International Journal of
Public Finance and Fiscal Policy
Volume 3, Number 2, 2024

The Impact of Political Policies on Global Economic Stability: A Literature Review

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Abstract

Article history:
Received: July 11, 2024
Revised: August 21, 2024
Accepted: October 7, 2024
Published: December 30, 2024

Keywords:
Economic Growth,
Fiscal Resilience,
Global Economy,
Political Policy,
Political Stability.

Identifier:
Zera Open
Page: 149-166
https://zeraopen.com/journal/ijpffp

This study aims to analyze the relationship between political policies and global economic stability through a literature review approach focusing on studies published over the past five years. The findings highlight that political stability plays a crucial role in maintaining macroeconomic balance, enhancing investment flows, strengthening public trust in economic institutions, and fostering inclusive growth. Conversely, political instability generates fiscal uncertainty, reduces investor confidence, slows down economic growth, and hampers sustainable development efforts. The study further reveals that transparent fiscal governance, robust public institutions, and credible political communication are the main determinants of economic resilience. In addition, the adaptation of political and fiscal policies to global transformations such as digitalization and the green energy transition has become a strategic necessity for sustaining long-term development. This research concludes that adaptive, coherent, and inclusive political policies are essential to creating durable economic stability and resilience amid the growing complexity of modern global challenges.

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1. Introduction

National economic stability is a reflection of the effectiveness of political policies and the government's ability to manage global economic dynamics. In the modern context, politics and economics cannot be separated, because political decisions determine the direction of fiscal, monetary, and governance policies that have a direct impact on economic growth and resilience (Malik et al., 2023). Since 2019, various countries have faced political turbulence due to the COVID-19 pandemic, energy crisis, geopolitical tensions, and regime changes that affect investor confidence and market stability (Bossman et al., 2023). In this situation, political stability is a strategic factor that determines a country's ability to maintain economic sustainability and protect its citizens from the impact of global shocks. This shows that political stability has a positive correlation with economic stability, both through investment, international trade, and public trust in economic institutions (Manioudis & Meramveliotakis, 2022).

Inconsistent fiscal and monetary policies often exacerbate economic uncertainty, especially in developing countries that are still vulnerable to political tensions (Abaidoo & Agyapong, 2023). Public policy uncertainty has led to a decline in Foreign Direct Investment (FDI), rising unemployment, and exchange rate fluctuations. Countries with weak institutional capacity tend to be unable to respond quickly to economic changes because political decisions are often colored by short-term considerations. In this regard, strong governance is key to creating a stable and sustainable economic climate (Noja et al., 2019). Governments that are able to manage fiscal efficiently can maintain a balance between public spending and economic growth through budget transparency, public oversight, and spending policies that are adaptive to global conditions (Montes et al., 2019). Conversely, when political policies are dominated by the interests of certain groups, the direction of economic development becomes inefficient, lowering national competitiveness, and increasing the potential for corruption (Roumpakis, 2020).

In the framework of globalization, the relationship between politics and economics is increasingly complex and interdependent. Countries with stable governance regimes have a greater capacity to adopt economic policies that are adaptive to the dynamics of international trade and investment. Political stability creates space for long-term policy formulation, such as tax reform, digital transformation, and sustainable investment. On the other hand, political instability has the potential to create macroeconomic pressures in the form of high inflation, fiscal deficits, decreased public sector productivity, and weakening exchange rates (Khan et al., 2020). In this context, political stability not only has an impact on short-term economic indicators, but also on the economy's resilience to long-term crises and the country's ability to maintain sustainable development.

Furthermore, the integration of public policy with the principles of transparency, accountability, and social participation is an important element in building market and public trust. Gong et al. (2022) found that countries with high political stability indexes show stronger financial market performance, lower inflation, and more stable investment levels than countries with uncertain political conditions. In the digital era, this is increasingly relevant because trust in the government system is a key factor in attracting investment in the innovation and technology sectors. Politics in the modern context functions not only as a decision-maker, but also as a strategic instrument that determines the direction, speed, and sustainability of economic development.

