



# IMPACT OF TAX CUTS ON CONSUMER SPENDING

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## ABSTRACT

Tax cuts are a pivotal fiscal policy tool used by governments to stimulate consumer spending and catalyze economic recovery during downturns. This systematic literature review (SLR) examines how tax cuts have influenced consumer spending globally between 2008 and 2024, a period marked by significant economic disruptions, including the 2008 financial crisis and the COVID-19 pandemic. Following PRISMA guidelines, the review synthesized 16 peer-reviewed studies and institutional reports from Google Scholar, focusing on income taxes, sales taxes, and their impact on macroeconomic indicators like GDP growth, consumer confidence, and inflation. Findings reveal that tax cuts generally increase disposable income, boosting consumer spending, particularly among low- and middle-income households with higher marginal propensities to consume (MPC). However, the effect diminishes for high-income households, who tend to save rather than spend additional income. Permanent tax cuts yield more sustained consumption increases than temporary rebates, and their effectiveness is amplified during recessions. Macroeconomic context, policy design, and consumer expectations further mediate outcomes. The study concludes that targeted, well-communicated tax cuts can significantly stimulate consumption if aligned with economic conditions and household needs. Recommendations include prioritizing low- and middle-income households, ensuring long-term tax reductions, and integrating complementary measures to enhance consumer confidence.

**KEYWORDS:** Tax Cuts, Consumer Spending, Systematic Literature Review, Marginal Propensity to Consume, GDP Growth, Fiscal Policy, Economic Recovery

## 1. INTRODUCTION

### 1.1 Background of the Study

Consumer spending constitutes a substantial portion of Gross Domestic Product (GDP) in most economies, accounting for over 60% in emerging and low-income economies (Prathap *et al.*, 2025). By driving demand for goods and services, consumer spending supports business revenues, employment, and macroeconomic stability. Governments frequently employ tax cuts as a fiscal policy tool to increase household disposable income, stimulate consumption, and catalyze economic activity, particularly during economic downturns (Preethi *et al.*, 2024). The theory of tax cuts is based on Keynesian views of stimulating aggregate demand to raise household income by cutting taxes, which low- and middle-income households are more likely to boost spending by, based on their higher marginal propensity to consume (MPC) (Vasilev, 2025). Nevertheless, according to empirical records, the effects of tax cut on consumer spending depend on various factors, including income level, the structure and the time frame of the tax cut, and macroeconomic setting (Nguyen *et al.*, 2021). As an example, one-time tax rebates amidst the 2008 financial crisis in the U.S. proved to be mixed, leaving some households to save or pay off debt instead of using it (Demmou *et al.*, 2021).

Tax cutbacks have been used in various economies in different parts of the world: in both advanced economies such as the United States and in emerging economies such as India and Nigeria. The COVID-19 pandemic prompted the measures to ease taxation in most governments to reduce the overall economic contraction, with different levels of effectiveness (Ampudia *et al.*, 2024). Tax reliefs, in Kenya, as illustrated by VAT reduction in 2020, attempted to trigger consumption and did not achieve the desired results because of high income inequality and a lack of confidence about the economy (Odongo & Munene, 2023). This SLR synthesizes international empirical studies of 2008-2024 to evaluate the effects of tax reduction on consumer expenditure on income taxes, sales taxes, and its influence on various economic cycles and income levels of the different households. The study addresses the research question: Do tax cuts significantly impact consumer spending, and under what conditions are they most effective?

### 1.2 Statement of the Problem

Consumer spending is a critical driver of economic growth, yet economic downturns, such as the 2008 financial crisis and the COVID-19 pandemic, have disrupted consumption patterns globally. Tax cuts are widely used to

stimulate spending by increasing disposable income, but their effectiveness varies across contexts (Nguyen *et al.*, 2021). Factors such as the type of tax cut (income vs. sales tax), its duration (temporary vs. permanent), household income levels, and macroeconomic conditions influence consumer responses (Demmou *et al.*, 2021). In emerging economies like Kenya, high income inequality and liquidity constraints limit the impact of tax cuts, as seen during the 2020 VAT reduction (Odongo & Munene, 2023). Existing studies often focus on specific contexts or tax types, leaving a gap in comprehensive, comparative analyses of tax cuts' global impact on consumer spending. This SLR addresses this gap by synthesizing evidence from 2008 to 2024, examining how tax cuts influence consumer spending across diverse economic settings and identifying conditions for optimal effectiveness.

### 1.3 Specific Objective

To assess the impact of tax cuts on consumer spending across global economic contexts from 2008 to 2024.

