International Journal of
Public Finance and Fiscal Policy
Volume 3, Number 1, 2024

Adaptive Fiscal Policy and Equitable Taxation as Instruments for Inclusive and Sustainable Economic Recovery

Yosep Hardian Devates[1]

[1] Universitas Sarjanawiyata Tamansiswa, Yogyakarta, Indonesia

Abstract

Article history:
Received: January 11, 2024
Revised: February 25, 2024
Accepted: April 14, 2024
Published: June 30, 2024

Keywords:
Economic Inequality,
Fiscal Policy,
Optimal Taxation,
Redistribution,
Sustainable Growth.

Identifier:
Zera Open
Page: 1-18
https://zeraopen.com/journal/ijpffp

Fiscal policy plays a crucial role in maintaining economic resilience and promoting recovery through three main mechanisms: social support, fiscal incentives, and structural reform. Within the context of fiscal constraints, tax efficiency and equity serve as the foundation for sustainable development. Taxes, in addition to being the primary source of government revenue, function as an instrument of redistribution to reduce income inequality. Redistributive fiscal policy, implemented through a progressive tax system and targeted social spending, helps balance wealth distribution and enhance the welfare of low-income groups. The concept of optimal taxation emphasizes the equilibrium between economic efficiency and social equity to achieve maximum social welfare. This study examines the role of fiscal policy and taxation in economic recovery and inequality reduction through a narrative approach based on recent literature. The analysis reveals that adaptive fiscal policy and an equitable taxation system contribute significantly to inclusive and sustainable economic growth, reinforcing the importance of fiscal governance in achieving long-term stability.

©2024 The Author(s).
This is an open-access article under CC-BY-SA license (https://creativecommons.org/licence/by-sa/4.0/)

1. Introduction

Fiscal policy holds a truly essential role in directing both the stability and economic growth of a nation, especially when facing global shocks or increasingly complex social inequalities. Through its two main instruments, namely taxation and government spending, fiscal policy not only functions as a means of revenue collection but also as a strategic instrument to influence the distribution of welfare and reduce economic gaps. In the context of the modern economy, the link between fiscal policy and income inequality has become an increasingly strategic issue, demanding in-depth study based on empirical evidence. As articulated by Giordono et al. (2019), the combination of tax policy and social spending can curb inequality while simultaneously fostering economic growth by boosting the purchasing power of low-income communities.

On the other hand, many nations face fiscal limitations that necessitate efficient, transparent, and sustainable management of public resources. Efficiency in the tax system is a fundamental foundation for maintaining fiscal sustainability while increasing public trust in the government. Therefore, comprehensive tax reform is highly necessary to broaden the tax base, reduce economic distortions, and strengthen the nation's fiscal legitimacy. Malla and Pathranarakul (2022) emphasize that strong institutional capacity is a fundamental prerequisite for the effectiveness of fiscal policy in reducing income gaps and strengthening social justice.

Taxation serves an inseparable dual function: as the main source of state revenue and as a mechanism for income redistribution. Through the implementation of a progressive tax system, high-income groups contribute proportionally more, while the revenue collected is allocated to fund social programs targeting vulnerable community groups. The findings of Abdulkarim (2023) indicate that social expenditures sourced from tax revenues play a significant role in strengthening economic inclusion, particularly in developing countries. Thus, redistributive fiscal policy can function as an important instrument in reinforcing social cohesion while tackling structural inequalities that impede inclusive growth.

Furthermore, beyond its redistributive function, fiscal policy also plays a vital role in accelerating the process of post-crisis economic recovery. Various instruments such as subsidies, tax incentives, and fiscal stimuli are designed to stimulate aggregate investment and consumption activity. According to Kaneva et al. (2022), tax policies formulated adaptively to support post-pandemic recovery have been proven to contribute significantly to increased economic growth and sustainable development. Nevertheless, the main challenge governments face is maintaining a balance between fiscal expansion and budget sustainability in the long term so as not to cause excessive fiscal pressure.