Thus, political stability is not only the result of a good governance system, but also a major prerequisite for the achievement of sustainable economic prosperity. In the face of the post-pandemic era, green energy transition, and digital disruption, governments around the world are required to be able to integrate inclusive political policies with economic policies that are responsive to global changes. Therefore, it is important to re-examine the linkages between political policy and economic stability in a cross-temporal and cross-country context.

This research aims to analyze how political policies affect economic stability in general, especially in the last five-year period marked by global challenges such as the COVID-19 pandemic, geopolitical fluctuations, and the digital transformation of the world economy. Through a literature study approach, this study seeks to identify effective political policy patterns in maintaining macroeconomic balance, as well as explore the role of political institutions in supporting inclusive and sustainable development.

2. Literature Review

2.1. The Relationship Between Political Policy and Economic Stability

The nexus between political policy and economic stability has long been a major concern for modern economists, especially in the context of increasing global uncertainty over the past five years. Various studies confirm that political stability functions as a catalyst for economic growth through the mechanism of increasing investment, controlling inflation, and strengthening public trust in economic institutions. Aaki (2019) shows that a consistent and stable system of government provides space for the implementation of effective fiscal policies, suppresses market volatility, and strengthens the foreign trade balance. Countries with maintained political stability tend to have better economic competitiveness because investors value low political risk as a guarantee of capital security and legal certainty.

In addition, Roumpakis (2020) found that countries with democratic and participatory systems of government show higher levels of economic growth compared to authoritarian countries. Stable democracy creates public policy predictability, strengthens political legitimacy, and increases the effectiveness of fiscal and monetary regulations. Meanwhile, Ashraf (2022) emphasized that the sustainability of economic development is highly dependent on the extent to which political stability is able to create synergy between short-term economic policies and long-term social policies. The combination of fiscal discipline and political stability creates a conducive business climate, reduces market uncertainty, and ensures the sustainability of economic growth in a dynamic global era.

2.2. The Role of Fiscal and Institutional Governance in Sustaining Economic Stability

In addition to political factors, fiscal governance and the strength of public institutions play a central role in maintaining national economic stability. The quality of good fiscal management not only determines the effectiveness of economic policies, but also the foundation of public trust in the government. Larch et al. (2021)

emphasized that the effectiveness of transparent, accountable, and targeted fiscal policies determines a country's ability to deal with external pressures such as the global financial crisis, pandemics, and fluctuations in commodity prices. When public spending is efficiently managed and tax policies are designed fairly, countries have stronger fiscal resilience and are able to maintain macroeconomic stability. In the context of modern governance, Zhuo et al. (2021) show that the quality of governance that includes bureaucratic effectiveness, control over corruption, and the rule of law is positively related to key economic indicators such as GDP growth, low inflation, and exchange rate stability.

Countries with high integrity government systems tend to have more disciplined and consistent fiscal policies, thereby lowering the risk of political uncertainty. Furthermore, Niu (2022) highlight the importance of digital governance as a new mechanism that strengthens fiscal transparency, accelerates bureaucratic processes, and increases accountability in public budget oversight. The integration of digital innovation, institutional reform, and smart fiscal policies is proving to be a key pillar of economic resilience in an era of global disruption and uncertainty. Thus, the success of the modern economy is determined not only by sound economic policies, but also by institutional capacity that is consistent and adaptive to global changes.

3. Method

This research method uses a library research approach, which focuses on a systematic analysis of relevant scientific literature between the last five years. This approach was chosen because it allows researchers to gain a comprehensive understanding of the relationship between political policy and economic stability without being tied to a specific region or context. This research does not involve the collection of direct field data, but rather utilizes secondary sources such as Google Scholar-indexed scientific journals, international policy reports, and publications of global financial institutions such as the World Bank and IMF. The main objective of this method is to identify patterns, trends, and research gaps related to the impact of political policies on national and global economic growth and stability.

