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Impact of Fiscal Policies on Economic Growth in Developing Countries

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Abstract

This study examines the impact of fiscal policies on economic growth in developing countries by synthesising empirical evidence from post-2015 academic and institutional literature. Using a qualitative, secondary-data-based approach, the study analyses how government expenditure, taxation, fiscal sustainability, and institutional frameworks influence growth outcomes under typical developing-country constraints. The findings indicate that fiscal policy affects economic growth in a highly conditional manner. Productive public expenditure and efficient investment management are consistently associated with positive growth effects, whereas pro-cyclical fiscal behaviour, high public debt under weak institutions, and volatile fiscal policy tend to undermine long-term performance. The evidence further suggests that fiscal multipliers in developing countries are generally modest, reflecting high informality, openness, and limited financial depth. On the revenue side, growth outcomes depend more on tax structure and administrative capacity than on overall tax levels. Overall, the study highlights the importance of composition, stability, and institutional quality in designing growth-oriented fiscal policies in developing economies.

Keywords: Fiscal policy, economic growth, developing countries, public expenditure, taxation

Introduction

Fiscal policy occupies a central position in debates on economic growth in developing countries because it is one of the few levers governments can adjust directly in response to macroeconomic volatility, structural transformation pressures, and persistent development deficits. In practice, the fiscal stance and its composition shape aggregate demand in the short run while also influencing potential output through investment in physical infrastructure, human capital, and institutional capacity. Yet developing economies face tighter constraints than advanced economies: narrower and more pro-cyclical tax bases, larger informal sectors, higher borrowing costs, and greater exposure to external shocks that complicate counter-cyclical policy. These constraints make the growth consequences of fiscal actions more ambiguous than standard textbook predictions, especially when policy changes are undertaken alongside exchange rate pressures, capital flow reversals, and binding debt-servicing obligations. The international policy literature increasingly highlights that fiscal interventions affect growth through multiple channels, including incentives for private investment, productivity effects of public capital and service delivery, and credibility effects on risk premia and macroeconomic stability (International Monetary Fund, 2015; International Monetary Fund, 2015). At the same time, evidence from emerging and developing economies indicates that instability in fiscal policy itself can be growth-

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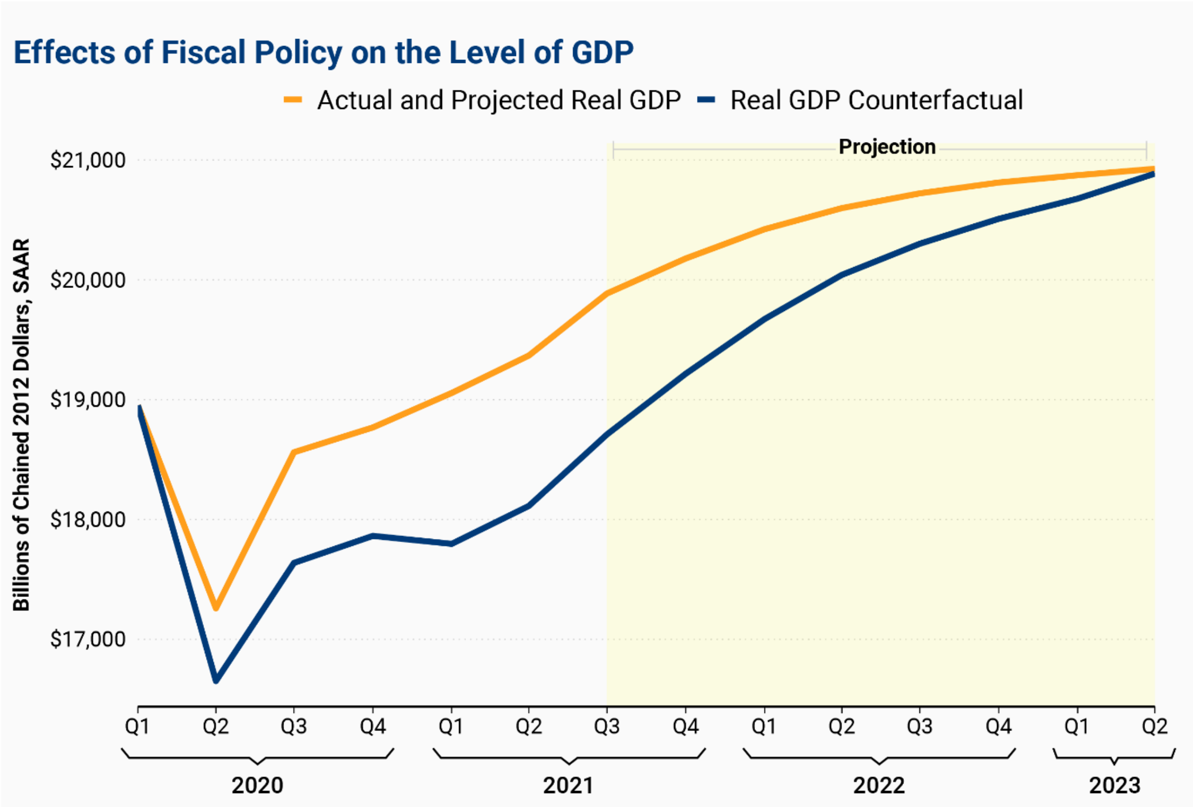
damaging, reflecting political economy frictions, commodity-revenue cycles, and weak budget institutions (Marioli, Fatás, & Vasishtha, 2023).



