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The Influence of Economic Policy Uncertainty and Habit Formation on Rural Residents' Consumption

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ABSTRACT

Based on the household survey data of rural residents in 30 provinces (cities, districts) of China from 1995 to 2019, this paper constructs an econometric model of farmers' consumption behavior with habit formation and economic policy uncertainty, and makes an empirical analysis of farmers' consumption behavior by using sys-gmm estimation method. The results show that: since the reform and opening up, the changes of Chinese farmers' consumption behavior not only show excessive sensitivity to income changes on the whole, but also show a significant habit forming effect, and the existence of habit effect will reduce the impact of economic policy uncertainty on consumption; there is a large gap between regions, and the consumption in the western region is affected by the uncertainty of economic policy, the impact is greater. Therefore, the government should pay attention to the impact of economic shock on consumption, maintain the systematicness and stability of the policy, enhance the stability, continuity and accuracy of the policy, drive the development of the western region, build a long-term policy mechanism to promote the sustained and rapid increase of farmers' income, and further change farmers' consumption concept.

1. Introduction

With the accelerating process of reform and opening up, China's economic system reform has achieved remarkable results. Expanding domestic demand, especially the consumption demand of rural residents, has become a hot topic of academic circles and government departments. In the new stage of China's high-quality development, it has become a major task during the "14th five year plan" period to adapt to the general trend of China's consumption upgrading and speed up the release of the consumption potential of 1.4 billion people. On November 18, 2020, the executive meeting of the State Council made a plan on "boosting major consumption and promoting the release of rural consumption potential". Rural consumption is an important part of the consumer market and has great development potential. In 2021, No. 1 central document confirmed that rural construction should be placed in the important position of socialist modernization, and the rural industry, talent, culture, ecology and organization should be promoted in an all-round way, so as to accelerate the modernization of agriculture and rural areas, and speed up the formation of mutual promotion between workers and peasants, mutual complementarity between urban and rural areas,

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and coordinated development. Fernandez Villaverde J[1] and other scholars pointed out that the impact of economic policy uncertainty may lead to the decline of macroeconomic variables such as consumption, output, investment and employment, and this negative relationship is relatively stable. However, the novel coronavirus pneumonia has hitherto unknown impact on consumption, and consumption and key consumption are the first to bear the brunt. Rural consumption has also been greatly affected. As a developing country in the transition of market economy, the frequent changes of government officials, economic reform and macroeconomic regulation and control make the overall level of China's economic policy uncertainty index higher and the fluctuation range larger. Moreover, at this stage, the instability of China's economic growth model of "focusing on investment and export while ignoring consumption" needs to be solved. Therefore, it is particularly important to explore the consumption of rural residents under the condition of economic policy uncertainty.

In order to explore ways to expand residents' consumption, scholars at home and abroad have carried out extensive discussions, in which habit formation is an important perspective. Habit formation reflects residents' preference for current and future consumption, fits the consumption characteristics of rural residents' consumption under the impact of economic policy uncertainty, and is one of the internal causes of residents' consumption change. From a theoretical point of view, the study of economic policy uncertainty and habit formation on rural residents' consumption is an innovation based on previous theories. Starting from the dual perspective of uncertainty and habit formation, the study of rural residents' consumption is a more detailed elaboration of the evolution process of China's rural residents' consumption level and consumption structure, which is conducive to innovation or improvement and has Chinese characteristics The consumption behavior theory of color. In a practical sense, China is a typical country with dual economic structure. The income gap between urban and rural residents is relatively large, which leads to a large gap in the consumption behavior of urban and rural residents. This paper studies the consumption behavior of rural residents from the perspectives of habit formation and uncertainty, and puts forward corresponding policy suggestions according to the results of empirical analysis, which can provide the basis for expanding the consumption demand of residents, and has non important practical significance for promoting the steady and healthy development of rural economy and the realization of Rural Revitalization Strategy.