In a broader framework, the effort to maintain a balance between economic efficiency and social justice forms the basis for the concept of optimal taxation. Optimal taxes are designed in such a way that they can maximize social welfare without creating significant economic distortions. Therefore, the role of fiscal policy should not merely be reactive to crisis dynamics, but also needs to be proactive in shaping an economic structure that is more adaptive, inclusive, and competitive. Through an approach oriented towards long-term welfare, effective fiscal policy can become a strategic means of directing economic transformation towards equitable distribution. Thus, this study aims to deeply examine how fiscal policy and the tax system contribute to reducing economic inequality while strengthening sustainable economic recovery, using a narrative approach based on a review of current literature.

2. Literature Review

2.1. Fiscal Policy as an Instrument for Reducing Economic Inequality

Fiscal policy has long been regarded as a fundamental instrument in suppressing economic inequality and strengthening the social structure through income redistribution mechanisms. Giordono et al. (2019) affirm that the synergy between tax policy and social spending plays a crucial role in lowering market inequality while simultaneously encouraging inclusive economic growth. Through the utilization of instruments such as direct and indirect taxes, as well as social spending policies, the government can expand the purchasing power of low-income groups and strengthen the national social protection system. The findings of Abdulkarim (2023) also demonstrate that the allocation of social expenditures sourced from tax revenues contributes significantly to reducing poverty rates and promoting more equitable economic growth in developing countries.

In this context, fiscal policies that are responsive to the dynamics of inequality in the labor market and gaps in access to public services have proven to be more effective than general macroeconomically oriented monetary policies. Nevertheless, the success of fiscal policy in carrying out its redistributive function is highly determined by institutional capacity and good fiscal governance. Malla and

Pathranarakul (2022) highlight that weak institutional capacity can reduce the effectiveness of a progressive tax system due to fiscal leakage and bureaucratic inefficiency. Therefore, comprehensive institutional reform and increased transparency in the management of public finances are essential prerequisites for the success of fiscal policy oriented towards justice and social equity.

2.2. The Role of the Tax System in Fostering Social Justice and Economic Growth

An efficient and just tax system is a key pillar in the modern fiscal policy framework. Gunasinghe et al. (2021) state that the implementation of progressive direct taxes in OECD (Organisation for Economic Co-operation and Development) countries has proven effective in reducing income gaps, although it must be carefully designed so as not to diminish incentives for economic growth. In this context, the concept of optimal taxation seeks to balance economic efficiency and social justice, with rate setting that considers productivity, income distribution, and long-term fiscal stability. The research by Kaneva et al. (2022) confirms the urgency of implementing tax policies that are adaptive to changes in macroeconomic conditions, especially after global crises such as the COVID-19 pandemic.

Tax reforms focusing on expanding wealth taxes and reducing the tax burden on productive sectors are deemed capable of strengthening fiscal resilience and accelerating the process of national economic recovery. Consistent with this, Ahuja and Pandit (2021) emphasize the importance of synergy between tax policy and public spending directed towards expanding employment opportunities, increasing productivity, and strengthening economic inclusion across all segments of society.

Furthermore, tax policy cannot be separated from the complementary role of social programs. Nolan et al. (2019) assert that without strong social policy support, the redistributive effect of taxation tends to be temporary. Therefore, the design of fiscal policy needs to consider the links between the tax system, social spending, and labor market policies to create a just and sustainable economic equilibrium.

2.3. Adaptive Fiscal Policy and Optimal Taxation for Inclusive Growth

In the post-pandemic context and the rising global uncertainty, adaptive fiscal policy becomes a crucial instrument in maintaining national economic stability and resilience. Malla and Pathranarakul (2022) stress the importance of fiscal policy flexibility to enable it to respond to the dynamics of changing economic structures while meeting the evolving social needs of the community. This approach includes providing selective subsidies, offering tax incentives for productive sectors, and strengthening social spending focused on vulnerable community groups. In maintaining fiscal sustainability without hindering economic growth, the application of the optimal taxation concept is an essential component. Salim et al. (2020) posits that tax policies designed with a consideration for the balance between economic efficiency and social justice can broaden the state's revenue base while strengthening income redistribution more equitably.