The analytical case for studying fiscal policy and growth in developing countries rests on both Keynesian and supply-side mechanisms, but the balance between them depends on country conditions and policy design. On the expenditure side, the growth impact is sensitive to whether spending is tilted towards productive outlays, such as well-executed public investment and quality-enhancing social expenditure, versus recurrent spending with limited multiplier or productivity effects. Research on public investment emphasises that efficiency is a decisive mediator: when project selection, procurement, and implementation are weak, higher capital spending may translate into limited additions to effective public capital, with adverse implications for debt sustainability and medium-term growth (Berg et al., 2015). On the revenue side, the structure of taxation matters for growth through labour supply, investment incentives, and formalisation dynamics; the same revenue increase can have different implications depending on whether it relies on broad-based consumption taxes, corporate income taxation, or distortionary trade and production taxes. Empirical work using developing-country panels also suggests non-linearities and threshold effects, where fiscal deficits or debt burdens may shift the growth response from supportive to harmful once sustainability concerns dominate (Salma, 2016). These mechanisms intersect with the macro-financial environment: fiscal multipliers tend to be smaller where exchange rates are flexible, economies are highly open, or debt is elevated, implying that similar fiscal actions can yield markedly different growth outcomes across developing countries and over time (Ilzetzki, Mendoza, & Végh, 2013).

Against this background, the research problem is not simply whether fiscal policy affects economic growth, but under what configurations of policy instruments, constraints, and institutions fiscal policy becomes growth-enhancing or growth-impairing in developing contexts. Recent scholarship has expanded from the size of government or headline deficits towards questions of fiscal composition, volatility, and rules-based frameworks designed to reconcile stabilisation with development needs. Work on "second-generation" fiscal rules, for instance, stresses that rule design must balance simplicity and enforceability while avoiding unintended compression of productive investment, particularly in low-capacity settings (Eyraud et al., 2018). Complementary evidence indicates that fiscal rules can shape how consolidation episodes protect or erode public investment, with implications for long-run growth prospects (Ardanaz, Cavallo, Izquierdo, & Puig, 2021). At the micro level, new findings link consolidation actions to slower firm growth in developing economies, highlighting transmission channels beyond aggregate demand, including credit conditions and expectations (Pahula, 2024). Building on these strands, this study frames fiscal policy as a multidimensional growth determinant in developing countries and motivates a systematic examination of how expenditure composition, revenue design, sustainability conditions, and institutional anchors interact to influence growth trajectories over time (International Monetary Fund, 2015; Marioli et al., 2023).

Need Of the Study

The need for this study arises from the persistent divergence between the theoretical expectations of fiscal policy and its observed growth outcomes in developing countries. While fiscal policy is frequently promoted as a core instrument for stimulating economic growth, reducing inequality, and accelerating structural transformation, empirical evidence from developing economies remains mixed and often context-specific. Many countries have undertaken expansionary spending programmes, tax reforms, or fiscal consolidation under the guidance of international institutions, yet growth outcomes have varied considerably across regions and time periods. This inconsistency suggests that broad generalisations about the growth effects of fiscal policy may be inadequate without closer examination of country-specific constraints such as institutional capacity, debt sustainability, and economic structure. Existing studies often focus either on advanced economies or on narrow fiscal indicators such as deficits or debt ratios, leaving gaps in understanding how fiscal policy operates as a growth mechanism in developing contexts characterised by informality, weak revenue mobilisation, and vulnerability to external shocks (International Monetary Fund, 2015; Berg et al., 2015).

A further motivation for this study is the evolving nature of fiscal challenges faced by developing countries in the post-2010 period. Rising public debt levels, recurrent global crises, climate-related fiscal pressures, and increasing demands for social spending have significantly altered the fiscal landscape. The COVID-19 pandemic, in particular, expanded fiscal deficits and debt burdens, intensifying debates on whether growth should be prioritised over consolidation or whether fiscal restraint is necessary to restore macroeconomic stability.