2. Literature Review and Theoretical Hypothesis

2.1 The Impact of Economic Policy Uncertainty on Rural Residents' Consumption

At present, the mainstream literature at home and abroad generally believes that the judgment and expectation of economic participation institutions and individuals on the current economic situation are inconsistent, which leads to the uncertainty of economic policy. Baker[2] and others defined the uncertainty of economic policy as the economic risk caused by the government's uncertain policy effect in response to the economic environment. By constructing different policy uncertainty indexes, Bonn and Pfeifer[3] confirm that policy uncertainty has a negative impact on economic growth, and this negative relationship is relatively stable. Kim and Kung[4] also confirmed that when faced with uncertainty, enterprises will increase cash holdings, thus reducing investment. The impact of economic policy uncertainty may lead to the decline of macroeconomic variables such as consumption, output, investment and employment. By analyzing the data, Susan Basu[5] found that the impact of uncertainty led to a significant decline in output, consumption, investment and working hours. Therefore, in view of the greater impact of uncertainty on Residents' consumption, reducing uncertainty is of great significance for releasing residents' consumption potential. Cheng Yanran[6] found that under the influence of uncertainty, the consumption behavior of Chinese residents generally shows strong precautionary saving motivation, which has obvious differences between urban and rural areas and regions; but the inhibitory effect of economic uncertainty on investment behavior is only obvious in the central and western regions and the northeast regions. Huang Dongyan[7] uses the relevant data of urban residents' consumption in Hebei Province from 2000 to 2015 to find that the impact of economic policy uncertainty has a certain negative impact on urban residents' consumption in Hebei Province, but the duration is not long; and income has a certain regulatory effect on the impact effect. Relevant research literature shows that macroeconomic uncertainty often has a negative impact on the economy, such as the lack of aggregate demand, the interruption of enterprise capital chain, the lack of liquidity, enterprises will reduce investment or wait-and-see attitude, wait for investment opportunities, or delay investment decisions. Based on the above statements, this paper puts forward the following assumptions:

Hypothesis 1: the uncertainty of economic policy will

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have a negative impact on the consumption of rural residents.

2.2 The Influence of Habit Formation on Rural Residents' Consumption

Scholars at home and abroad have conducted a lot of meaningful research and Discussion on Residents' consumption behavior from the perspective of habit formation theory. The theory of consumption habit formation was put forward by Duesenberry[8]. The hypothesis holds that consumers' current consumption expenditure level will be affected by both current income and past consumption. Kueng and Yakovlev[9] both think that there is obvious habit formation in residents' consumption behavior, which is influenced by past consumption experience and current consumption level. In other words, the habit formation effect of residents is weak in the short term, but strong in the long term. Yang Qi [10] uses the group method to construct "pseudo panel" for GMM estimation, and finds that migrant workers' family consumption has excessive sensitivity to immediate income; because the consumption habit is in the transition from rural residents' consumption mode to urban residents' consumption mode, migrant workers' family consumption has no significant internal habit formation effect, but has significant external habit formation effect. Zang Xuheng[11] studies the dynamic influence mechanism of habit formation on Residents' consumption under the current consumption environment. Facing the impact of external uncertainty, the habit formation characteristics of residents' consumption will reduce their consumption tendency and inhibit its recovery. In the mutual restriction between the two, the consumption tendency of residents will eventually tend to decrease. Wang Xiaohua[12] et al. Constructed an econometric model of farmers' consumption behavior, and found that the changes of Chinese farmers' consumption behavior not only showed excessive sensitivity to income changes on the whole, but also showed significant habit formation effect; both the excessive sensitivity and habit formation effect were greatly different due to the different stages of farmers' income growth rate. Dong Yan[13] constructs the econometric model of household savings model under the habit formation. Starting from the urban-rural dual economic structure, she concludes that the influence of habit formation factors on rural family residents is stronger than that of urban family residents. Based on the above statements, this paper puts forward the following assumptions:

Hypothesis 2: the current consumption level of rural residents is affected by the formation of habits.

Hypothesis 3: the existence of habit formation reduces the impact of economic policy uncertainty on rural residents' consumption.

