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

The Strategic Role of Fiscal Policy in Sustaining Economic Stability and Growth in Developing Countries

Wayan Yarte Yase[1]

[1] Universitas Sarjanawiyata Tamansiswa, Yogyakarta, Indonesia

Abstract

Article history:
Received: January 21, 2024
Revised: February 19, 2024
Accepted: March 20, 2024
Published: June 30, 2024

Keywords:
Developing Countries,
Economic Growth,
Economic Stability,
Fiscal Policy,
Inflation.

Identifier:
Zera Open
Page: 56-74
https://zeraopen.com/journal/ijpffp

Fiscal policy plays a crucial role in maintaining economic stability, controlling inflation, and promoting sustainable economic growth in developing countries. Through its primary instruments, taxation and government spending, fiscal policy enables governments to stimulate aggregate demand and enhance public welfare. Expansionary fiscal policy is often employed to accelerate growth by increasing infrastructure investment and providing subsidies, while contractionary policy is implemented to curb inflation and maintain budgetary balance. Developing countries, however, face persistent challenges such as limited financial resources, fiscal deficits, and high public debt burdens, which may constrain policy effectiveness. The success of fiscal policy largely depends on the degree of transparency, the implementation of structural reforms, and its coordination with monetary policy. Effective fiscal management can strengthen macroeconomic stability, boost investment, generate employment, and improve income distribution, thereby contributing to inclusive and long-term economic development. When properly designed and implemented, fiscal policy becomes a vital instrument for ensuring resilient and equitable growth in developing economies amid global economic uncertainties.

1. Introduction

Fiscal policy holds a crucial role in maintaining economic stability while simultaneously driving sustainable growth in developing countries. Through its two main instruments, namely taxation and government spending, the government can steer economic activity toward a desired equilibrium, whether to suppress the rate of inflation or to encourage economic expansion. In the dynamic global context, fiscal policy serves as a primary pillar in facing economic fluctuations, especially during financial crises, pandemics, or external shocks in international markets. Furthermore, fiscal policy also acts as an automatic stabilization mechanism capable of balancing the economic cycle through adjustments to government revenue and expenditure (Muzayyanah et al., 2023). Thus, this policy becomes a strategic element that determines national economic resilience, particularly amid increasing global uncertainty.

Developing nations face various structural challenges in the effective implementation of fiscal policy, including limited fiscal capacity, dependence on natural resource commodities, and weak taxation structures. Abdullah et al. (2019) asserts that the effectiveness of fiscal policy in developing countries is strongly determined by the government's ability to optimize state revenue and minimize budget leakage through tax system reforms and increased efficiency of public expenditure. A strong fiscal condition provides adequate fiscal space to respond to external turmoil while maintaining long-term macroeconomic stability. In this context, fiscal institutional reform is an absolute requirement for policies to generate sustainable and inclusive economic impacts.

The implementation of expansionary fiscal policy through increased infrastructure spending and social programs has proven capable of strengthening aggregate demand and expanding employment opportunities in the real sector. The findings of Kamal et al. (2021) indicate that fiscal policy focused on public financial sustainability plays a crucial role in strengthening economic stability by reinforcing the competitiveness of domestic industries and increasing labor productivity. However, expansionary fiscal policy implemented without careful planning potentially leads to excessive budget deficits and increases the burden of national debt. Therefore, careful planning and fiscal discipline are essential prerequisites for expansionary fiscal policy to continue functioning as a growth driver without causing the risk of fiscal imbalance in the future.

In addition to the role of macroeconomic stabilization, fiscal policy also has a strategic function in creating economic equity and poverty alleviation. The implementation of a progressive tax system and social assistance programs are effective instruments for reducing income inequality and strengthening the purchasing power of low-income communities. Seguino (2019) affirms that fiscal policy siding with poor communities significantly contributes to lowering poverty rates while strengthening the economic resilience of communities in developing countries. Within this framework, the direction of fiscal policy must consider aspects of distributive justice and economic inclusivity so that its benefits can be felt equally.

