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## Studying the effect of value added tax on the size of current government and construction government

Mohammad Alizadeh<sup>a</sup>, Masoume Motallabi<sup>b,\*</sup>

<sup>a</sup>Assistant professor, Faculty of Economics, University of Lorestan, Lorestan, Iran

<sup>b</sup>PHD Student of Economic, University of Lorestan, Lorestan, Iran; Corresponding author

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### Abstract

The present research studies the effect of value added tax on the size of current government and construction government. Research hypotheses tested by studying the relationship between value added tax and the size of current government (in the form of current cost to gross domestic product (GDP)) and the size of construction government (in the form of construction cost to GDP). In this regard, seasonal time-series statistic within the period of 2008-2014 applied through using ARDL model. Research results show that there is a positive, significant relationship between value added tax and the size of current and construction governments. This tax more influences the size of construction government than the size of current one. Indeed, contrary to developed countries, collecting value added tax mostly influences the ratio of construction expenditures to GDP rather than influencing reduced poverty through increasing welfare expenditure, which increase government current expenditures.

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### 1. Introduction

Government plays a critical role in macro-economy. Government economic activities have social outcomes and objectives, on one hand; and governmental activities influence private sector activities, on the other hand. Government

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\* Corresponding author. Tel.: +989122903127

E-mail address: [masoumehmotallebi@yahoo.com](mailto:masoumehmotallebi@yahoo.com)

requires sources of income to play its various roles and to fund its expenses. Taxes are one of the government earning sources. Taxes in Iran historically provided little share of government revenues. The most common reason may be due to the easily earned oil revenue directing country's economic system to the road in which taxes were on the edges.

Financing government current expenditures by tax revenues has always been interested by national planners and statesmen. Increased nontax revenues and oil revenues in different periods besides inadequate considering of financial discipline in government budget as well as lack of efficient tax system caused taking temporary measures. However, covering government current costs not only requires preventing excessive increasing of government current costs, but also it needs enhancing tax system and increasing tax revenues (Kiyani et al, 2012; 2). Introducing a new tax such as value added tax in the area of increased tax revenues may help in raising tax ratio to government current costs (Samimi et al, 2005; 4).

Value added tax (VAT) is a multistep tax obtained in various steps of importing, production and distribution based on some percent of added value of the sold goods or delivered services in each step. However, settlement in each step of import, production, and distribution chain transferred to the chain next step element so that finally paid by the final consumer (Central Bank balance sheet, 2008).

The present research studies the relationship between value added taxes and the size of current and construction government in Iran's economy. If government size merely measured through absolute cost tools disregarding other factors (such as the size of total economy), then no significant work is done. Since while country's general costs increase, other economic items including personal income, prices, total product and population increase, too. The scientific value of the aforementioned comparison introduced where relative rates of the relation between public costs and other key factors considered. Therefore, to show a much precise size of public sector requires comparing costs with some macroeconomic elements (Dadgar, 2013; 209). The present research used costs to gross domestic production (GDP) ratio to estimate government size. In this regard, two hypotheses proposed: 1. Value added tax increases the ratio of government current expenditures to GDP. 2. Value added tax decreases the ratio of government construction expenditures to GDP. Research hypotheses tested using the size of current and construction government. In this paper, the model is introduced following studying theoretical basics and related works. Research findings are presented in section five. And finally, section seven concludes and proposes further recommendations.

## 2. Theoretical basics

### 2.1. Government size theories

Some theories of government size were citizen-oriented and some formulated based on the government.

- Citizen-oriented theories: these are based on this that government size grows relying on citizens' demands.

One of the oldest government growth theories is Wagner theory. He analyzed expenditure data of several developed countries and claimed that the public sector share of GDP has an increasing trend. He, firstly, noticed that economic growth requires legal infrastructures. Secondly, developing urbanism also requires increased government costs. Thirdly, public goods have high income attraction. Finally, he concluded that public sector gets larger once real per capita income increased. Though, Wagner theory properly interpreted government growth, it merely relied upon demand dimension such that supply area was ignored.

Government as fair distribution element: according to some theories, government is mainly focused on fairly distributing wealth and income. These theories stated that the majority prefer high tax rate for reach and transfer payment for low income individuals. As middle-income and low-income citizens include the majority of the society, meeting the majority demands requires government growth. Since, higher tax rate, on one hand; and increasing public sector costs, on the other hand, cause reduced gross production and increased government cost ratio to production, which per se indicates government growth. Of the well-known theorists in this area Meltzer and Richard (1983) may be mentioned.

- Government-based theories and other theories of government size: these theories center on government preferences rather than citizens'.

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