3. Empirical Research

3.1 Estimation Method

Considering that the variables of habit formation and economic policy uncertainty are variable coefficients varying with time, and in order to avoid the endogenous problems between explanatory variables and random disturbance terms, Difference-Generalized method of moments (diff-gmm) estimation method proposed by Arellano and bond (1991) is used to solve the problem, and to ensure the robustness of the results and avoid the possible endogenous problems in the model in this paper, we choose the estimation method of system generalized estimation (sys-gmm) proposed by Blundell and bond (1998) to solve the problem of system consistency and sequence correlation.

$$Y_{i,\ t} = \beta_0 Y_{i,t-1} + \beta_1 X_{i,t} + \mu_i + \varepsilon_{i,t} \quad (1)$$

Among them, Yi, tare explained variables, Yi ,t-1 are explained variables of lag period, Xi ,tare explained variables, β is estimated coefficient, individual effect and random disturbance term.

In order to further test the reliability of the estimation results of sys-gmm model, this paper conducts sargan test after dynamic panel regression to judge whether the instrumental variables in this paper are effective. In addition, in order to test whether there is sequence correlation in random disturbance terms, AR test is also carried out. In order to ensure the robustness of the empirical results as far as possible, the dynamic panel two-step sys-gmm estimation is carried out, and the p value corresponding to AR (1) and AR (2) is tested according to the Arellano bond test, so as to show that there is no second-order autoregression. Sargan test is used to ensure the validity of instrumental variables and avoid over identification. In addition, we also added random effects (RE) for robustness test, and the results of panel mixed regression OLS and dynamic panel difference GMM as the control group to test the equation.

3.2 Model Setting and Variable Selection

In the aspect of model setting, this paper takes the consumption of rural residents in each province as the explained variable, the disposable income as the explained variable, and the lag consumption and economic policy uncertainty as the explained variable. At the same time, considering that there are significant differences in economic degree among provinces in China, in order to control the influence of other factors on the accuracy of the

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results, control variables are introduced into the equation. In addition, considering the endogenous problem and sequence correlation problem, the lag term is introduced as a tool variable to reduce the error of parameter estimation. Therefore, the basic form of the dynamic model is as follows:

$$C_{i,\ t} = \beta_0 + \beta_1 C_{i,t-1} + \beta_2 y_{i,t} + \beta_3 g_{i,\ t-1} + \mu_{i,t} \quad (2)$$

In order to better verify the impact of the internal effect of economic policy uncertainty and habit formation on rural residents' consumption, the product of economic policy uncertainty ($EPU_{i,\ t-1}$) and rural residents' consumption ($C_{i,\ t-1}$) in the lag period is added as a new control variable:

$$C_{i,\ t} = \beta_0 + \beta_1 C_{i,t-1} + \beta_2 y_{i,t} + \beta_3 EPU_{i,t-1} + \beta_4 EPU_{i,t-1} * C_{i,t-1} + \mu_{i,t} \quad (3)$$

$C_{i,\ t}$ are the explained variables, which indicate the consumption level of the rural residents in the T period of the i-th province. The endogenous variable ($C_{i,\ t-1}$) of the explained variable lags one period to reflect the formation effect of farmers' consumption habits. $Y_{i,t}$ are the core explanatory variables, which indicate the current per capita disposable income of rural residents. $\beta_1$reflects the intensity of farmers' habit formation effect, β_2 represents farmers' marginal propensity to consume, and the Lag one period $EPU_{i,t-1}$ represents the uncertainty of economic policy. This paper selects the annual data of EPU as the control variable, and then uses the weighted average method to transform the monthly data:

$$EPU_t = \frac{EPU_1 * 1 + EPU_2 * 2 + \ldots + EPU_{12} * 12}{1 + 2 + \ldots + 12} \quad (4)$$

β_3>0,When the income of rural residents is stable, they will increase consumption appropriately; β_3< 0, $Epu_{i,\ t-1}$ * $C_{i,\ t-1}$ refers to the moderating effect of habit formation on the uncertainty of economic policy, which is a random disturbance term, reflecting the impact of random factors on the model, including rural per capita GDP and rural consumer price index (CPI) as control variables, indicating the variables that affect the consumption of rural residents, including Beijing, Shanghai and Tianjin, regardless of urban and rural consumption prices Lattice index, so it is not in the scope of this paper.

3.3 Descriptive Statistics

In this paper, the official statistical yearbooks of rural areas in various provinces are selected. Due to the lack of data in Tibet and Chongqing, the data are eliminated. Finally, the panel data of 30 provinces and cities in China from 1995 to 2019 are selected for regression analysis. Then, the country is divided into three regions: Eastern, central and western regions. For the main variables, in order to eliminate the heteroscedasticity between the variables, the logarithmic processing is carried out, as shown in Table 1 Descriptive statistical results of the main variables.