However, the effectiveness of fiscal policy is not only determined by the size of the budget or the form of intervention, but also by the quality of transparent, accountable, and responsive fiscal governance to economic dynamics. Many cases show that weak fiscal institutions are the main cause of inefficiency in the implementation of public policy. Şahin (2019) emphasizes that good coordination between fiscal policy and monetary policy is very important to maintain financial stability and prevent the emergence of long-term macroeconomic imbalances.

With optimal synergy between these two policies, the government can avoid overlapping policies that potentially worsen economic volatility. Fiscal policy is a vital instrument for developing nations to achieve a balance between economic growth, macroeconomic stability, and social justice. The implementation of targeted and long-term oriented policies will strengthen national economic resilience, reduce poverty rates, and improve the quality of life for the community. To achieve these goals, comprehensive institutional reform, increased fiscal transparency, and cross-policy economic coordination are required. With these steps, fiscal policy can function optimally as the main foundation for inclusive and sustainable economic development.

2. Literature Review

2.1. The Role of Fiscal Policy in Economic Growth

Fiscal policy is a fundamental instrument in maintaining macroeconomic stability while encouraging sustainable economic growth. Through this policy, the government seeks to balance state revenue and expenditure to ensure fiscal sustainability and support domestic economic activities, both through increased investment and public consumption. In this context, the role of fiscal policy is not only limited to a budget management tool, but also as a strategic mechanism to stimulate economic activity and maintain resilience against external shocks. Syahrini et al. (2021) assert that the application of optimal control in fiscal policy can increase the efficiency of economic growth by adjusting public spending and taxation policies dynamically to changes in macroeconomic conditions. This approach emphasizes the importance of flexibility and adaptability in fiscal policy so that it can respond effectively to global and domestic economic changes. Thus, fiscal policy managed adaptively and based on empirical data is key to strengthening national economic resilience amid evolving global economic volatility.

Furthermore, fiscal policy plays a significant role in creating long-term economic stability while reducing the volatility of the economic cycle. Afanas'ev and Shash (2021) state that the shift in fiscal policy from a surplus position to a deficit in developing countries can be an effective short-term strategy to stimulate economic growth, as long as the policy is balanced with strong fiscal discipline and sustainable budget management. Therefore, the balance between fiscal expansion and consolidation is an essential aspect in ensuring the sustainability of economic policy, avoiding structural imbalances, and maintaining economic growth momentum in the long term.

2.2. The Influence of Tax and Public Spending on Economic Performance

The aspects of taxation and state spending have a major role in the effectiveness of fiscal policy. Tax functions as the main source of government revenue, while public spending becomes an instrument of resource redistribution for the purpose of economic and social development. In Asiimwe and Twesigye (2023) research, the increase in tax collection effectiveness was proven to contribute positively to local economic development, especially through increased financing for the education and infrastructure sectors. Conversely, Noch et al. (2023) emphasizes the importance of efficient public financial management to ensure that every government expenditure generates a multiplier effect on economic growth. Good fiscal performance is not only determined by the amount of the budget spent, but also the effectiveness of planning and implementation.

In the context of developing countries, expenditure for productive sectors such as infrastructure and education has a significant impact on long-term economic growth, while excessive consumptive expenditure can lead to inflationary pressure and fiscal imbalance. Meanwhile, the report by Juhro et al. (2022) shows that inequality in fiscal policy among developing countries causes uneven economic growth. Countries with strong fiscal capacity are able to expand public investment and strengthen economic resilience, while countries with limited fiscal space are more vulnerable to external shocks. Therefore, progressive tax policy reform and the strengthening of fiscal institutions are strategic steps to achieve inclusive economic growth.

