Journal website : https://pse.razi.ac.ir

Razi University

Public Sector Economics Studies 16 PSE
Qurterly
Department of Economics, Faculty of Economics and Accounting, Razi University
Vol. 5, Issue 16, Summer 2026 | Online ISSN: 2821-2681

The Role of Economic Growth Regimes in the Influence of Financial Globalization and Government Expenditure on Income Inequality in Iran

Mohamadian, F.[1] ‖ Mohammed Ahmed, A.[2] ‖ Ablihl Salloom, H.[3]

Type of Article: **Research**
10.22126/pse.2026.13334.1228
Received: 10 December 2025; Accepted: 18 March 2026
pp. 239-262

Abstract
Economic growth is one of the key factors in determining income inequality, which can influence the impact of other economic factors, such as financial globalization and government spending, on the income gap. This study examines the role of the economic growth threshold in the effect of financial globalization and government spending on income inequality in Iran, using data from 1980 to 2022 and the Threshold Autoregressive method. The results show that the effect of the variables on income inequality is dependent on the economic growth threshold (8.63%) in two different regimes. In the first regime, where economic growth is below the threshold, economic growth and foreign direct investment have a positive and significant effect on inequality, while government spending and financial globalization have a significant diminishing effect. In the second regime, with economic growth above the threshold, financial globalization and government spending have a greater impact on reducing the income gap, and the effect of economic growth reverses, leading to a reduction in inequality, which supports the Kuznets hypothesis. Therefore, economic policies should be designed based on the level of economic growth and purposefully aimed at reducing income inequality.

Keywords: Economic Growth, Financial Globalization, Government Expenditure, Threshold Autoregression, Income Inequality.

JEL Classification: D31, E44, I32.

1. Assistant Professor, Department of Economics, Faculty of Literature and Humanities, Ilam University, Ilam, Iran (Corresponding Author).
Email: f.mohamadian@ilam.ac.ir

2. Master's student in Economics, Department of Economics, Faculty of Literature and Humanities, Ilam University, Ilam, Iran.
Email: abdalrahman.abdullah98@gmail.com

3. Master's student in Economics, Department of Economics, Faculty of Literature and Humanities, Ilam University, Ilam, Iran.
Email: hat1997em@gmail.com

Citations: Mohamadian, F., Mohammed Ahmed, A., & Ablihl Salloom, H. (2026). "The Role of Economic Growth Regimes in the Influence of Financial Globalization and Government Expenditure on Income Inequality in Iran". *Public Sector Economics Studies*, 5(16), 239-262.

Homepage of this Article: https://pse.razi.ac.ir/article_4214.html?lang=en

1. Introduction

Income inequality has emerged as a persistent structural challenge in the Iranian economy, shaped by fluctuations in economic growth, the expansion of financial globalization, and changes in the size and composition of government expenditure. Financial globalization—through capital account liberalization, increased cross-border capital flows, and deeper integration into international financial markets—can foster growth and improve financial efficiency. However, in economies with institutional weaknesses, its benefits may accrue disproportionately to higher-income groups, thereby widening income disparities. Government expenditure, on the other hand, plays a potentially redistributive role through social spending, infrastructure investment, and human capital development. Yet empirical evidence suggests that the effects of financial globalization and public spending on inequality are not linear or uniform; rather, they depend on the level and sustainability of economic growth. This study investigates whether economic growth acts as a threshold variable that alters the direction and magnitude of the effects of financial globalization and government expenditure on income inequality in Iran over the period 1980–2022.

2. Theoretical Framework

The analysis draws upon a synthesis of the Kuznets hypothesis proposed by Simon Kuznets, endogenous growth theory, and international trade and finance models. The Kuznets hypothesis suggests an inverted U-shaped relationship between economic growth and income inequality, implying that inequality may initially rise during early stages of development but decline as economies mature and structural transformation, human capital accumulation, and redistributive mechanisms expand. From the perspective of financial globalization theory, integration into global financial markets can enhance access to capital and improve allocation efficiency; however, without strong institutional frameworks, its gains may be concentrated among capital owners and skilled labor. Public finance theories further emphasize that the redistributive effectiveness of government expenditure depends on income levels, fiscal capacity, and institutional quality. Accordingly, economic growth may function as a threshold variable that conditions how financial globalization and government spending influence income distribution.

3. Methodology

This study employs annual time-series data for Iran covering 1980–2022. Income inequality is measured by the Gini coefficient. Explanatory variables include the annual GDP growth rate, growth of government expenditure, foreign direct investment (FDI) inflows (as a percentage of GDP), and the financial globalization index derived from the financial sub-index of the KOF Globalization Index. To capture potential nonlinearities and regime shifts, a Threshold Autoregressive (TAR) model is estimated. Preliminary tests include unit root tests (ADF), the Pesaran bounds test for cointegration, and the BDS test for nonlinearity. The results confirm the presence of nonlinear dynamics and a statistically significant structural break. Economic growth is identified as the optimal threshold variable, with an estimated threshold level of 8.63 percent, dividing the sample into two distinct growth regimes.

4. Discussion

The empirical results reveal that the effects of financial globalization and government expenditure on income inequality are regime dependent. In the first regime, where economic growth is below 8.63 percent, GDP growth and FDI exert a positive and statistically significant effect on inequality, suggesting that in low-growth environments, the benefits of expansion are disproportionately captured by higher-income groups. In contrast, government expenditure and financial globalization reduce inequality in this regime, though the magnitude of their redistributive effect is relatively limited. In the second regime, where economic growth exceeds the threshold, the impact of GDP growth on inequality becomes negative and significant, indicating that higher levels of sustained growth contribute to a more equitable income distribution. This finding is consistent with the inverted U-shaped pattern predicted by the Kuznets hypothesis. Moreover, in this high-growth regime, the inequality-reducing effects of government expenditure and financial globalization become stronger, and FDI shifts toward a mitigating role. These results suggest that the distributive consequences of macroeconomic and financial policies are critically conditioned by the prevailing growth environment.

5. Conclusion and Suggestions

The findings demonstrate that economic growth plays a pivotal moderating role in shaping the distributional effects of financial globalization and fiscal policy in Iran. Policies aimed at reducing inequality should therefore be designed in accordance with the prevailing growth regime. During low-growth periods, capital inflows and financial liberalization should be accompanied by institutional strengthening, improved regulatory oversight, and expanded financial inclusion to prevent the concentration of benefits among privileged groups. During high-growth periods, policymakers should leverage fiscal capacity to channel government expenditure toward education, healthcare, social protection, and productive infrastructure, thereby reinforcing the inclusive effects of growth. Overall, achieving inclusive and sustainable development requires a coordinated strategy that combines macroeconomic stability, institutional reform, efficient fiscal policy, and carefully managed financial integration. Only under such a framework can economic growth and financial globalization evolve from potential sources of inequality into effective instruments for distributive justice and social welfare improvement.

6. Ethical Consideration

6.1. Compliance with ethical guidelines

The present study has followed the scientific principles of research.

6.2. Funding

This paper does not have the financial support of any organization.

6.3. Authors' Contributions

The authors have contributed equally to the writing of this article.

6.4. Conflict of interest

The authors declare that there is no conflict of interest in this research.

6.5. Acknowledgments

The authors are grateful to the respected reviewers whose valuable comments helped improve the quality of the article.