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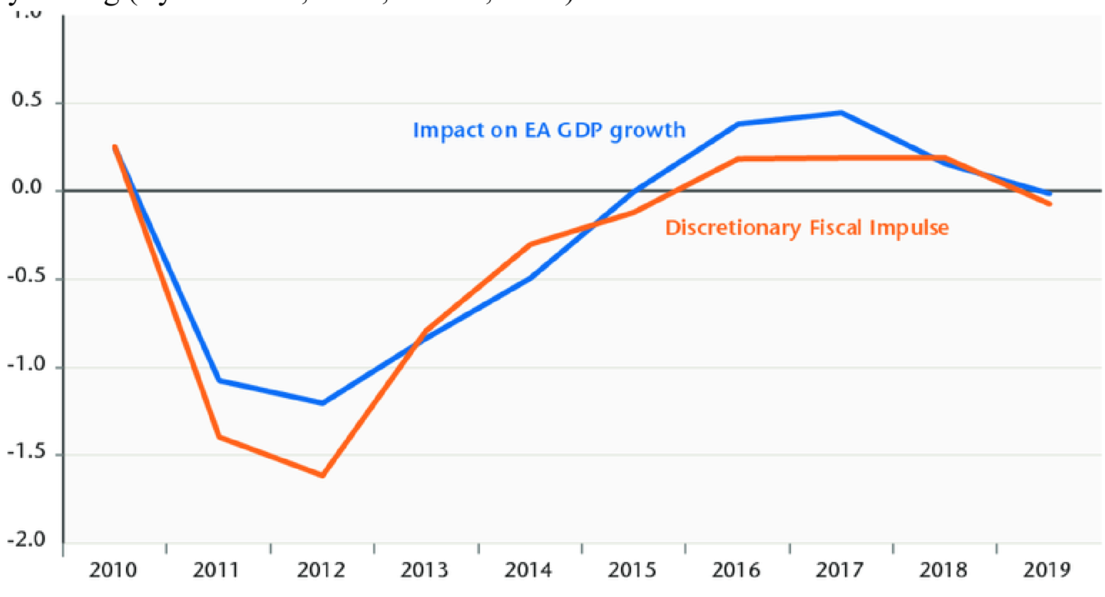
Recent empirical research indicates that poorly designed consolidation can undermine medium-term growth, especially when it disproportionately compresses public investment or social expenditure critical for productivity and human capital formation (Ardanaz et al., 2021; Marioli et al., 2023). At the same time, revenue-side reforms aimed at broadening tax bases and improving compliance are increasingly central to development strategies, yet their growth implications remain underexplored in comparative developing-country settings. This creates a clear need for updated analysis that reflects contemporary fiscal realities rather than relying on pre-2010 growth–fiscal relationships.

The study is also needed to support more informed policy formulation by clarifying the conditions under which fiscal policy contributes positively to economic growth in developing countries. Policymakers often face trade-offs between short-term stabilisation and long-term development objectives, particularly when fiscal space is limited and political pressures are high. Without a nuanced understanding of how expenditure composition, taxation structure, and fiscal sustainability interact with growth, policy choices risk being either overly expansionary or excessively restrictive. By synthesising post-2015 empirical evidence and focusing explicitly on developing economies, this research seeks to address a critical knowledge gap in the literature. It provides a structured basis for evaluating fiscal strategies not merely in terms of macroeconomic balance but in relation to their broader growth implications, thereby contributing to more context-sensitive and growth-oriented fiscal policymaking (Eyraud et al., 2018; Pahula, 2024).



Scope of the research

The scope of this research is defined by its focus on examining the relationship between fiscal policies and economic growth within the specific context of developing countries, recognising the heterogeneity that characterises this group of economies. The study concentrates on the post-2015 period in order to capture recent fiscal dynamics shaped by global financial uncertainty, rising public debt, and evolving development priorities. It considers a broad range of developing economies across different regions, rather than a single-country case, to allow for comparative insights into how fiscal policy outcomes vary under differing structural, institutional, and macroeconomic conditions. The analysis is limited to macro-level relationships, emphasising aggregate growth outcomes rather than sector-specific or micro-level effects, while acknowledging that these broader outcomes are influenced by underlying institutional and policy frameworks (International Monetary Fund, 2015; Marioli et al., 2023).

Within this framework, the research scope includes both the expenditure and revenue dimensions of fiscal policy and their interaction with economic growth. On the expenditure side, attention is given to the composition of government spending, particularly the distinction between productive and non-productive expenditure and its implications for long-term growth potential. On the revenue side, the study examines how different forms of taxation and revenue mobilisation strategies influence growth through investment incentives, consumption behaviour, and formalisation of economic activity. Fiscal sustainability indicators such as budget deficits and public debt are considered as conditioning variables rather than primary outcomes, allowing the study to assess how growth effects of fiscal policy change when sustainability constraints become binding. However, the research does not extend to detailed evaluation of monetary policy interactions or exchange rate regimes, except where these factors are necessary to contextualise fiscal outcomes (Eyraud et al., 2018; Salma, 2016).