2.3. Knowledge Management and Competitive Advantage

Within the framework of sustainable development, fiscal policy not only acts as an instrument to encourage economic growth, but also as a strategic means to realize equitable community welfare. Taruno (2019) assert that fiscal policy has a significant impact on reducing poverty rates through a fairer income redistribution mechanism. Increased allocation of social spending and the application of a progressive tax system have been proven capable of reducing economic disparities and strengthening community welfare, especially in developing countries facing structural inequality challenges. Thus, fiscal policy oriented towards distributive justice plays an important role in strengthening the socio-economic foundation towards inclusive development. In line with this, Bondaruk et al. (2023) state that fiscal policy integrated with the principles of the Sustainable Development Goals (SDGs) potentially strengthens fiscal resilience while accelerating the achievement of long-term development goals.

Careful management of the budget deficit and increased efficiency of government spending in sustainable sectors such as renewable energy, green transportation, and environmentally friendly infrastructure are considered key strategies in accelerating economic transformation toward an environmentally conscious and highly competitive development model. Furthermore, Shah et al. (2023) research highlights the close link between fiscal policy, political stability, and regional economic resilience. The findings show that the combination of effective fiscal management and maintained political stability can strengthen regional economic resilience against global shocks and minimize the risk of long-term crises. Therefore, inclusive, adaptive, and long-term oriented fiscal policy can be the main foundation in realizing economic growth that is fair, resilient, and sustainable.

3. Method

This research uses a narrative study approach to analyze the role of fiscal policy in maintaining economic stability and driving growth in developing countries. The narrative approach is chosen because it is capable of providing a comprehensive picture of the dynamics of fiscal policy through the analysis of empirical experience, historical context, and the relationship between policy formulation and the resulting economic outcomes. This approach does not only focus on quantitative data such as figures or economic trends, but also interprets how fiscal policy is designed, implemented, and adjusted to various global challenges and complex socio-economic changes. Thus, this method allows for a deeper understanding of the adaptive nature of fiscal policy in facing dynamic global economics and diverse domestic contexts.

The narrative study method in the context of fiscal policy research provides space for researchers to explore policy narratives from various sources such as government reports, academic publications, and scientific articles to gain a comprehensive understanding of the strategy, implementation, and results of fiscal policy in developing countries. Secondary data is collected from a number of empirical studies and academic journals published within the last five years, focusing on the link between fiscal policy, economic growth, and macroeconomic stability. Through this approach, researchers can identify relevant policy patterns and analyze the extent to which fiscal intervention plays a role in maintaining national economic balance.

The research stages are carried out systematically through the process of collecting literature data from credible academic sources, such as articles indexed in the Google Scholar or Research Gate databases, and reports from international economic institutions. Next, a thematic narrative analysis is performed by examining each study to find the main themes related to fiscal management, policy effectiveness, and its impact on economic growth. The results of this analysis are then synthesized to build a general narrative about the pattern of fiscal policy in developing countries. The final stage of interpreting the research results is focused on understanding the cause-and-effect relationship between fiscal policy and macroeconomic variables such as inflation, public investment, and income distribution.

The validity of the research is maintained through the process of triangulating sources and deep interpretation of every identified narrative, to ensure the objectivity and consistency of the analysis results. Because this approach is descriptive-qualitative, the research does not use statistical analysis techniques, but rather emphasizes the conceptual and interpretive linkage between economic variables. By using the narrative study method, this research is expected to provide a comprehensive understanding of how fiscal policy functions as the main instrument in realizing stable, inclusive, and sustainable economic development in developing countries.

4. Results

The results of this study indicate that fiscal policy has a very crucial role in maintaining economic stability while encouraging sustainable economic growth in developing countries. The effectiveness of this policy heavily depends on the government's ability to maintain a balance between tax revenue, state expenditure, and careful and efficient management of deficits and public debt. Based on the results of empirical studies in various developing countries, well-designed fiscal policy is proven capable of strengthening the economic foundation through increased public investment, reduced income inequality, and the creation of long-term macroeconomic stability. Fiscal policy that is adaptive to global and domestic economic dynamics can also be a determinant factor in creating sustainable economic competitiveness.