In line with this, Kaneva et al. (2022) highlight the urgency of integrating fiscal policy into the sustainable development framework, particularly through innovation and digitalization of the tax system to enhance fiscal effectiveness and transparency. Moreover, Ahuja and Pandit (2021) affirm that inclusive fiscal policy not only plays a role in fostering economic growth but also strengthens social legitimacy and public trust in the government. Thus, the combination of a progressive tax system, efficient public spending, and comprehensive structural reform forms the primary foundation for realizing equitable, inclusive, and sustainable economic growth.

3. Method

This study employs a narrative review approach focusing on conceptual analysis and literature synthesis to understand the relationship between fiscal policy, the tax system, and economic inequality. The narrative approach was chosen because it allows the researcher to trace the theoretical and empirical dynamics of various relevant studies, and connect them with the dynamic global economic context. This method is not intended to test quantitative hypotheses, but to construct a comprehensive understanding of how fiscal policy plays a role in supporting economic recovery while reducing social inequality. Data were obtained through a literature study by reviewing academic articles, international institution reports, and scientific publications published within the last five years.

The analyzed articles were selected based on their relevance to the themes of fiscal policy, tax justice, and economic redistribution. The analysis phase was carried out through three main steps. First, the collection of relevant literature from academic databases such as Google Scholar or Research Gate. Second, the evaluation and categorization of the literature into three major themes: (1) fiscal policy as an instrument for reducing inequality, (2) the tax system in promoting social justice and economic growth, and (3) the concept of optimal taxation and adaptive fiscal policy for inclusive growth. Third, narrative analysis and theoretical synthesis, which involves connecting the results of previous research to find conceptual patterns and causal relationships between economic variables.

To maintain validity, the sources used were verified through peer-reviewed publications and published within the last five years. This research also considered the results of cross-country studies to gain a broader understanding of the variations in fiscal policy and their impact on income distribution. The results of the narrative analysis are expected to provide a new conceptual framework that explains how the interaction between fiscal policy, tax structure, and social policy can form a more just and sustainable economic system. Furthermore, this approach is expected to provide a strong theoretical basis for subsequent empirical research focusing on the effectiveness of fiscal policy in addressing economic inequality in various macroeconomic contexts.

4. Results

The results of this study show that fiscal policy has a significant influence on economic inequality, inclusive growth, and long-term fiscal sustainability. Based on the synthesis of current literature, the relationship between fiscal policy and income distribution is reciprocal: on one hand, fiscal policy influences the pattern of income distribution, while on the other, the level of income inequality also determines the effectiveness of the implemented fiscal policy. The main findings indicate that direct tax instruments, especially progressive income tax, play a central role in curbing market inequality. Malla and Pathranarakul (2022) assert that progressive tax policies balanced with targeted and efficient public expenditure are capable of significantly reducing the income gap in countries with strong fiscal systems. However, the effectiveness of these policies is highly dependent on institutional capacity and the integrity of tax administration. Countries with weak fiscal institutions generally face revenue leakage and bureaucratic inefficiency, which ultimately weakens the redistributive power of fiscal policy by reducing its effectiveness in addressing income disparities, limiting revenue mobilization, and constraining the government's capacity to finance social programs that promote equity and inclusive economic development..

Empirical analysis by Cevik and Correa-Caro (2020) shows that fiscal policy countries yields varying impacts on income inequality. Direct taxes and social spending are proven to have a strong redistributive effect, whereas indirect taxes such as VAT actually worsen inequality because the tax burden is relatively heavier for low-income groups. The study also highlights that fiscal policies prioritizing subsidies in education and health have a more sustainable influence on inequality reduction compared to short-term cash transfer policies. Research by Khan (2021) strengthens this finding with empirical evidence from developing countries. He shows that an increase in the ratio of direct tax to GDP (Gross Domestic Product) has a negative correlation with the Gini coefficient, meaning the greater the contribution of direct taxes to state revenue, the less income inequality occurs. However, this relationship weakens when the fiscal structure is dominated by indirect taxes, which are regressive towards the consumption of low-income people.