Table 1. Overall statistical characteristics of panel data in 30 provinces from 1995 to 2019

Variables	Eastern Region		Central region		Western Region	
	Mean	SD	Mean	SD	Mean	SD
Per capita consumption expenditure (C)	8.45	0.822	8.163	0.863	7.966	0.85
Per capita disposable income(y)	8.776	0.818	8.404	0.835	8.161	0.813
Economic policy uncertainty(EPU)	0.5	0.806	0.5	0.806	0.5	0.807
Per capita GDP(GDP)	10.22	0.925	9.609	0.897	9.507	0.986
Consumer price index of rural residents (CPI)	4.133	1.437	4.637	0.0381	4.635	0.039

Source: China Rural Statistical Yearbook.

The results of descriptive statistics in Table 1 show that: firstly, the rural per capita consumption expenditure, per capita disposable income and rural per capita GDP in the eastern region are higher than those in the central and western regions, and the standard deviation is larger, which indicates that the economic level of the eastern region is higher as a whole, and there are differences between the income level and consumption level among regions. The consumption level of rural residents in the central and western regions is relatively close, and the difference between the eastern and the central and western regions is obvious. However, the consumer price index of rural residents in the central and western regions is relatively close, and that in the eastern region is the lowest. Due to the relative lack of resources in the central and western regions, the transportation cost is on the high side.

4. Empirical Test Results and Analysis

Because the lag index of the explained variable is used as the explanatory variable in this paper, the individual effect and disturbance effect may have the problem of autocorrelation. In addition, due to the resource endowment, cultural differences and other factors in different provinces, in order to overcome these endogenous problems, we use sys-gmm estimation.

4.1 Regression Results

Because this paper uses the lag index of the explained variable as the explanatory variable, the individual effect

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and disturbance effect may have the problem of autocorrelation. In addition, because there are some factors in different provinces, such as regional resource endowment, cultural differences and so on, which may have a certain correlation with the explanatory variable, so in order to overcome these endogenous problems, this paper finally uses the method Sys-gmm estimation.

Table 2. The estimated results of the impact of economic policy uncertainty and habit formation on rural residents' consumption

Variables	OLS mixed regression	Random effect of re	DIFF-GMM	SYS-GMM
Habit formation (Ci, t-1)	-0.755** (-2.24)	-0.601* (-1.71)	-0.000** (-2.19)	-0.356 (-1.02)
Economic policy uncertainty (EPUi, t-1)	-8.745*** (-2.89)	-8.181*** (-2.66)	-0.000*** (-3.99)	-3.213 (-1.03)
Superposition effect (EPUi,t-1*Ci,t-1)	8.860*** (-2.92)	-0.048*** (-2.61)	-0.001 (-1.46)	0.022** (-2.3)
Rural per capita disposable income (Y)	0.123*** (-3.53)	0.109*** (-3.11)	0.050*** (2.76))	0.114* (-1.76)
Rural per capita Gross Domestic Product (GDP)	0.411*** (-9.41)	0.404*** (-9.07)	-0.044 (-0.56)	-0.319*** (-3.68)
Consumer price index of rural residents (CPI)	-0.004 (-0.31)	-0.011 (-0.73)	0.041* (1.79)	0.062* (-1.79)
Constant	-9.283*** (-2.84)	-9.278*** (-2.82)	0.142 (0.17)	-7.151 (-1.36)
Observations	646	646	590	562
Prob > chi2	0	0	0	0
R-squared	0.8655	0.8607		
P value of AR (1) test			0.0000	0.059
P value of AR (2) test			0.2351	0.170
Sargan test p value			1.000	1.000

Note: ***, **, and * are significant at 1%, 5%, and 10% levels respectively. The data in brackets are t statistics.

The output results of the model show that the P values of AR (1) test and AR (2) test are greater than 0.1, which indicates that there is no sequence correlation in the residual term, so the original hypothesis of "no autocorrelation in the disturbance term" is accepted, and the setting of dynamic regression model is reasonable. In terms of instrumental variables, the p value of sargan test and sargan difference test of the model are both much greater than 0.1, which means that the original hypothesis of "all instrumental variables are valid" is satisfied, that is, the selected instrumental variables are valid. The specific results of regression are shown in Table 2.