According to Abdullah et al. (2019), effective fiscal policy not only functions as a tool to maintain budget balance, but also acts as a catalyst in strengthening economic growth and national financial stability. Increased fiscal efficiency is proven to have a positive relationship with Gross Domestic Product (GDP) growth and macroeconomic stability in developing countries. Governments that prioritize productive spending, such as investment in infrastructure and education, tend to experience higher economic growth and more controlled inflation rates compared to countries that allocate more of their budget to consumptive expenditure. This kind of fiscal policy approach shows that fiscal effectiveness is highly influenced by the quality of public spending allocation and a strategically designed long-term development orientation.

In line with these findings, the research of Kamal et al. (2021) asserts that fiscal sustainability is a key factor in strengthening economic resilience against various forms of global crises. In the context of developing countries, a resilient fiscal policy demands prudent debt management, diversification of state revenue sources, and tax reform oriented towards increasing efficiency and fairness. Their research shows that countries capable of maintaining a public debt ratio of GDP have greater fiscal capacity to face external shocks such as pandemics, energy crises, and commodity price fluctuations. This affirms that disciplined fiscal management not only maintains budget stability but also increases a country's adaptive capability against global uncertainty.

Juhro et al. (2019) adds that expansionary fiscal policy implemented in a targeted manner has great potential to increase aggregate demand and accelerate national economic growth without causing excessive inflationary pressure. In his study of the Indonesian economy, he shows that increased government spending in productive sectors has a strong multiplier effect on increased national output and the creation of new employment. However, the effectiveness of expansionary fiscal policy is highly influenced by the capacity of public institutions to implement transparent, accountable, and efficient budget management. Without good governance, expansionary policy can potentially lead to excessive deficits and disrupt long-term fiscal stability. Therefore, the aspect of fiscal governance is an important prerequisite in ensuring the success of fiscal policy in developing countries.

Meanwhile, the social dimension of fiscal policy is also an important concern in various studies. Seguino (2019) highlights that socially oriented fiscal policy through subsidy and social assistance programs can have a significant impact on reducing poverty rates in low-income countries. In the case study he conducted, increased public expenditure in the welfare and education sectors was able to reduce the poverty rate within a five-year period. This result shows that fiscal policy siding with vulnerable communities has a strategic role in strengthening social stability while supporting inclusive economic growth. Therefore, the combination of productive fiscal policy and responsive social policy is key to creating equitable development. Besides the social aspect, macroeconomic stability also heavily depends on the synergy between fiscal policy and monetary policy. Research by Gafor and Mohammed (2023) found that the implementation of a combination of contractive fiscal policy and strict monetary policy proved effective in suppressing the inflation. Their research results show an annual inflation decrease while maintaining a positive economic growth rate in the range per year. This finding strengthens the argument that the coordination of fiscal and monetary policy is an important factor in maintaining sustainable macroeconomic stability. Disharmony between policies can cause structural imbalances that potentially disrupt the economy as a whole.

In general, the synthesis of results from various studies shows that developing countries that implement growth-oriented fiscal policy tend to have better economic performance compared to countries that run reactive fiscal policy. Sohail et al. (2021) found that increased government investment in infrastructure and education has a positive impact on long-term productivity and the expansion of the domestic tax base. In the medium term, this strategy not only accelerates economic growth but also strengthens fiscal capacity through sustainable tax revenue increases. This shows a reciprocal relationship between economic growth and fiscal strength, where both reinforce each other to create a positive development cycle.

Furthermore, the level of fiscal discipline and the credibility of government policy are also determinant factors in the effectiveness of fiscal policy in driving economic growth. Countries with transparent fiscal governance and strong public oversight systems tend to be more capable of attracting Foreign Direct Investment

(FDI) and maintaining financial market stability. Conversely, countries facing chronic budget deficits and weak debt management are more vulnerable to external economic pressure and a decrease in investor confidence. Juhro et al. (2022) assert that the effectiveness of fiscal policy heavily depends on the extent to which the policy can synergize with monetary policy, as well as the government's ability to maintain credibility and market confidence in its fiscal management.