The first stage in this study is a literature inventory by conducting a structured search using keywords such as political stability, fiscal policy, economic governance, and macroeconomic resilience. The selected sources are then evaluated based on their credibility, relevance, and publication period. This move ensures that only scientific works from the last five years are used, including articles that discuss the relationship between political policy and national economic stability. After the initial selection, the literature was categorized into three major groups: (1) studies on political and macroeconomic relations, (2) studies on fiscal governance and economic institutions, and (3) research on the impact of politics on economic indicators such as inflation, investment, and GDP growth.

The second stage is content analysis, which aims to identify similarities and differences in arguments between studies. This technique allows researchers to assess the extent to which political factors such as governance stability, fiscal transparency, and public policy consistency affect economic stability. In addition, this study also adopts the principle of thematic synthesis, where various literature findings are grouped based on relevant themes, such as the role of fiscal policy in economic stability and the impact of political uncertainty on investor confidence. The final stage is the interpretation and synthesis of results, in which findings from various sources are combined to construct a conceptual narrative that explains the relationship between political policy and economic stability in a global context. The results of this literature study approach are expected to make a conceptual contribution to the development of stable, adaptive, and sustainable economic development public policies.

4. Results

The results of this study show that national economic stability is directly or indirectly influenced by political policies, fiscal governance, and government institutional capacity. Based on the literature review over the past five years, there is a strong consensus that political stability is a determining factor for sustainable economic growth. Maintained political stability can increase investor confidence, reduce macroeconomic risks, and strengthen a country's fiscal legitimacy (Abaidoo & Agyapong, 2023). Countries with stable political systems consistently show a positive correlation with increased Foreign Direct Investment (FDI), controlled inflation, and exchange rate stability. On the other hand, political uncertainty arising from inconsistencies in public policies and too frequent changes of government can hinder investment flows, exacerbate fiscal deficits, and reduce the credibility of economic policies (Roumpakis, 2020).

The findings from Malik et al. (2023) strengthen this argument by emphasizing that in developing countries, politics has a dual function: as a director of economic policy as well as a determinant of the direction of long-term development. A stable government, with a consistent and transparent political system, creates a positive business climate where domestic and international investment can grow simultaneously. The study also highlights that stable and credible fiscal policies play an important role in reducing social inequality, creating jobs, and strengthening national productivity. On the contrary, political inconsistencies worsen economic competitiveness, lower market efficiency, and slow down the process of industrialization.

Furthermore, Montes et al. (2019) emphasized that the effectiveness of fiscal governance plays a major role in maintaining long-term economic stability. Countries with transparent and accountable fiscal systems have proven to be more resilient to external shocks such as pandemics, energy crises, and global inflation. Governments that have an open financial reporting mechanism and strict budget discipline tend to be more trusted by investors. Zhuo et al. (2021) through the Worldwide Governance Indicators report also found that indicators of political stability and government effectiveness have a significant positive correlation with economic growth, inflation control, and public policy efficiency. These findings show that political stability and institutional quality are two sides of the same coin in building national economic resilience.

In the modern context, government technology and digital governance are becoming new factors that strengthen the relationship between politics and economics. Niu (2022) found that countries that implement digital governance have a greater ability to reduce fiscal leakage, detect corruption, accelerate budget distribution, and improve the efficiency of public services. Digitalization of government is not only about technical efficiency, but also about strengthening political accountability and public trust in the country's economic institutions. With the integration of information technology, governments can monitor the effectiveness of fiscal policies in real-time, increase transparency of public spending, and respond to global economic dynamics in a more adaptive manner.

In addition to institutional factors, the political, social dimension and public trust have also been proven to have an influence on economic resilience. Bhattacharya and Stern (2020) highlight that countries with high levels of social trust in the government are better able to implement fiscal and monetary policies effectively during the COVID-19 crisis. When people trust the government, the level of compliance with policies increases and the negative economic impact can be suppressed. This reinforces the argument that public trust, political stability, and fiscal policy effectiveness form a triangle of national economic stability.

