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Research Article

## The Impact Of Fiscal Policy On Economic Growth

Omar Al-Kasasbeh

Universiti Sultan Zainal Abidin, Malaysia

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Corresponding Author: Email: [siz449@putra.unisza.edu.my](mailto:siz449@putra.unisza.edu.my)

**Abstract.** The relationship between fiscal policy and economic growth has attracted a great deal of attention in recent years. The growth experience of several countries during the last decades has generated a growing strand of theoretical and empirical literature trying to explain these events. Although one could argue that economic growth and fiscal policy influence each other. The aim of this paper is to review the research work conducted on fiscal policies and economic growth, noting that there are three tools of fiscal policy; the first type is government expenditure, the second type is taxation, and the third type is debts. In addition, according to previous research, the relationship between fiscal policy and economic growth is not clear and consistent, where in some cases a positive relationship, while in others it may be a negative relationship. In this paper, we will discuss the concept of fiscal policies, economic growth, and the relationship between those two variables through some of the previous research

**Keywords** : Fiscal policy, Economic growth, Government Expenditure, Taxation

## INTRODUCTION

The goal of achieving positive economic growth rates is one of the priorities sought by governments of different countries, especially in developing and underdeveloped countries (Xue, Weng & Yu, 2018). Such countries are always looking for economic growth to enhance and strengthen their economies. Economic growth has therefore become the main factor officially accepted for evaluating the success and development of the economy (Al-kasasbeh, 2022a). The importance of economic growth stems from the positive effects on the national economy that give a strong boost to new investment, resulting in job opportunities and increased purchasing power for the community (Murinde, 2012; Iamsiraroj, 2016).

The determinants of economic growth remain a crucial and motivating study issue in the field of economics and are almost unanswered. The critical question to be asked here is whether the fiscal policy has an impact on economic growth or otherwise? Theoretically, fiscal policy sector growth is debated from the three dimensions: feedback, demand, and supply hypotheses (Ziaei, 2015). When policy makers struggle to find possible economic growth and have a stable economy for their countries, fiscal policy and economic growth relationship becomes more critical. New research in this area is important refers to the significance of the economic growth for each country (Kasasbeh, 2021; Jayeola, 2022).

Furthermore, several studies have also been conducted on the relationship between government expenditure, taxes, public debt, and economic growth. The just mentioned topics have been diversely investigated by several studies with a concentration on fiscal policy variables. Such as Herndon and Pollin (2014); Lof and Malinen (2014); Kia and Mousavi (2015); Gale, Krupkin and Rueben (2015); Alawneh (2017); Abueid et al, (2018); Al-kasasbeh (2022); and Kasasbeh, (2021).

Indeed, the analysis of economic growth, fiscal policy is of significant interest to various, of researchers, including Tcherneva, (2011); Audu (2012); Karagöz and Keskin (2016); Nursini (2017); Ugwuanyi & Ugwunta (2017) and Al-kasasbeh et al, (2022). All these studies attempted to discover the link between them. It is frequently believed that economic growth performance is established by several factors such as energy consumption, international trade, financial development, CO<sub>2</sub> emission, population, monetary policy and many others.

Furthermore, current research indicates that advanced economies have concentrated on exploring the impact of fiscal policy determinants such as (Stoilova and Patonov, 2013; Atilgan, Kilic and Ertugrul, 2017; d'Agostino, Dunne, and Pieroni, 2018). The just-mentioned factors encouraged the researcher to try to identify fiscal policy as one of the most important tools of economic growth.

## RESULTS AND DISCUSSION

### Fiscal Policy

There is no doubt that economic policies include several measures such as fiscal and monetary policy and policy on credit and exchange rates. Fiscal policy plays an important position in these policies, because the various objectives they are looking for can be reached. The national economy depends on its various tools, which can be adapted to affect all the economic and social aspects of society, the government's

approach to the economy was *laissez-faire*. After the Great Depression, ideas emerged calling for their intervention in economic life to regulate unemployment, inflation and business cycles.

Fiscal policy has become a major instrument of economic policy in guiding the economic course and addressing what is exposed to shocks and crises. Their different definitions of the concept of fiscal policy (Al-kasasbeh, 2022b). For example, it is defined as a set of public revenue policies for public expenditure in order to achieve specific objectives. On the other hand, some define it as a set of goals, directions, actions, and activities adopted by the state to influence the national economy and society to maintain its overall stability and development (Tcherneva, 2011).