Furthermore, the research results of Tanya and Suyanto (2022) confirm the existence of a simultaneous relationship between fiscal policy, economic growth, and income distribution. In the estimated structural model, public social expenditure increases long-term economic growth through increased labor productivity, while progressive tax policies contribute to social stability and the strengthening of human capital. However, too high a tax burden on productive sectors can hinder investment and slow down the pace of economic growth. Therefore, the balance between redistributive goals and economic efficiency is a fundamental element in the design of optimal fiscal policy. From an institutional perspective, Basri and Hill (2020) again emphasize the importance of the state's fiscal capacity in effectively implementing redistributive policies. Countries with modern, digital data-based tax administration systems and high levels of fiscal transparency are better able to optimize tax revenue and allocate it fairly.

Conversely, in countries with weak institutions, fiscal corruption, tax avoidance, and budget leakage are major obstacles that exacerbate socio-economic inequality. The findings from Nolan et al. (2019) also support this view. They found that the combination of progressive tax policies with efficient social expenditure can reduce post-tax inequality by up to compared to the pre-tax condition. This effectiveness increases significantly when the allocation of expenditure is focused on productive sectors such as education, health, and economic empowerment-based social assistance. Conversely, fiscal policies that are too oriented toward consumption subsidies tend to create social dependence and do not contribute significantly to long-term economic growth.

Khan (2021) also highlights the difference between the short-term and long-term impacts of fiscal policy. In the short term, expansionary fiscal policies such as subsidies, fiscal stimuli, and cash assistance can temporarily reduce inequality. However, in the long term, the effectiveness of these policies will decline if not accompanied by structural reforms in taxation, strengthening of labor productivity, and efficiency of public expenditure. This finding reinforces the argument that adaptive fiscal policy needs to be accompanied by sustainable structural reforms to avoid economic distortions that potentially hinder growth. In addition to its redistributive function, fiscal policy also plays an important role in maintaining macroeconomic stability. Basri and Hill (2020) suggest that increased public spending on strategic sectors such as infrastructure, education, and research generates a significant multiplier effect on the national economy while reducing inter-regional gaps.

However, excessive fiscal expansion without being balanced by careful debt management potentially creates fiscal risks and long-term budgetary instability. In general, the results of the literature review indicate that effective fiscal policy in reducing inequality and strengthening inclusive growth has three main principles. First, the implementation of an efficient and just progressive tax system, where rates are proportional to the ability to pay and do not inhibit productive economic activity. Second, a focus on productive social expenditure oriented towards human capital development, such as education, health, and job training. Third, institutional reform that encourages fiscal transparency, public accountability, and increased capacity for tax administration. These three elements form the basis of the "optimal tax" concept, which is a tax system that not only collects state revenue efficiently but also maximizes social welfare and supports sustainable economic growth.

Cross-country evidence shows that redistribution-oriented fiscal policies have stronger effectiveness in countries with transparent, participatory, and accountable fiscal governance. In countries with low transparency levels, the redistributive impact is often reduced due to fiscal leakage and weak oversight mechanisms for public spending. Thus, improving the quality of public governance is a determinant factor in ensuring the effectiveness of fiscal policy towards inequality reduction. These results affirm that the relationship between fiscal policy and economic inequality is complex and multidimensional. Although progressive taxes and social expenditures are proven effective in curbing inequality, their effectiveness can vary depending on the economic structure, institutional capacity, and socio-political conditions of each country.