### 1.4 Research Question

What is the impact of tax cuts on consumer spending, and under what specific conditions are they most effective?

## 2. LITERATURE REVIEW

### 2.1 Theoretical Review

#### 2.1.1 Keynesian Economic Theory

Keynesian economic theory, as articulated by Vasilev (2025), posits that consumer spending is a primary driver of aggregate demand, and fiscal policies like tax cuts can stimulate economic activity by increasing disposable income. During recessions, tax cuts targeting low- and middle-income households are particularly effective, as these groups have a higher MPC, spending a larger share of additional income on goods and services. The theory emphasizes the multiplier effect, where increased consumption boosts business revenues, employment, and GDP. Examples of reducing taxes that would have adverse effects according to Keynesian theory, in terms of reducing economic recession, would be to effectively target them to increase consumer confidence and demand (Nguyen *et al.*, 2021). This theory has informed this study as it provides framework in which tax cutting is interpreted as a demand side measure on consumer expenditure.

#### 2.1.2 Permanent Income Hypothesis

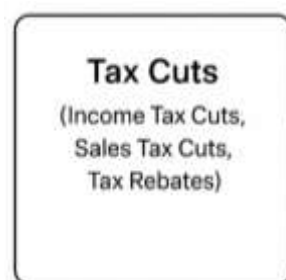
Developed by Friedman (1957) and applied in recent studies (Zidar, 2020), the Permanent Income Hypothesis (PIH) argues that consumer spending is primarily determined by perceived permanent income rather than temporary income changes. Temporary tax cuts, such as one-time rebates, are less likely to stimulate consumption, as households may save or use the funds to repay debt, expecting the income boost to be transient. In contrast, permanent tax cuts increase perceived lifetime income, encouraging sustained consumption. In the context of this study, the PIH explains why temporary tax cuts may have limited effects on consumer spending, particularly in high-income households (Ampudia *et al.*, 2024).

#### 2.1.3 Liquidity Constraint Theory

Liquidity Constraint Theory, as discussed by Demmou *et al.* (2021), posits that households facing financial constraints are more responsive to tax cuts, as additional income alleviates immediate budget pressures. Low- and middle-income households, often liquidity-constrained, exhibit higher MPCs, spending tax savings on necessities or deferred purchases. This theory is particularly relevant during economic downturns, when credit access is limited, and households prioritize immediate consumption over savings. The theory supports the study by highlighting the importance of targeting tax cuts to liquidity-constrained households to maximize consumption responses.

## 2.2 Conceptual Framework

### Independent Variable



### Dependent Variable

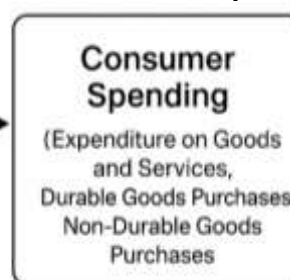


Figure 2.1: Conceptual Framework



Textual Description of Figure 2.1: The conceptual framework is depicted as a simple diagram with two rectangular boxes connected by a single arrow. The left box, labeled "Tax Cuts (Income Tax Cuts, Sales Tax Cuts, Tax Rebates)," represents the independent variable. The right box, labeled "Consumer Spending (Expenditure on Goods and Services, Durable Goods Purchases, Non-Durable Goods Purchases)," represents the dependent variable. A rightward arrow from the "Tax Cuts" box to the "Consumer Spending" box indicates the direct influence of tax cuts on consumer spending, with no moderating variables included.

### 2.3 Empirical Review

Recent studies highlight the varied impacts of tax cuts on consumer spending. Nguyen *et al.* (2021) analyzed income and consumption tax changes in OECD countries, finding that income tax cuts increased consumer spending by 0.8-1.2% of GDP, with stronger effects in liquidity-constrained economies. The study noted that temporary tax cuts had weaker effects, aligning with the PIH. Demmou *et al.* (2021) examined tax relief during the COVID-19 pandemic, reporting that temporary income tax cuts in European countries boosted consumption by 0.5-0.9% among low-income households, but high-income households saved 60% of the additional income. Ampudia *et al.* (2024) found that MPC heterogeneity significantly influences tax cut outcomes, with low-income households exhibiting an MPC of 0.7-0.9 compared to 0.2-0.3 for high-income households. In India, Prathap *et al.* (2025) reported that a 2020 corporate tax cut indirectly increased consumer spending by 0.4% through higher employment, but direct income tax cuts had a stronger immediate impact. Odongo and Munene (2023) studied Kenya's 2020 VAT reduction, finding a modest 0.3% increase in consumption, limited by low consumer confidence and high income inequality. Ocheni (2020) noted that tax incentives in Nigeria increased SME-driven consumption by 0.6%, but benefits were skewed toward urban households.