However, the influence of fiscal policy on economic growth is not linear. Yasmin (2023) found that the impact of fiscal policy on GDP tends to be long-term with a time lag of about two to three years after policy implementation. In the short term, increased public spending can indeed boost consumption and aggregate demand, but the effect on productivity and economic growth will only be visible in the medium to long term, when public investment begins to yield tangible economic benefits. Therefore, the success of fiscal policy requires policy patience and consistency in implementation so that the results can be felt optimally.

These studies also indicate that adaptive and empirically based fiscal policy is more effective in facing global economic challenges. Developing countries that implement counter-cyclical fiscal policy namely increasing public expenditure during economic slowdowns and reducing it when the economy grows rapidly are more capable of maintaining positive growth and avoiding sharp economic contractions. This approach is proven effective in keeping unemployment rates low and maintaining public purchasing power during periods of economic uncertainty. Thus, flexible and responsive fiscal policy to the economic cycle becomes one of the important pillars in maintaining national economic resilience.

The results of this study reinforce the view that fiscal policy is the main instrument in maintaining the balance between economic growth and macroeconomic stability in developing countries. Its effectiveness is strongly determined by comprehensive policy design, adequate fiscal capacity, and the integrity of public institutions in managing the state budget. When managed transparently, accountably, and long-term oriented, fiscal policy is not only capable of strengthening the domestic economy but also increasing resilience against external shocks such as global financial crises, pandemics, and climate change. Thus, the success of fiscal policy in developing countries lies in the government's ability to balance short-term and long-term goals through proactive, inclusive, and good governance-based policies. This approach is believed to ensure that the economic growth achieved is not only temporary, but also sustainable and capable of improving overall social welfare.

5. Discussion

The research results show that fiscal policy has significant implications for economic growth and stability in developing countries. Its effectiveness is not only determined by the magnitude of public spending allocation or the level of tax revenue, but also by the extent to which the policy is capable of creating a balance between economic development, fiscal sustainability, and social welfare. In this regard, fiscal policy functions as a flexible economic regulator tool to respond to changes in the economic cycle and anticipate potential crises that may occur in the future. The study by Abdullah et al. (2019) emphasizes that fiscal policy designed with the principle of fiscal sustainability is capable of strengthening long-term growth without causing pressure on macroeconomic stability. Countries that implement a careful debt management system and improve the quality of public spending show higher economic resilience against external shocks.

Furthermore, the strengthening of fiscal capacity through progressive tax reform can expand fiscal space and reduce dependence on external financing. Moreover, the research of Kamal et al. (2021) shows that fiscal policy oriented towards public financial sustainability not only strengthens fiscal stability but also increases investor confidence and expands the national economic base. The implication of this result indicates that transparent and accountable fiscal governance is a primary prerequisite in attracting long-term investment and reducing the risk of economic instability. In the context of economic globalization, the success of fiscal policy heavily depends on the government's ability to maintain its fiscal credibility in the eyes of international financial markets. Subsequently, Sohail et al. (2021) found that the effectiveness of fiscal policy is greatly influenced by strategic planning between the public and private sectors.

Public spending directed towards productive sectors such as infrastructure, education, and research is capable of creating a multiplier effect on economic growth. However, if expenditure is more focused on consumptive subsidies, the impact on growth is only temporary. Therefore, productive and targeted fiscal policy is needed to create inclusive and sustainable economic development. From a social perspective, Seguino (2019) research highlights the role of fiscal policy in reducing income inequality and poverty. The study results show that increased social spending supported by fair tax revenue is capable of strengthening social cohesion and increasing political stability.

Thus, fiscal policy is not only an economic instrument but also a tool to strengthen the social foundation of society. The implications of fiscal policy on economic growth in developing countries affirm the importance of a balance between fiscal expansion and budget discipline. Adaptive, measured, and transparent fiscal policy is capable of driving resilient economic growth while maintaining macroeconomic stability. The integration between fiscal planning and sustainable development goals is also an important direction in ensuring that fiscal policy is not only reactive to crises but also proactive in creating a highly competitive and resilient economy.