In macroeconomic reviews, political polarity and social tensions are often the main obstacles to long-term economic growth. Bossman et al. (2023) reveal that extreme political polarization lowers market confidence and increases the volatility of stock prices and exchange rates. Socio-political tensions create a perception of high risk among investors and lead to an increase in capital costs. In line with that, Gong et al. (2022) note that the increasing global political uncertainty since 2020 has negatively impacted the performance of financial markets, especially in developing countries with fragile political systems. On the other hand, countries that are able to maintain political stability show stronger capital market performance, more consistent FDI growth, and lower macroeconomic volatility.

The study of Khan et al. (2020) added that political stability plays an important role in supporting the sustainable development agenda. Stable governments have a greater capacity to implement social, environmental, and economic policies consistently without being disrupted by political conflicts or regime change. Political stability ensures the continuity of long-term development policies, such as green energy transitions and social welfare programs. In contrast, political instability often forces governments to shift their focus from long-term development policies to short-term crisis management, which can slow down sustainable development processes and exacerbate social inequality.

In addition, Manioudis and Meramveliotakis (2022) emphasizes the importance of strong economic institutions as a key factor in maintaining a balance between political legitimacy and economic effectiveness. In a democratic system, public support for the government strengthens the credibility of economic policies and allows for more effective implementation of structural reforms. Governments with high legitimacy can set long-term fiscal policies without creating excessive political uncertainty. In contrast, countries with weak institutions often experience policy reversals due to internal political pressures, which reduce policy effectiveness and market confidence.

Ashraf (2022) and Larch et al. (2021) simultaneously found that fiscal stability has a dual role: as an instrument of development and a guarantor of social stability.

Fiscal discipline allows the government to maintain a balance between public spending and state revenues, while ensuring that social programs continue to run despite global economic pressures. Governments that are able to keep fiscal deficits within safe limits and prioritize productive spending tend to have more stable economic growth. This condition is in line with the results of Malik et al.'s (2023) research which emphasizes that consistent and adaptive fiscal policies can encourage the productive sector, strengthen industrial competitiveness, and reduce socio-economic disparities.

Another aspect that is also crucial is the relationship between political legitimacy and the effectiveness of economic policies. Governments that change frequently are usually stuck on short-term populist policies to maintain political support, while stable governments can devise measurable, long-term economic strategies. Noja et al. (2019) affirm that political stability contributes to predictable economic policies, lowers transaction costs, improves market efficiency, and strengthens the country's fiscal capacity. A government that has strong political legitimacy is also better able to maintain a balance between expansionary fiscal policy and inflation control.

Meanwhile, Zhao et al. (2022) show that long-term economic stability cannot be separated from the government's ability to manage political and economic dynamics simultaneously. Politics used as a means of achieving social consensus allows economic policies to be carried out more effectively. However, when politics becomes an arena for conflict and power struggles, economic policies are often unsustainable because they are hampered by internal political resistance. Therefore, political stability can be seen as a strategic index of macroeconomic policy effectiveness.

Finally, an analysis of the literature as a whole shows that political stability is the main foundation of all economic policy instruments. Without political stability, fiscal and monetary policies lose direction, credibility, and impetus for development. A stable government is able to prioritize long-term strategies based on innovation, sustainability, and social equity. In contrast, unstable governments tend to be caught up in reactive and populist policies. Therefore, the relationship between political policy and economic stability is reciprocal and synergistic: stable politics creates a resilient economy, while a strong economy strengthens political legitimacy.

The results of this study confirm that political policy has two main roles in the modern economic system. First, as a policy driver that determines the direction of development through fiscal, monetary, and public governance policies. Second, as a control mechanism that ensures the sustainability and equitable distribution of development results so that it not only focuses on growth, but also on social justice. Thus, political stability is not only an indicator of government success, but also a major prerequisite for the creation of national economic resilience in an increasingly complex global era.