Therefore, fiscal policy that is adaptive, contextual, and integrated with social policy yields more sustainable long-term results. Thus, the results of this narrative study conclude that fiscal policy designed strategically, based on empirical evidence, and supported by strong institutional capacity has great potential to realize inclusive economic growth while sustainably reducing social inequality. This approach is not only relevant in the context of post-crisis economic recovery but also essential in the long-term endeavor to establish an economic system that is just, resilient, and oriented toward shared prosperity. By integrating adaptive fiscal strategies, equitable taxation, and sustainable public spending, governments can strengthen institutional capacity, promote inclusive growth, and ensure social cohesion. Ultimately, such a framework supports structural transformation and fosters an economy capable of withstanding future global shocks while maintaining fairness and sustainability.

Ultimately, such a framework supports structural transformation and fosters an economy that is resilient, adaptive, and capable of withstanding future global shocks while maintaining principles of fairness and sustainability. By promoting inclusive fiscal mechanisms, efficient taxation, and strategic public investment, governments can strengthen productive capacity, enhance human capital, and stimulate innovation-driven growth. Moreover, embedding sustainability into fiscal policy design aligns national development priorities with global sustainability agendas, including the pursuit of social justice, environmental balance, and economic resilience. Therefore, the integration of adaptive fiscal strategies and redistributive policies becomes a cornerstone for achieving inclusive development one that empowers marginalized groups, sustains economic competitiveness, and nurtures collective prosperity across generations within a fair and balanced macroeconomic framework.

5. Discussion

The discussion of the research results confirms that fiscal policy has a strategic role in maintaining the balance between economic growth and social justice. One of the key findings from various literature reviews indicates that the effectiveness of fiscal policy is highly dependent on its ability to manage the trade-off between economic efficiency and income redistribution. Gunasinghe et al. (2021) highlight that developed countries implementing progressive tax systems often face a dilemma between sustaining the pace of economic growth and achieving social justice goals. Nevertheless, their research results also show that in the long term, a reduction in inequality actually contributes to macroeconomic stability and broadens the tax revenue base through increased economic participation of low-income communities. On the other hand, Salim et al. (2020) emphasizes that in developing countries, the effectiveness of fiscal policy is often hampered by limited institutional capacity and a high reliance on regressive indirect taxes.

Fiscal reform focusing on strengthening direct taxes and increasing the efficiency of public expenditure is deemed capable of encouraging more inclusive and equitable economic growth (Sugangga et al., 2023). This approach also allows for the creation of a more proportional income distribution structure without significantly reducing economic productivity. The institutional aspect is a determining factor in the successful implementation of fiscal policy. Basri and Hill (2020) found that countries with transparent fiscal governance and automated tax systems are more effective in achieving distributive justice. A high level of fiscal transparency not only contributes to minimizing budget leakage but also increases public trust in the government. This trust, in turn, strengthens tax compliance and expands the state's fiscal capacity.

Therefore, institutional strengthening and the application of digitalization in tax administration are key steps towards an adaptive, efficient, and sustainable fiscal system. Furthermore, Anwar (2023) affirms that inclusive fiscal policy is not only effective in reducing income inequality but also makes a tangible contribution to achieving the Sustainable Development Goals (SDGs). Fiscal investments directed at the education, health, and social infrastructure sectors have a significant multiplier effect on increasing labor productivity and equitable economic welfare. This finding strengthens the view that fiscal policy does not merely function as a redistribution tool but also as a strategic instrument in promoting sustainable economic development.

From the entirety of the literature reviewed, it can be concluded that optimal fiscal policy must be capable of balancing economic efficiency, social justice, and fiscal sustainability. The implementation of progressive taxation, increased efficiency of public expenditure, and transparent institutional reform form the main foundation for building an economy that is inclusive and resilient to external shocks. In facing global uncertainty, technological transformation, and increasingly complex socio-economic challenges, an adaptive approach to fiscal policy will become increasingly vital as the main instrument in maintaining long-term stability and welfare.