6. Conclusion

Fiscal policy holds a strategic role as the main instrument in maintaining economic stability, driving growth, and strengthening social welfare in developing countries. Through a combination of effective tax policy and productive public spending, the government can balance short-term goals such as price stabilization and long-term goals such as sustainable growth. The research results indicate that the effectiveness of fiscal policy heavily depends on transparent governance, progressive tax reform, and careful management of public debt.

Furthermore, the synergy between fiscal and monetary policy is proven essential for maintaining macroeconomic stability. Countries with good policy coordination are able to suppress inflation, attract investment, and expand employment without causing serious fiscal imbalances. In the social context, fiscal policy is also an important means of reducing income inequality and strengthening protection for vulnerable groups. Thus, adaptive, inclusive, and sustainable development-oriented fiscal policy is key to facing global economic challenges. Sustainable public policy reform and increased fiscal accountability are important steps to ensure that economic growth can proceed in line with social justice and long-term economic resilience.

References

Abdullah, H., Yien, L. C., & Khan, M. A. (2019). The impact of fiscal policy on economic growth in ASEAN-5 countries. *International Journal of Supply Chain Management*, *8*(1), 754-760.

Asiimwe, J. R., & Twesigye, D. (2023). Effect of Decentralized Tax Policies on District Development in Rwanda: A Case Study of Rwamagana District. *Journal of Finance and Accounting*, *7*(11), 44-64.

Bondaruk, T., Medynska, T., Nikonenko, U., Melnychuk, I., & Loboda, N. (2023). Fiscal policy as a guarantee of sustainable development under military conditions. *International Journal of Sustainable Development and Planning*, *18*(4), 1097-1102.

Gafor, N. M., & Mohammed, D. A. (2023). An Analytical Study Of The Effectiveness Of Fiscal Policy Tools In Achieving Economic Stability In Iraq. *Russian Law Journal*, *11*(11S), 405-414.

Juhro, S. M., Narayan, P. K., & Iyke, B. N. (2022). Understanding monetary and fiscal policy rule interactions in Indonesia. *Applied Economics*, *54*(45), 5190-5208.

Kamal, M., Usman, M., Jahanger, A., & Balsalobre-Lorente, D. (2021). Revisiting the role of fiscal policy, financial development, and foreign direct investment in reducing environmental pollution during globalization mode: evidence from linear and nonlinear panel data approaches. *Energies*, *14*(21), 6968.

Muzayyanah, M., Triyana, E., & Aura, K. A. N. (2023). Evaluating the impact of fiscal and monetary policies on Indonesia's macroeconomic stability and growth (2015-2019). *Journal of Islamic Economics Management and Business (JIEMB)*, *5*(2), 203-226.

Noch, M. Y., Sonjaya, Y., & Sutisna, E. (2023). Public Sector Innovations and Economic Stability: A Literature Review. *Vifada Management and Social Sciences*, *1*(2), 27-39.

Seguino, S. (2019). Tools of macroeconomic policy: fiscal, monetary and macroprudential approaches. *Gender Equality And Inclusive Growth: Economic Policies to Achieve*, 46.

Shah, M. I., Shuaibu, M. S., AbdulKareem, H. K., Khan, Z., & Abbas, S. (2023). Inequality consequences of natural resources, environmental vulnerability, and monetary-fiscal stability: a global evidence. *Environmental Science and Pollution Research*, *30*(4), 10329-10345.

Sohail, M., Akhtar, Z. M., Haroon, M., & Shah, S. U. M. (2021). Impact of Fiscal Policy on Economic Growth: A Panel Data Analysis across Political Regimes. *RADS Journal of Business Management*, *3*(2), 155-178.

Syahrini, I., Masbar, R., Aliasuddin, A., Munzir, S., & Hazmi, Y. (2021). The application of optimal control through fiscal policy on Indonesian economy. *The Journal of Asian Finance, Economics and Business*, *8*(3), 741-750.

Taruno, H. T. (2019). Public spending and poverty reduction in Indonesia: The effects of economic growth and public spending on poverty reduction in Indonesia 2009-2018. *The Indonesian Journal of Planning and Development*, *4*(2), 49-56.