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The Effects of Tax Revenues on Iran's Economic Growth during Business Cycles; With Emphasis on the Various Components of Direct and Indirect Taxes

Ezzati Shourgholi, A.[1] | Moradi, Y.[2] | Mohammadpour, R.[3] | Ezzati, R.[4]

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Abstract

Iran's economy is an oil-dependent economy that has faced severe economic sanctions in recent years. This has led the government to find another source of revenue instead of oil to fill the gap. Therefore, in the Iranian economy the role of taxes has become more prominent than ever. However, there is a lot of theoretical and empirical evidence that shows how tax revenues affect economic growth during business cycles. Therefore, this article has estimated and determined the tax multiplier using quarterly data of the Iranian economy during the period 1993 to 2022 (1372-1401 SH) and using the Markov switching model. The results of the present study showed that the largest multiplier among the various components of direct and indirect taxes is related to income tax and consumption and sales tax, respectively. Among the various components of direct tax, during a recession income tax is a good tool to stimulate production and in the expansion, the use of corporate tax should be preferred to income tax. During the recession, if the goal is to stimulate production with indirect taxes, the use of consumption and sales taxes is preferred to import taxes.

Keywords: Multiplier, Direct Tax, Recession and Expansion, Markov Switching Model.

JEL Classification: E62, E32, C24.

1. Asisstant professer, Department of Financial Affairs, School of Human Science, Afagh Higher Education Institute, Urmia, Iran (Corresponding Author).
   Email: ahmetezzati@afagh.ac.ir

2. M.Sc. in Economics, Faculty of Economics and Management, University of Urmia.
   Email: yousef.moradi63@gmail.com

3. Asisstant professer, Department of Financial Affairs, School of Human Science, Afagh Higher Education Institute, Urmia, Iran.
   Email: r.mohammadpour@afagh.ac.ir

4. M.Sc. in Economics, Income expert of Salmas municipality, Salmas, Iran.
   Email: reza.ezzati.salmasi@gmail.com

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1. Introduction

The role of fiscal policy in the economy can be divided into two perspectives: Keynesian and non-Keynesian. If expansionary (contractionary) fiscal policy leads to an increase (decrease) in private consumption and production, it has a Keynesian effect; otherwise, it has a non-Keynesian effect (Khodavaisi et al., 2019). However, various factors influence the impact of fiscal policy on economic growth. For example, business cycles are one of the most important factors in determining the size and role of fiscal policy in the economy. Empirical and theoretical studies in this area indicate that the impact of fiscal policy on output changes with the occurrence of recessions and economic booms (Deskar-Škrbić and Hrvoje, 2017). Iran's economy relies heavily on oil and has been severely affected by economic sanctions in recent years. This has led the government to seek alternative sources of income to fill this gap instead of relying on oil revenues. Therefore, the role of taxes in Iran's economy has become more prominent than ever.

In this context, distinguishing between direct and indirect taxes is of particular importance, as each category exerts different effects on growth and production. Moreover, the structure of the Iranian economy, characterized by high inflation, dependency on imports, and fiscal vulnerability, provides a unique case to analyze how fiscal multipliers vary across business cycles. This study contributes to filling this research gap by addressing both theoretical debates and empirical evidence.

2. Methodology

Various studies have been conducted on how fiscal policy impacts macroeconomic variables, especially economic growth, and the results of these studies indicate that it is not possible to establish a universal rule in this regard. On the one hand, researchers face the challenge of not considering these asymmetries in studying the impact of fiscal policy on macroeconomic variables, given the role of business cycles, which can lead to misleading results. Researchers in the new generation of studies in this field have addressed this issue by considering different economic conditions and mostly resorting to nonlinear econometric methods. Numerous studies have also been conducted in Iran in this area, and recently, Ezzati Shurgoli et al. (2021) estimated the overall multiplier of government tax revenues during business cycles. However, since the structure and impact of each tax can vary, it is necessary to differentiate between direct and indirect taxes and evaluate the effects of their different components on economic growth during business cycles. The present study aims to fill this gap in domestic research by using the nonlinear Markov-switching approach to examine the impact of direct and indirect taxes (divided into their components) on economic growth during business cycles.

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3. Discussion

Among the three different components of direct taxes, the income tax has the highest multiplier. Additionally, both the income tax and the corporate tax have larger multipliers during periods of expansion compared to recessions, but this relationship is reversed for the wealth tax. On the other hand, both components of indirect taxes, namely import taxes and sales and consumption taxes, have a larger impact on economic growth during recessions compared to periods of expansion. Furthermore, both fiscal policy instruments have a negative effect on economic growth during periods of expansion. In a general comparison of all the different components of direct and indirect taxes, the income tax has the highest multiplier, followed by the corporate tax and then the sales and consumption tax. The wealth tax and import tax have the lowest multipliers among the various components of taxes.

These findings suggest that fiscal policy in Iran is highly state-dependent. While direct taxes such as income and corporate taxes can stimulate production in expansionary regimes, indirect taxes like consumption and sales taxes become more effective during recessions. This highlights the need for a countercyclical approach, where the government selects tax instruments based on prevailing economic conditions rather than adopting uniform policies across all cycles.

4. Conclusion and Suggestions

If the goal of economic policymakers is to induce positive changes and shocks in direct taxes, they should refrain from using income tax and wealth tax during periods of expansion. On the other hand, policymakers should be aware that among the various components of direct taxes. during expansion, it is preferable to use corporate tax instead of income tax. Furthermore, import taxes have a weaker impact on production stimulation compared to sales and consumption taxes. Therefore, economic policymakers should consider two key points regarding indirect taxes. Firstly, both types of indirect taxes have a negative effect on economic growth during periods of expansion, so they should not be used as tools to stimulate production during these periods. Secondly, during recessions, if the goal is to stimulate production, it is preferable to use sales and consumption taxes rather than import taxes.

In conclusion, fiscal strategies must be flexible and adaptive, taking into account not only the type of tax but also the phase of the business cycle. Strengthening the tax system's efficiency, broadening the tax base, and reducing dependence on volatile oil revenues are necessary steps for sustainable growth. By applying differentiated tax instruments according to economic conditions, Iran can achieve both stabilization and growth-oriented goals.

5. Ethical Considerations

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5.2. Authors' Contribution

Authors contributed equally to the conceptualization and writing. All of the authors approved the content of the manuscript and agreed on all aspects of the work.

5.3. Conflict of Interest Authors

The authors declare no conflict of interest.

5.4. Acknowledgments

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