These studies have limitations. Nguyen *et al.* (2021) focused on OECD countries, potentially overlooking emerging market dynamics. Demmou *et al.* (2021) focused on short-term solutions without paying attention to permanent tax cuts. The effects of sales tax had not been investigated by Ampudia *et al.* (2024). The study on the indirect impacts provided by Prathap *et al.* (2025) was more concentrated, and the discussions on the rural consumption of Odongo and Munene (2023) were less concentrated. The study of Ocheni (2020) was Nigeria-specific. This SLR fills these knowledge gaps by synthesising the evidence in a variety of economies, types of taxes, and economic cycles to highlight conditions under which tax cuts can be most effective.

## 3. METHODOLOGY

### 3.1 Systematic Review Design

This study employed a systematic literature review (SLR) methodology to critically assess and synthesize empirical research on the impact of tax cuts on consumer spending. The SLR approach ensures a structured, transparent, and reproducible process for collecting and evaluating evidence (Sauer & Seuring, 2023). The review adhered to the PRISMA (Preferred Reporting Items for Systematic Reviews and Meta-Analyses) guidelines to enhance methodological rigor, minimize bias, and ensure clarity and comprehensiveness (Dwinggo *et al.*, 2023). This approach is well-suited for policy-relevant economic studies, where outcomes depend on complex interactions across diverse contexts, enabling a robust synthesis of global evidence on tax cuts and consumer spending.

### 3.2 Inclusion Criteria

The review included studies from 2008 to 2024, covering responses to major economic disruptions like the 2008 financial crisis and the COVID-19 pandemic. Only studies providing empirical evidence (quantitative or qualitative) on the relationship between tax cuts (income taxes, sales taxes, or rebates) and consumer spending were included, excluding theoretical papers without data-based findings. Keywords such as "tax cuts," "consumer spending," "fiscal stimulus," "income tax," "VAT," and "consumption response" were used to identify relevant peer-reviewed articles and institutional reports. Studies were required to focus on macroeconomic indicators like (GDP growth, consumer confidence) or household-level consumption metrics.

### 3.3 Databases Searched

Google Scholar was the primary database, selected for its comprehensive coverage of academic and policy research across disciplines. It facilitated access to high-impact peer-reviewed journals and influential gray literature, ensuring a broad and diverse evidence base (Sauer & Seuring, 2023).