The fiscal policy situation remained neutral until appeared on the horizon of the economic crisis that swept the world in 1929. It can be said that the significant development of fiscal policy has stemmed from the major contribution to the great economist John Maynard Keynes in his book "The General Theory of Jobs and Interest and Income", when emphasizing the weakness of market mechanisms alone in coping with economic problems, especially the Great Depression crisis, and the consequent need to follow Keynes views of state intervention in economic activity. Since then, fiscal policy has assumed a more critical role and has become a major instrument of economic policy tools to guide the economic entity's course and address what it is exposed to shocks and crises, as well as their impact on the development of the economy, in particular, in the growing countries (Hoover, 2015; Al-kasasbeh et al., 2022).

According to Ugwuanyi and Ugwunta (2017), fiscal policy includes many patterns affecting economic activities such as government spending, public debt, and taxation, as well as influencing employment and aggregate demand growth level. Fiscal policy strengthens policymakers ability to manage the economy by managing their income and spending power to achieve specific goals that lead to economic growth. Fiscal policy also represents government policies related to the state budget, which is represented in tax revenue, government borrowing, government spending, or even deficit financing (Sanni, 2012). Fiscal policy's main objective is to provide countries with economic stability by improving economic conditions and factors in a way that strengthens the state's business and ensures that government decisions are appropriate for economic stability (Ndubuisi, 2017).

Historically, there are numerous points of view on the success of fiscal policies that have been pursued by different economic schools from time to time. The classic approach, which prevailed until The Great Depression (1929), highlights the importance of a balanced budget for the efficiency of fiscal policies. It also pointed out that budget deficits are likely to create economic instability. Classical economists also claimed that budget should generally be identical, apart for some variations. They also argued that the effectiveness of government spending or tax regulations was related to strategies through which such policies were shaped and implemented (Erkam, 2010).

However, the classic approach with its assertion of financing the budget deficit through borrowing and its consequential obscurity has failed to resolve the crisis in the absence of its inability to predict The Great Depression. Confirming that the

government should intervene in the economy through revenue, public spending and the budget, Keynesian views opened the debate to the principle of a balanced budget and pointed to the relevance and macro-economic impact of the imbalanced budget (Karagöz and Keskin, 2016). Keynesian view argues that the effectiveness of monetary policy tools is limited due to liquidity trap and other factors and it argues that aggregate demand could be complemented by public spending and public revenue. Thus, in order to reduce inflation, fiscal policy should be applied by following budget surplus policy, while in the time of recession monetary expansion would be provided by budget deficit (Bozkurt & Göğül, 2010).

According to Keynesian argument, the fiscal contraction leads to a temporary contraction through aggregate demand channel. A frequently used and popular Keynesian-Monetarist contention in theory of economics further clarifies the effectiveness of fiscal policy. Monetarist view holds economy to be generally stable and believes interventionist monetary policy to be objectionable and thus, consequentially, fiscal policy to be harmful (Erkam, 2010). Meanwhile Friedman says, if intervention is inevitable, monetary policy should be preferred to fiscal policy because of the delayed impacts of fiscal policy (Dudley-Evans, 2017).

### Empirical Literature Review

In this section of the paper, a series of previous research and studies on the subject of fiscal policy and its relation to economic growth in a number of countries will be presented in order to gain a deep understanding of the nature of the relationship between fiscal policy and economic growth, as follows:

Table Error! No text of specified style in document.1: Summary of Previous Empirical Literature Review

	AUTHORS	COUNTRY AND DATA	METHOD	MAJOR FINDINGS
TAXES AND ECONOMIC GROWTH				
1	Ivanyna, Moumouras, and Rangazas, (2016)	developing countries	dynamic general equilibrium model	(-)
2	Aghion, Akcigit, Cage, and Kerr, (2016)	U.S states	Granger causality	→
3	Riba, (2017)	South Africa 2003 - 2016	ARDL cointegration and Granger causality	(+) ↔
4	Biswas, Chakraborty, and Hai, (2017)	U.S. state	GMM, and OLS model	(-)
5	Di Sanzo, Bella, and Graziano, (2017)	panel of twenty European countries 1970 to 2012	VAR model	(-)