6. Conclusion

This study concludes that fiscal policy and the tax system play a central role in creating a balance between economic growth and social justice. Through the mechanism of progressive taxation and targeted public expenditure, fiscal policy is capable of reducing income inequality, strengthening public purchasing power, and supporting sustainable economic recovery. The concept of optimal taxation is an important foundation in ensuring that the tax system is not only oriented toward revenue efficiency but also toward the achievement of social welfare broadly. The effectiveness of fiscal policy is highly dependent on institutional capacity, fiscal transparency, and good governance. Countries with modern tax administration systems and productivity-based expenditure policies have proven more successful in reducing income inequality and boosting inclusive growth.

The synergy between adaptive fiscal policy, structural reform, and productive social policy is the main factor in strengthening long-term economic stability. Thus, the future direction of fiscal policy must emphasize the balance between redistribution and economic efficiency, through the optimization of tax revenue, institutional strengthening, and strategic allocation of state expenditure. The implementation of this policy is expected to realize economic growth that is more inclusive, just, and sustainable, while simultaneously solidifying the national economic foundation in the face of global challenges.

References

Abdulkarim, Y. (2023). A systematic review of investment indicators and economic growth in Nigeria. *Humanities and Social Sciences Communications*, *10*(1), 1-13.

Ahuja, D., & Pandit, D. (2021). A review and research agenda of fiscal policy post 2008 financial crisis. *International Journal of Indian Culture and Business Management*, *24*(2), 225-246.

Anwar, S. (2023). The Effect of Fiscal Policy on Economic Inequality and Sustainable Development in ASEAN. *Atestasi: Jurnal Ilmiah Akuntansi*, *6*(1), 139-156.

Basri, C., & Hill, H. (2020). Making economic policy in a democratic Indonesia: The first two decades. *Asian Economic Policy Review*, *15*(2), 214-234.

Cevik, S., & Correa-Caro, C. (2020). Growing (un) equal: fiscal policy and income inequality in China and BRIC+. *Journal of the Asia Pacific Economy*, *25*(4), 634-653.

Giordono, L. S., Jones, M. D., & Rothwell, D. W. (2019). Social policy perspectives on economic inequality in wealthy countries. *Policy Studies Journal*, *47*, S96-S118.

Gunasinghe, C., Selvanathan, E. A., Naranpanawa, A., & Forster, J. (2021). Rising income inequality in OECD countries: does fiscal policy sacrifice economic growth in achieving equity?. *The European Journal of Development Research*, *33*(6), 1840-1876.

Kaneva, T., Chugunov, I., Pasichnyi, M., Nikitishin, A., & Husarevych, N. (2022). Tax policy for economic recovery and sustainable development after covid-19. *Problemy Ekorozwoju*, *17*(2), 102-109.

Khan, S. (2021). The impact of fiscal policy on income inequality: A Case Study of Pakistan. *Lahore Journal of Economics*, *26*(1), 57-84.

Malla, M. H., & Pathranarakul, P. (2022). Fiscal policy and income inequality: the critical role of institutional capacity. *Economies*, *10*(5), 115.

Nolan, B., Richiardi, M. G., & Valenzuela, L. (2019). The drivers of income inequality in rich countries. *Journal of Economic Surveys*, *33*(4), 1285-1324.

Salim, A., Rustam, A., Haeruddin, H., Asriati, A., & Putra, A. H. P. K. (2020). Economic strategy: Correlation between macro and microeconomics on income inequality in Indonesia. *The Journal of Asian Finance, Economics and Business*, *7*(8), 681-693.

Sugangga, A., Handayati, P., & Zagladi, A. N. (2023). Measuring the contribution of financial literacy in building the competitive advantage of MSMEs in Indonesia: Systematic Literature Review (SLR). *Brilliant International Journal Of Management And Tourism*, *3*(3), 63-77.

Tanaya, O., & Suyanto, S. (2022). The causal nexus between foreign direct investment and economic growth in Indonesia: An autoregressive distributed lag bounds testing approach. *Periodica Polytechnica Social and Management Sciences*, *30*(1), 57-69.