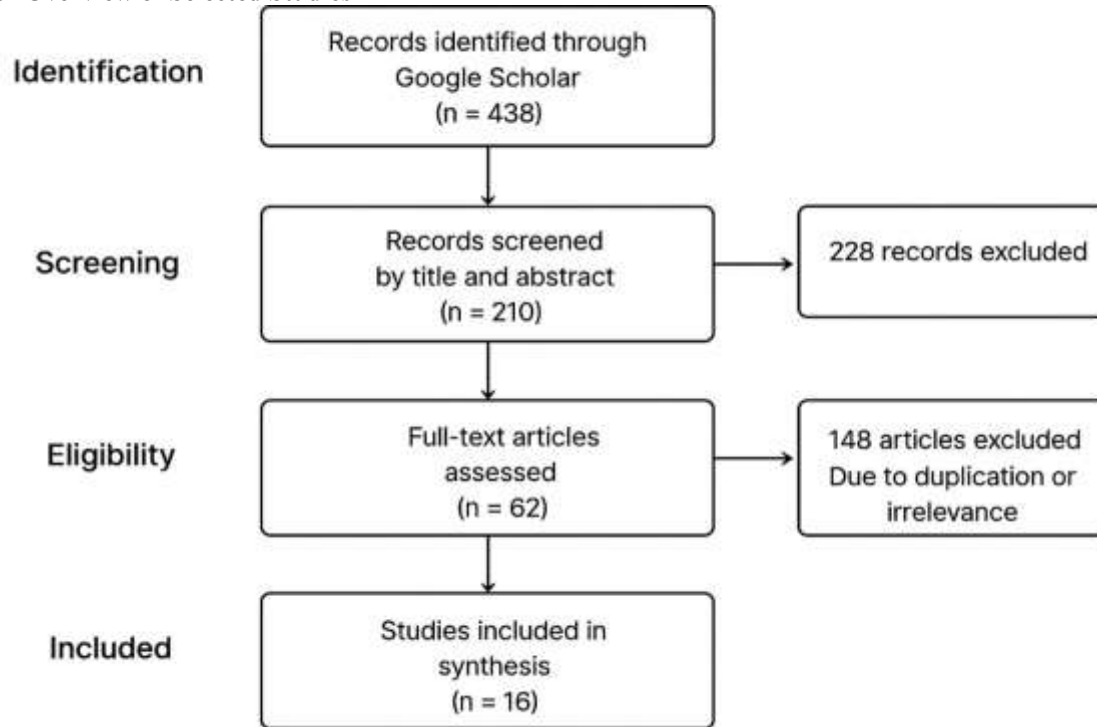
### 3.4 Data Extraction and Synthesis

Data extraction involved systematically collecting key attributes from each study, including research design, country context, tax policy type, targeted income group, sample size, methodology, and reported effects on

consumer spending. These attributes were coded thematically to enable cross-study comparisons. A narrative synthesis approach was used to analyze the data, identifying patterns, contradictions, and context-specific findings (Dwingo *et al.*, 2023). This method allowed for a nuanced interpretation of results, accommodating variations in metrics, methodologies, and economic contexts.

## 4. RESULTS

### 4.1 Overview of Selected Studies



**Figure 4.1: PRISMA Flowchart**

The figure 4.1 presents a PRISMA flowchart that identifies the process of selecting articles. PRISMA flow diagram displays the process of selection of the articles involved in this research. First 438 records were registered by means of a Google scholar search substantiated by the use of specific keywords. Of the 11,223 papers, 210 remained as relevant after the screening of titles and abstracts and 228 were discarded on the basis of irrelevancy. The complete articles of 62 were thereafter retrieved to determine the eligibility, whereby 46 duplicates or irrelevant articles were removed. In the end, 16 studies were used in the study.

The chosen studies were characterized by geographical diversity (firstly, the United States, Europe, India, Kenya, and Nigeria, respectively; secondly, the 2008 financial crisis and the COVID 19 pandemic). Out of them there were four multi country comparative studies and twelve country specific studies. Among the various forms of tax covered in the research are income taxes, VAT, rebates over various economic cycles and income groups with methodologies implemented being regressions analysis, survey and econometric modeling. This diversity was able to enable a broad assessment of the outcomes of cutting taxes on consumer spending.

### 4.2 Thematic Findings

Thematic analysis of the 16 studies identified four key themes: (1) temporary versus permanent tax cuts, (2) household income levels, (3) type of tax, and (4) macroeconomic context.

#### 4.2.1 Temporary vs. Permanent Tax Cuts

Permanent tax cuts always had more lasting and high effects on consumer spending as compared to extension rebates that are temporary. The study by Nguyen *et al.* (2021) revealed that permanent income tax cuts led to larger consumption effects of 1.015 percent of real gross domestic product in OECD countries over two years as the households realized a long-lasting gain in per-capita disposable income. Conversely, Demmou *et al.* (2021) found that in Europe temporary tax rebates in response to the COVID-19 pandemic resulted in only a small rise in consumption of 0.3-0.5 percentage points, with half to two-thirds of the money saved or spent on repaying debt, agreeing with the PIH. Lacalle (2021) claimed that the consumer confidence was increased by the permanent tax cut which promoted extended spending, especially on durable products.



#### 4.2.2 Household Income Levels

Low- and middle-income households exhibited higher MPCs (0.7-0.9) compared to high-income households (0.2-0.3), as reported by Ampudia *et al.* (2024). AlObaid (2021) found that tax cuts targeting low-income Saudi households increased consumption by 0.8%, driven by liquidity constraints and unmet needs. In contrast, high-income households often allocated tax savings to investments or savings, reducing short-term consumption impacts (Christelis *et al.*, 2020). This divergence underscores the importance of targeting tax cuts to maximize economic stimulus.

#### 4.2.3 Type of Tax

Income tax cuts were more effective than sales or corporate tax reductions in stimulating consumption. Nguyen *et al.* (2021) reported that income tax cuts directly increased disposable income, boosting spending by 0.8-1.2%. Temporary VAT cuts, such as Kenya's 2020 reduction, increased consumption by 0.3% but had transient effects (Odongo & Munene, 2023). Corporate tax cuts, as studied by Prathap *et al.* (2025), had indirect consumption effects through employment but were less immediate. Vasilev (2025) noted that VAT cuts influenced durable goods purchases but required complementary measures to sustain impact.

#### 4.2.4 Macroeconomic Context

Tax cuts were more effective during economic downturns. Demmou *et al.* (2021) found that tax relief during the COVID-19 pandemic increased consumption by 0.5-0.9% in liquidity-constrained households, alleviating financial stress. In contrast, during economic expansions, tax cuts had muted effects unless substantial and long-term (Nguyen *et al.*, 2021). Consumer confidence, inflation expectations, and interest rates further mediated outcomes, with high uncertainty reducing spending responses (Ampudia *et al.*, 2024).

