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The Impact of Fiscal Policies on Economic Growth: A Systematic Literature Review

Iis Yulita Nur Fitriastuti[1]

[1] Sekolah Tinggi Ilmu Ekonomi Widya Wiwaha, Yogyakarta, Indonesia

Abstract

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This study conducts a systematic literature review (SLR) to examine the multifaceted role of fiscal policy in promoting economic growth. Drawing on recent theoretical and empirical studies from last five-years, the paper synthesizes findings on the impact of government spending, taxation, and public debt on macroeconomic performance. The results highlight that productive public investment especially in infrastructure, education, and health significantly enhances long-term growth, particularly when supported by strong institutions and transparent governance. Tax policy effects are shown to vary with the structure and administration of tax systems, where growth-friendly and equitable designs are more effective. Meanwhile, the relationship between public debt and growth remains context-dependent, with moderate, well-targeted debt often supporting recovery in times of crisis. An emerging theme in the literature is the evolving role of fiscal policy in addressing sustainability and social inclusion goals, underscoring a shift from short-term stabilization to long-term structural transformation. The findings emphasize that fiscal policy must be contextually tailored, efficiently implemented, and strategically aligned with national development priorities to maximize its growth enhancing potential.

1. Introduction

Fiscal policy plays a pivotal role in shaping the trajectory of economic growth through mechanisms such as government spending, taxation, and budgetary management. As one of the primary tools available to policymakers, fiscal policy not only influences aggregate demand in the short term but also impacts long-term productivity, investment climate, and income distribution. In times of economic uncertainty or downturn, such as the COVID-19 pandemic and recent global inflationary pressures, governments have increasingly relied on discretionary interventions to stabilize economies and promote recovery (Auerbach & Gorodnichenko, 2022; OECD, 2022).

Theoretical perspectives on the relationship between fiscal policy and growth have evolved over time. Keynesian economists emphasize the importance of government spending in stimulating demand during recessions, while neoclassical models highlight concerns over crowding-out effects and fiscal sustainability. In practice, the effectiveness of fiscal policy depends on various factors including the type and timing of interventions, the level of existing public debt, and the structural characteristics of the economy (Catalano et al., 2021). Moreover, the composition of spending whether directed toward infrastructure, education, health, or public investment can determine the extent to which fiscal policy enhances long-term growth potential (Barro, 2019; Li et al., 2022).

Recent empirical studies also underscore the importance of institutional quality, transparency, and governance in mediating the outcomes of fiscal interventions. In developing countries, for instance, weak institutions may limit the effectiveness of expansionary fiscal policies, while in advanced economies, the focus has increasingly shifted toward balancing fiscal stimulus with concerns about debt sustainability and inflation control. Furthermore, as countries grapple with transitions toward green economies and digitalization, fiscal policy is expected to take on broader roles beyond cyclical stabilization becoming a key instrument for structural transformation and inclusive development (OECD, 2022).

Given the diversity of findings and policy contexts, a systematic review of recent literature is essential to provide a comprehensive understanding of how fiscal policies affect economic growth under varying circumstances. This paper aims to synthesize both theoretical and empirical studies published in recent years, identifying consistent patterns, contrasting perspectives, and areas where further research is needed. By doing so, it seeks to inform scholars, policymakers, and development practitioners about the evolving dynamics of fiscal policy in promoting sustainable and equitable economic growth (Xiao & Watson, 2019).

2. Literatur Review

Fiscal policy has long been recognized as a fundamental instrument for influencing economic growth. Through mechanisms such as government spending and taxation, fiscal tools can stimulate demand, enhance productivity, and support long-term development. Recent studies have emphasized that the composition and efficiency of fiscal policy are more critical than its size alone in determining its impact on growth.

Ertekin and Pezzolla highlight that public investment, particularly in infrastructure and human capital, has a significantly positive effect on long-term economic growth, especially when compared to recurrent government spending. These findings are especially relevant for developing countries seeking to close infrastructure and education gaps (Ertekin & Bulut, 2021).