According to the dynamic panel model (3), table 2 lists the regression results of mixed OLS, random effects and the regression results of diff-gmm and sys-gmm. From sys-gmm The regression results of the model show that the habit formation coefficient from 1995 to 2019 is -0.356, which is basically at the same level as the panel mixed regression result and the random effect result, indicating that the habit formation has a negative impact on the consumption of rural residents, and the coefficient of economic policy uncertainty is -3.213, which indicates that under the impact of economic policy uncertainty, the rural residents will have a negative impact The coefficient of the superposition effect of habit formation and economic policy uncertainty is 0.022, which is significant at the 5% significant level, indicating that the impact of economic policy uncertainty on rural residents' consumption will be weakened due to the existence of habit formation, and because of the lag of economic policy uncertainty, every 1% increase in the superposition effect will increase farmers' consumption by 0.023; per capita consumption can be reduced The coefficient of disposable income is 0.014, which is significant at the significant level of 10%, indicating that income has a significant role in promoting the consumption of rural residents. The coefficient of income level of rural residents is 0.306, which is also significant at the level of 1%, indicating that the consumption behavior of rural residents in China shows a habit effect, and has a strong dependence on income, which is related to the uncertainty of economic policy 066, which is also significant at the level of 1%. The surface economic policy uncertainty has a significant impact on the consumption of rural residents.

From the regression results of control variables, the regression coefficient of consumer price index (lnCPI) is 0.062, and the result coefficient is significant. The results of Table 2 also show that at the significant level of 1%, the coefficient of rural per capita GDP is -0.319. Although China is the second largest economy, the consumption rate level of China has been at a relatively low level. From the stability of the regression results, in the sys-gmm, the consumption rate of China is relatively low In the model, the $\ln C_{i, t-1}$ estimation results are close to the estimator level of random effects, which indicates that there is no serious error problem caused by weak instrumental variables in the regression results. In addition, the P value of AR (2) test is 0.17, and there is no sequence correlation in the random disturbance term of the horizontal equation. At the same time, the p value of sargan overidentification test is 1, which indicates that the instrumental variables used in the estimation process of sys-gmm model are appropriate and effective, and that the estimation of sys-gmm model is

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applicable to the empirical equation set in this paper.

4.2. The Influence of Different Regions on the Consumption Differentiation of Rural Residents

Table 3. Estimated results of the impact of economic policy uncertainty and habit formation on rural residents' consumption in different regions.

Variables	Eastern Region		Central region		Western Region	
	FE	SYS-GMM	FE	SYS-GMM	FE	SYS-GMM
Habit formation (Ci, t-1)	0.523*** (10.90)	0.430 (1.50)	-0.003 (-0.05)	0.312* (1.90)	0.049 (0.87)	0.813 (1.24)
Economic policy uncertainty (EPUi,t-1)	0.065*** (3.77)	0.152 (0.74)	0.066 (1.43)	0.059* (1.87)	0.105* (1.76)	-0.192 (-0.66)
Superposition effect (EPUi,t-1*Ci,t-1)	-0.001 (-0.57)	-0.004 (-0.58)	0.000 (0.00)	-0.004 (-0.63)	0.003 (0.83)	0.004 (0.72)
Rural per capita disposable income (Y)	0.035 (1.52)	0.342 (0.84)	0.881*** (5.16)	0.541* (2.12)	0.106 (1.35)	-0.406 (-0.37)
Rural per capita Gross Domestic Product (GDP)	0.395*** (10.02)	0.294 (1.09)	0.093 (0.80)	0.192* (1.87)	0.627*** (8.29)	0.494 (1.42)
Consumer price index of rural residents (CPI)	-0.015 (-0.57)	-0.238 (-1.31)	2.089** (2.32)	-0.152 (-1.42)	1.821* (1.78)	0.054 (0.26)
Observations	232	232	230	230	184	184
Number of regions	10	10	10	10	8	8
R-squared	0.974		0.851		0.788	
P value of AR (1) test		0.079		0.199		0.246
P value of AR (2) test		0.018		0.552		0.871
Sargan test p value		0		0.003		0
Hansen statistics		1		1		1

Note: ***, **, and * are significant at 1%, 5%, and 10% levels respectively. The data in brackets are t statistics.