5. Discussion

The findings of the literature study show that the relationship between political policy and economic stability is reciprocal and mutually reinforcing. Stable politics creates predictable macroeconomic conditions, thereby strengthening market confidence, while stable economics also strengthen political legitimacy and prevent social turmoil. In this context, politics plays a role not only as an arena of power, but as a managerial instrument in the management of economic and fiscal resources (Manioudis & Meramveliotakis, 2022). This relationship can be explained through two main dimensions: institutional stability and public policy credibility.

First, institutional stability is the foundation for the effectiveness of economic policies. Countries that have strong fiscal governance, a consistent legal system, and a professional bureaucracy tend to be more resilient to global political and economic pressures. Montes et al. (2021) emphasized that fiscal transparency increases the effectiveness of monetary policy and lowers macroeconomic risks. This is in line with the findings of Zhuo et al. (2021) who stated that institutional qualities such as public accountability, rule of law, and effectiveness of government are positively correlated with economic growth and social stability. In other words, effective fiscal governance can only function optimally if it is supported by a stable political environment and free from opportunistic intervention.

Second, the credibility of public policy is an important factor in maintaining long-term economic stability. A government that is able to maintain policy consistency and transparent public communication will be more trusted by investors and the public. Gong et al. (2022) found that political uncertainty has a negative impact on financial market performance and exchange rates. In the 2020–2023 global crisis period, many countries failed to maintain market confidence due to too frequent changes in fiscal policy, causing domestic economic instability. On the other hand, countries that manage to maintain good political communication are able to withstand the impact of global fluctuations more effectively.

In addition to internal factors, the interaction between political policies and global economic integration also affects national stability. Ashraf (2022) show that political stability allows governments to implement sustainable development agendas, including green energy transition and strengthening food security. In this context, visionary political policies are able to bridge short-term goals (such as economic growth) with long-term goals (such as sustainability and social inclusion). However, when political stability is disrupted, economic priorities often shift towards handling temporary crises, at the expense of sustainable development.

Interestingly, Malik et al. (2023) highlight that in developing countries, political stability functions not only as an economic variable, but also as an indicator of institutional capacity. Stable governance creates policy predictability and opens up space for long-term economic planning. Thus, targeted politics and strong public institutions can be a catalyst for inclusive economic growth. The conclusion that emerges from the various literature is that political stability is not only the result of good governance, but also a prerequisite for effective economic policies. Credible institutions, disciplined fiscal policies, and transparent public communication are the connecting factors between the political and economic spheres. In the face of post-pandemic challenges and global geopolitical uncertainty, countries that are able to maintain political stability will be better prepared to face economic crises, strengthen social resilience, and drive long-term growth.

6. Conclusion

This research emphasizes that political stability is the main foundation for the creation of national and global economic stability. Based on the analysis of the latest literature, consistent political policies, transparent fiscal governance, and strong public institutions play an important role in maintaining macroeconomic balance and strengthening public trust in the government. Political stability has been proven to be able to increase investor confidence, strengthen exchange rates, and encourage inclusive and sustainable economic growth. On the contrary, political instability creates market uncertainty, lowers investment flows, hampers public policies, and worsens the socio-economic conditions of society.

This literature study approach also shows that the relationship between politics and economics is dynamic and interdependent. Stable governments have greater capacity to formulate measurable long-term policies, implement fiscal reforms, and maintain a balance between development and equity. The results of the study confirm that effective politics not only creates order, but also a means to ensure the sustainability of the national economy in the midst of global uncertainty. In the future, integration between inclusive political policies and adaptive economic policies is needed so that countries are able to face structural challenges such as economic digitalization, green energy transition, climate change, and international geopolitical dynamics. With a combination of stable, transparent, and long-term oriented policies, economic resilience can be realized in a sustainable manner.

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