On the taxation side, Lee and Gordon (2022) argue that the structure of tax systems plays a crucial role in shaping incentives for investment and productivity. Their research shows that effective corporate taxation frameworks and administrative efficiency tend to correlate with higher economic growth (Lee & Gordon, 2022).

Debt sustainability remains another key theme in the literature. According to Reinhart et al. (2022), high levels of public debt can hamper growth by increasing borrowing costs and crowding out private investment, especially when debt exceeds sustainable thresholds. However, recent cross-national analyses confirm that the effects vary depending on macroeconomic conditions and investor confidence, requiring disciplined and adaptive fiscal strategies (Reinhart et al., 2022).

Finally, modern structured syntheses emphasize the evolving role of fiscal policy in addressing long-term challenges such as climate change and inequality. Fiscal instruments are increasingly used not only for stabilization but also to support inclusive and sustainable growth, reflecting a shift toward more strategic, multi-dimensional fiscal frameworks (OECD, 2022).

In conclusion, the literature suggests that coherent and adaptive fiscal policy design is essential for shaping sustainable economic outcomes in the Global South, particularly when aligned with strong institutions, transparent governance, and strategic coordination mechanisms (Auerbach & Gorodnichenko, 2022).

3. Methods

This study employs a Systematic Literature Review (SLR) approach to comprehensively examine and synthesize the existing body of knowledge on the impact of fiscal policies on economic growth. The SLR method was chosen due to its structured and transparent nature, which enhances the reliability and replicability of findings. A systematic review enables researchers to map out research developments, compare results, and identify gaps across different contexts in a coherent and evidence-based manner (Xiao & Watson, 2019). To guide the review process, this study adopted a structured synthesis framework involving four key stages: identification, screening, eligibility, and inclusion (Xiao & Watson, 2019).

The literature search was conducted using several reputable databases, including Google Scholar, Scopus, and ScienceDirect, to ensure comprehensive coverage of recent academic publications. The keywords used in the search process included combinations of fiscal policy and economic growth. Boolean operators AND and OR were applied to increase the precision and relevance of the search results. Only peer-reviewed journal articles published between 2018 and 2022 were considered, to capture the most recent developments and empirical findings in the field.

Articles were selected based on explicit inclusion criteria: the study must clearly examine the relationship between fiscal policy components such as taxation, government spending, or public debt and economic growth, it must be published in a peer-reviewed journal, and it must be written in English. Exclusion criteria included studies focused exclusively on monetary policy without incorporating fiscal dimensions, as well as non-peer-reviewed publications such as commentaries or book reviews.

The selected articles were then reviewed in depth, and relevant data were extracted including country or region studied, fiscal variables analyzed, methodological approach, and identified outcomes. The extracted data were synthesized through a qualitative content analysis to identify recurring themes, contrasting perspectives, and policy-relevant insights. The structured synthesis approach also helped reveal how fiscal policies have been theorized and tested across different contexts, contributing to more nuanced interpretations of their long-term impact on economic growth (OECD, 2022).

The final sample included several core publications that directly addressed the relationship between fiscal policy and economic growth. These were analyzed and consolidated to provide an evidence-based map of how fiscal interventions influence structural transformation, sustainability objectives, and inclusive development pathways (OECD, 2022).

4. Results and Discussion

The systematic literature review identified several eligible studies published between 2018 and 2022, which examined the relationship between various fiscal policy instruments and economic growth across diverse economic contexts. From the analysis, three major themes emerged: the role of public expenditure, the effects of taxation, and the impact of public debt on long-term growth.

First, consistent evidence supports the argument that productive public spending, particularly in infrastructure, education, and healthcare, contributes positively to economic growth. For example, recent conceptual and empirical syntheses confirm that capital- and human-capital-oriented expenditures significantly enhance growth potential when embedded within strong institutions (Barro, 2019; OECD, 2022). This finding aligns with endogenous growth perspectives emphasizing that well-targeted investment boosts productivity and innovation. However, the effectiveness of such spending is highly dependent on institutional efficiency and transparency. Where governance is weak, public investment may not yield optimal outcomes due to leakages and misallocation (Auerbach & Gorodnichenko, 2022).