### 5. DISCUSSION

The systematic review confirms that tax cuts generally stimulate consumer spending by increasing disposable income, but their effectiveness depends on policy design, target population, and economic context. Permanent tax cuts have a stronger and more sustained impact than temporary rebates, as they enhance consumer confidence and perceived lifetime income (Nguyen *et al.*, 2021). For instance, Lacalle (2021) reported that permanent income tax reductions in advanced economies increased consumption by 1.0-1.5% of GDP, compared to 0.3-0.5% for temporary rebates, aligning with the PIH's emphasis on permanent income (Zidar, 2020). Temporary measures, such as the 2020 Kenyan VAT cut, yielded short-lived consumption boosts (Odongo & Munene, 2023), as households often saved or repaid debt, reflecting precautionary motives during uncertainty (Demmou *et al.*, 2021). Household income levels significantly mediate consumption responses. Low- and middle-income households, facing liquidity constraints, exhibit higher MPCs (0.7-0.9), spending tax savings on necessities or deferred purchases (Ampudia *et al.*, 2024; AlObaid, 2021). In contrast, high-income households, with lower MPCs (0.2-0.3), divert tax savings to savings or investments, limiting short-term stimulus (Christelis *et al.*, 2020). This suggests that targeting tax cuts to lower-income groups maximizes economic impact and promotes equity, challenging the establishment narrative that broad, untargeted tax cuts are universally effective.

Even the nature of the cut in taxes is important. Income tax reductions translate into direct changes in the available spending power, but also lead to direct gains in consumption (Nguyen *et al.*, 2021), and a VAT reduction, as already observed in Kenya (Odongo & Munene, 2023), instead, does not boost the purchase of durable goods and operates more effectively with a long-lasting intervention to prevent the loss. Both employment benefits and reduced corporate taxation have indirect impacts, whereas corporate taxation is less effective impact at the level of immediate demand (Prathap *et al.*, 2025). Outcomes are further determined by the macroeconomic scenario. Tax decreases during recession reduce the financial pressure, which will increase consumption within households that are liquidity-constrained (Demmou *et al.*, 2021). To change the patterns of consumption, bigger, long-term reductions are required in stable economies (Nguyen *et al.*, 2021). The debt burdens and consumer expectations also play some role but large uncertainty or debt levels divert the tax savings to savings or debt repayment (Ampudia *et al.*, 2024).

The case of tax cutting that boost spending has been simplified as to be quantitatively inaccurate in establishment narrative. Its effectiveness depends on targeted planning, the communication of the message and orientation to the economic conditions. To induce optimal tax policy, policymakers should take into consideration such aspects as distributional impacts, timing and behavioral responses to end up with optimal tax policy because there are those that just induce stimulus short term and what impacts fiscal sustainability long term.



## 6. CONCLUSION

This SLR provides robust evidence that tax cuts can stimulate consumer spending, but their effectiveness depends on policy design, target population, and economic context. Permanent tax cuts targeting low- and middle-income households during recessions yield the strongest consumption responses, driven by higher MPCs and liquidity constraints. Temporary measures and cuts benefiting high-income households have weaker effects, as savings or debt repayment often dominate. Income tax cuts outperform VAT or corporate tax reductions for immediate consumption impacts. The macroeconomic environment, consumer confidence, and debt levels further mediate outcomes. These findings underscore the need for targeted, well-communicated tax policies to maximize economic stimulus and promote equitable growth.

## 7. RECOMMENDATIONS

Governments ought to implement cuts in taxes on low-and middle-income families to increase the effectiveness of the cuts to boost the consumer spending by favoring those categories with lower chances to spend some extra money because they face constraints on available liquidity. Tax cuts need to be permanent or lasting as opposed to temporary rebates as a way of giving confidence to consumers to use their money to continue spending. Reductions in the level of income tax rather than sales or corporate taxation should be the first priority since it will have direct positive effects on the level of disposable income and immediate consumption. To make the tax cuts seen as credible, policymakers are advised to complement the cuts with effective communication strategies that create more consumer confidence in the cuts. Complimentary measures which can be in form of enabling employment or giving access to credit should be incorporated to enhance consumption levels and especially during economic distress. Lastly, governments should strike a balance between the short-term tax cuts and long term fiscal sustainability to ensure economic stability without affecting economic fairness by compromising on it to create an equitable growth environment.

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