he tried to find out whether all household members share same preferences or they were dictated by any one member of the household. They came to a conclusion that when income was in hands of females shares of expenditure increases towards housing, education, health, household services and recreation when males were given the budget they tend to spend excess on health, household service and recreation. Education was considered intervening variable for earning hence increase in consumption, so they excluded education from demand function and include it as a valid instrument for total income. The researchers have come to these conclusions by conducting linear and quadratic models on the complied data

Carroll et al. (1994) conducted a research about habit formation that consumption was happened at same level when a household was not enjoying same level of income as it did previously. Secondly they tried to analyze the impact of consumer sentiments on the consumption patterns taking into considerations the various economic variables into account. They ruled out permanent income and pure life cycle hypothesis and stated consumer spending was an unclear measure of uncertainty when uncertainty increased the level of consumption fell down hence leading to precautionary savings.

Fei et al. (2003) conducted a research explaining the fact how children influenced the spending patterns of family and in about 27.8% of families, children's consumption used one third of the family's total income. In 35.6% of families, children's consumption used 40% of the family's total income. In 19.4% of families, children's consumption took one half of the family's income. And in 7.4% of families, children's consumption took over one half of the family's income. Thus in most families, the child's consumption level was higher than the average per capita consumption of the family. He highlighted various factors such as higher education levels for children including extra amounts paid for private education and tutors. Moreover more recreational activities and high end gadgets like mobiles phone, laptops and increased expenses towards health care of the children.

Khan and Dhar (2004) carried out a research on behavioral decision theoretic perspective on hedonic and utilitarian choices and they found out that difference between purchase and consumption of goods and service. The study found out that there was a very thin line which consumer does not even realize and decision making of consumption was merely affected by income, preference and lifestyle of the consumer.

Aydin (2006) carried out the research about the consumption patterns in Turkey's different socio economic classes and found that globalization has led to transformation, reconfiguration and reformulations of class structure and this was leading to social shifts from class based politics to identity politics, ideology to lifestyles and mass production to consumption these forces have fuelled the social change hence leading to emergences of new middle class living a new leisure lifestyle. The research reapproved the fact <https://assignbuster.com/household-consumption-analysis-in-rawalpindi/>

that social class variables had a significant effect on consumption. Income had the strongest positive effect at all the consumption level simultaneously. Education had effected the class differentiation, i. e., the group with higher education had better living standards thus making education important mediating factor. The analysis in this research paper depicted the class structuration results due to interaction income, education levels, and residential location.

. D'orlando(2010) carried out a research to investigate the importance of behavioral principals in micro-foundation of Keynes consumption theory. It was concluded that behavioral instead of maximizing principals can be rightfully considered as possible for micro foundation for Keynes's work. He said there were chances of cross fertilization of Keynesian approach and behavioral sciences in reference to theory consumption function. This research showed that utility maximization was not the major focus Keynes representation of individual's behavior and many subjective factors were included in the consumption theory lastly the traditional aggregate consumption function is immensely based on maximizing agents.

### 3. Methodology:

Variables taken in the study will be both demographic and economic variables which are to be estimated. In this research thesis both time series and cross sectional data will be used. On economic variables including consumer price index, income and expenditure will be taken. Consumer price index data are time series for 2004-2014 (10 years) and data on income, expenditure, family size and age are cross sectional. Interview through



questionnaire will be undertaken from different income groups of the people living in Rawalpindi to gather the data on factors effecting consumption of household. To obtain the estimates of household consumption an Ordinary Least Square method will be used which meets econometric criteria. In this study two equations will be developed, equation one which will shows the consumption of household who belong to low income class while equation two will represents the consumption of household belong to high income class. In the study CPI, will be taken as independent variables which affect the consumption as if there is increase in price level for food and non food items over a period of time it would lead to reduce consumption of the masses as it would lead to reduce the purchasing power of money. The people who can afford to buy more goods before inflation now with the same amount of income they can buy less goods after inflation.

### 3. 1 Data:

The population in this study comprise of the District Rawalpinidi. Data will be collected through questionnaire from different classes of people besides secondary sources available on other variables.

The sample data on the variables will be collected by interviewing different people through questionnaire from the different class of people residing in Rawalpindi and also from secondary sources on monthly basis so that model shall gives true picture regarding the society behavior of the factors affecting consumption.

Generally data has two types in statistics

1) Primary data—first hand data

2) Secondary data—earlier data available

In this study primary data will be used for some demographic feature i. e. age and family size and income. Due to non availability of second hand data on variables like family size and age, and income survey will be conducted in Rawalpindi. The sample will include all the heads of households.

By considering the resource and time constraints, method of ordinary least square will be used for which sampled peoples will be surveyed in the area of district Rawalpindi for the study.

For addressing the issue, a set of few questions will be developed required for the study to be carried out. The study shall be rely both cross section and time series data values. A set of questions will be ask from the respondents to avail the data on demographic features. A questionnaire will be circulated to different groups or sectors including the Public Sector, and Private Sector. The secondary data will be taken from the sources which includes Pakistan Statistical Bureau and from Pakistan Social and Living Measurement regarding the consumer price index variable.

3. 2 Model:

$$CHH = f(Y_L, Y_H, A, FS, CPI)$$

Dependent Variable:

CHH= Average Household Consumption Expenditure (Rs per month)

Independent Variable:

$Y_L$  = lower income class; (Average monthly income less than or equal to Rs 25000)

$Y_H$  = High income class (Average monthly income of more than Rs 25000 and less than or equal to Rs 40000)

CPI= Consumer price index (index to measure inflation on per month basis)

A= Average Age of household (years)

FS= Family Size (No of persons)

On the basis of variables the following equations developed for estimation purpose.

$$CHH_L = \beta_0 + \beta_1 Y_L + \beta_2 FS + \beta_3 A + \beta_4 CPI + \mu_i \text{ Equation 1}$$

$$CHH_H = \beta_0 + \beta_1 Y_H + \beta_2 FS + \beta_3 A + \beta_4 CPI + \mu_i \text{ Equation 2}$$

Where;

$\beta_0$  = Intercept  $\beta_1, \beta_2, \beta_3, \beta_4$ , is the slope co-efficient of the model.

$\mu_i$  = Disturbance term of model.

$i$  = Number of households ( $i \sim 1$  to 120)

### Effects of different variables on household consumption

Parameter Theoretically expected effect

$\beta_{1+/-}$

$\beta_{2+/-}$

$\beta_{3+/-}$

$\beta_{4+/-}$

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