The coefficient of habit formation is 0.430 in the eastern region, 0.312 in the central region and 0.813 in the western region. The coefficient of habit formation in the western region is the highest, and the coefficient of uncertainty of economic policy in the western region is -0.192, which indicates that the uncertainty of economic policy has a negative inhibitory effect on the consumption of rural residents in the western region. Compared with the western region, the income level of the central and eastern region has been at a higher level, and the rural residents have accumulated a certain amount of savings, so they have a strong guarantee ability in the face of policy uncertainty in the economic system reform.

The income coefficient of the central and eastern regions is positive, which indicates that the increase of income is positively correlated with the consumption of rural residents, while the income coefficient of the western region is -0.011, which indicates that the increase of income has a crowding out effect on the consumption of the western region. It can be seen from table 3 that when the economic policy uncertainty and habit formation have a superposition effect, the coefficients of the eastern region and the central region are both negative -04, that is to say, in the face of drastic income fluctuations and policy uncertainty, it will lead to a decline in the formation effect of consumption habits, which has a certain degree of inhibitory effect on the consumption of rural residents in the Middle East.

From the perspective of control variables, rural per capita GDP, which reflects the level of economic and social development, has a positive impact on consumption

The impact of consumer price index (CPI) on the consumption of rural residents in the central and eastern regions is inhibited, while the impact on the western region is weak. When the uncertainty increases, there will be a certain expansion of goods. The rapid rise of prices inhibits the consumption of residents, especially in the eastern and central regions more obvious.

5. Conclusions and Policy Recommendations

Based on the dynamic panel data of 30 provinces in China from 1995 to 2019, this paper uses the estimation method of sys-gmm model to explore the impact of economic policy uncertainty and habit formation on rural residents' consumption. The empirical test results show that the consumption of rural residents has a strong stickiness on the whole, and the consumption lagging one period and the uncertainty of economic policy are negatively correlated with the current consumption. The consumption behavior of rural residents in China shows a habit effect, and has a strong dependence on income. The coefficient of superposition effect between the uncertainty of economic policy and the formation of habit is 0.022 and at the level of 5%, it also shows a significant phenomenon of promoting consumption. There is a significant difference between the income level and consumption level among regions. The consumption level difference between the western region and the central and eastern regions is more obvious. The influence of habit formation on consumption in the western region is more obvious, and it has a greater dependence on income. When facing the uncertainty of economic policy, it will be more impacted, and the consumption will be reduced Fees have also been significantly reduced. In view of the above conclusions, this paper puts forward the following policy recommendations:

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(1) The government should have a correct and reasonable understanding and evaluation of the relationship between economic policies and residents' consumption, and grasp the residents' sensitivity to policies, so as to prevent the stimulus effect of policies from declining or disappearing. In addition, government departments should maintain the system and stability in macroeconomic policy control, and reduce the negative impact of uncertainty on Residents' consumption.

(2) We should strengthen the overall planning of rural consumption market, change farmers' consumption concept, and improve the consumption environment of rural residents. We should promote the continuous extension of urban consumer market to rural areas, constantly enrich the types of rural consumer goods and improve the quality of rural consumer goods, so as to provide more possibilities for farmers to expand consumption; we should strengthen the investment and construction of rural infrastructure, establish the radiation driven transportation and network service system of "city leading countryside", provide convenience for farmers to consume in cities or online shopping, and stimulate farmers' consumption The scale expansion of demand.

(3) The development of the whole country is unbalanced, so is the development of the western region. The problem of regional gap is basically the gap between urban and rural areas, that is, the gap between the level of industrialization and urbanization. To develop the western region, we should coordinate the development of the whole country, allow some regions to get rich first, and realize common development and common prosperity. The government should reform and improve the economic system, expand the opening up to the outside and the inside, promote the resources of the economically developed regions, domestic and overseas resources, and be able to flow more to the western region driven by the market, so as to narrow the gap between urban and rural areas in the central and western regions.

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