Second, the literature shows that tax policy impacts growth differently depending on tax structure and administration. Lee and Gordon (2022) argue that the structure of tax systems plays a crucial role in shaping incentives for investment and productivity. Their research shows that effective corporate taxation frameworks and administrative efficiency tend to correlate with higher economic growth (Lee & Gordon, 2022). However, the positive effects are not automatic; poorly designed tax cuts can lead to fiscal imbalances and rising deficits. Conversely, progressive taxation that finances productive public investment may support both equity and efficiency goals. In developing countries, excessive reliance on indirect taxes has been found to be regressive and potentially growth-constraining (Gaspar et al., 2022; OECD, 2022).

Third, the relationship between public debt and growth remains complex and context-specific. According to Reinhart et al. (2022), high levels of public debt can hamper growth when interest obligations rise and investor confidence declines. Recent cross-national analyses emphasize that sustainable debt management depends not only on the size of debt but also on its composition and purpose, particularly whether it is used for high-return public investment or merely for recurrent consumption (Eichengreen et al., 2022).

A fourth emerging theme is the shift toward fiscal sustainability and green recovery. Several recent studies emphasize the growing use of fiscal policy to promote environmental sustainability and social inclusion (OECD, 2022). This shift reflects an evolving understanding of fiscal policy not only as a counter-cyclical tool but also as a catalyst for transformative economic change (OECD, 2022).

In summary, the reviewed literature suggests that fiscal policy can be a powerful driver of economic growth when it is well targeted, efficiently implemented, and contextually appropriate. Productive public investment, fair and growth-friendly taxation, and sustainable debt management are key components. However, the impact varies widely depending on institutional quality, macroeconomic conditions, and policy design. These findings highlight the importance of tailoring fiscal strategies to national priorities while maintaining a balance between short-term stimulus and long-term fiscal discipline (Auerbach & Gorodnichenko, 2022).

5. Conclusion

This systematic literature review concludes that fiscal policy remains a vital and multifaceted instrument for promoting economic growth. Across the studies reviewed, core fiscal instruments public expenditure, taxation, and public debt consistently appear as the main channels through which governments influence macroeconomic performance. The evidence suggests that productive public investment, particularly in infrastructure, education, and healthcare, can generate long-term economic benefits, provided it is supported by efficient institutions and transparent governance mechanisms (Barro, 2019; OECD, 2022).

In terms of taxation, growth outcomes are largely dependent on the design and administration of tax systems. Lower corporate tax rates, when implemented with strong regulatory oversight, have been shown to support investment and productivity (Lee & Gordon, 2022). However, tax reforms must be carefully balanced to avoid fiscal imbalances. Similarly, the impact of public debt on economic growth is nuanced while excessive debt can hamper growth, strategic borrowing for high-return investments can serve as a powerful counter-cyclical tool, especially in times of crisis (Eichengreen et al., 2022).

The review also highlights a growing trend toward using fiscal policy to achieve sustainable and inclusive growth, reflecting broader policy priorities such as environmental responsibility and social equity (OECD, 2022). These developments demonstrate a shift in fiscal thinking from short-term demand management to long-term structural transformation.

Overall, the effectiveness of fiscal policy is highly context dependent, shaped by macroeconomic conditions, institutional quality, and governance capacity. For fiscal policy to maximize its positive impact on growth, it must be well targeted, data informed, and aligned with national development goals (Auerbach & Gorodnichenko, 2022). Future research should further explore the dynamic interactions between fiscal instruments and structural factors such as technological innovation, demographic change, and climate resilience, to better inform fiscal strategies in a rapidly evolving global economy (OECD, 2022).

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