6	Babatunde, Ibukun, and Oyeyemi, (2017)	Africa from 2004 to 2013	Hausman test	(+)
7	Grdinić, Drezgić, and Blažić, (2017)	Central and Eastern Europe from 1990 to 2010	(GMM) regressions	(-)
8	Juliana, (2018)	Nigeria 1994 to 2016	cointegration test	(+)

PUBLIC DEBT AND ECONOMIC GROWTH

9	Stylianou (2014)	Greece during the period 1980 to 2010	Granger causality test	~
10	Al-Refai (2015)	OECD nations 1981 to 1995	OLS	(-) (+)
11	Chiu and Lee (2017)	61 countries 1985–2009	panel data framework	(+) (-)
12	Cherif, and Hasanov (2018)	USA	VAR	(-)
13	Ferando and Serafim (2018)	Angola 2004-2015	panel data approach	(-)
14	Gómez-Puig, and Sosvilla (2018)	euro area (EA) the period 1961-2013	Autoregressive Distributed Lag (ARDL) bounds	(-)
15	Esteve, and Tamarit (2018)	Spanish economy 1851–2013	dynamic ordinary least squares (DOLS) method	(-)
16	Ncanywa, and Masoga (2018) Kasasbeh (2021)	South Africa Jordan	autoregressive distributive lag Granger causality	(-) ↔

GOVERNMENT EXPENDITURE AND ECONOMIC GROWTH

17	Alptekin, and Levine, (2012)	review 32 empirical studies	panel Granger causality test	~
18	Keho (2015)	Ten African countries. over the interval 1965 to 2013	Granger causality test	↔ →
19	Osei, Aglobitse, and Bentum-Ennin, (2017)	Thirty-three countries from 1990 to 2014.	Autoregressive Distributed Lag (ARDL)	(+)
20	Atilgan, Kilic, and Ertugrul, (2017)	Turkey 1975–2013	autoregressive-distributed lag approach (ARDL)	(+)

21	Paul, and Furahisha, (2017)	Tanzania over the period of 1978 to 2014.	Johansen test of cointegration and Granger causality panel data methods	(+) →
22	d'Agostino, and Dunne, and Pieroni, (2018)	109 countries 1998–2014		(-)
23	Abad, Haron, and. Abueid, (2018)	Jordan for the period 1970-2017	(ARDL)	→
24	Le Van, Nguyen-Van, Barbier-Gauchard, and Le (2019)	UAE 1975Q1-2012Q4	annual data analyses	(+)
	Alkasasbeha, Haron, Abueid, (2018)	Jordan 1970-2017	(ARDL)	(+)

→ Means that the causality runs from economic growth to its determinants

← Means that the causality runs from the determinant of the economic growth to economic growth

↔ Means that bi-directional causality exists between economic growth and its determinants

~ means that no causality exists between economic growth and its determinants

(+) Means positive relationships between economic growth and its determinants

(-) Means negative relationships between economic growth and its determinants

The various empirical studies analyzed here reported inconsistent and inconclusive outcomes. For example, there are substantial positive and bidirectional relationships between economic growth and government expenditure, taxes, and public debt, and negative relationships have been documented in some studies. Other studies record various results. This mixture of outcomes and conclusions comes from differences in methodology, specific times of study and variables used.

## CONCLUSION

This paper seeks to determine whether a consensus exists about the impact of fiscal policy on economic growth. In reference to selected articles, were found to report a negative relationship between fiscal policy and economic growth. However, the results also suggested that the relationship may be positive. Similarly, there were studies that supported the neutrality of fiscal policy and economic growth. Therefore, there is no unanimity regarding the connection between fiscal policy and economic growth. The nature of the relationship may be positive, negative, or neutral. Overall, this review demonstrates that the effect of fiscal policy on economic growth is not constant and varies depending on a number of heterogeneous factors, such as the research methodology used, the level of development of the sampled countries, the relative size of the public sector, institutional quality, the composition, and the selected control variables, among others. The study finds, therefore, that the influence of fiscal policy on economic growth is ambiguous.

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**Omar Al-Kasasbeh**

The Impact Of Fiscal Policy On Economic Growth

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