The research scope is further bounded by its methodological and conceptual choices. It relies on secondary data and empirical evidence from peer-reviewed studies and institutional research available through Google Scholar, focusing on analyses published from 2015 onwards to ensure relevance and credibility. The study does not attempt to forecast future growth trajectories or prescribe country-specific fiscal rules; instead, it aims to synthesise existing evidence to identify recurring patterns and policy-relevant insights applicable across developing economies. By delimiting the scope in this manner, the research maintains analytical clarity while providing a coherent framework for understanding how fiscal policy influences economic growth under the structural and institutional constraints typical of developing countries (Ardanaz et al., 2021; Pahula, 2024).

Literature Review

The empirical and theoretical literature on fiscal policies and economic growth in developing countries has expanded markedly since the mid-2010s, moving beyond debates about the "size" of government towards the composition, cyclicality, credibility, and state capacity under which fiscal instruments operate. A common starting point is that fiscal policy affects growth through both demand-side and supply-side channels. In the short run, changes in government spending and taxation influence aggregate demand, while over longer horizons the productivity of public capital, the quality of human-capital formation, and incentive effects on private investment become central. For developing countries, these channels are mediated by structural features that are less binding in advanced economies, including high informality, shallow domestic financial markets, greater exposure to commodity and capital-flow shocks, and weaker budget institutions. Contemporary work therefore increasingly treats

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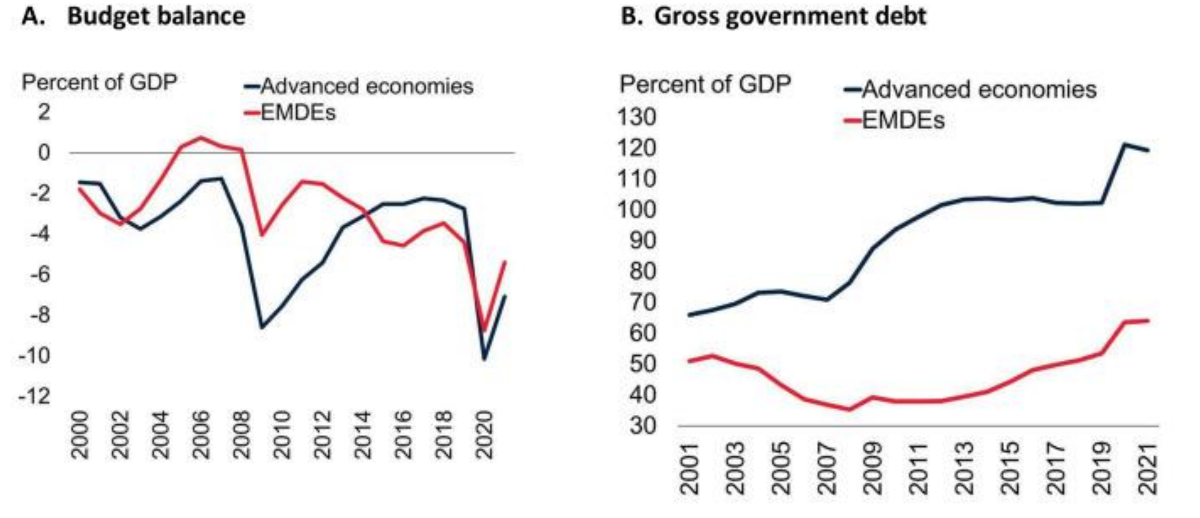
fiscal policy effectiveness as conditional, rather than uniform, across countries and over time (Aizenman, Hutchison, & Jinjarak, 2018; Jalles, Mallick, & Sousa, 2023).



Sources: IMF World Economic Outlook; World Bank.
Notes: EMDEs = emerging market and developing economies. Country weights based on PPP GDP.
A. Weighted averages of budget balance (as percent of GDP) for 35 advanced economies and 148 EMDEs. Data from 2000 to 2021.
B. Weighted averages of gross government debt (as percent of GDP) for 30 advanced economies and 144 EMDEs. Data from 2000 to 2021.

A substantial strand of the literature focuses on fiscal multipliers and the contexts in which spending expansions translate into output growth. Within low-income and developing settings, model-based evidence underscores that financing modalities and implementation constraints can materially alter the size and persistence of multipliers. Shen, Yang, and Zanna's work highlights how features common in low-income countries—such as limited home bias in investment and low marginal efficiency of public investment—can dampen output responses, and that externally financed spending may generate different dynamics compared with domestically financed spending when crowding out pressures are binding (Shen, Yang, & Zanna, 2018). A complementary empirical emphasis considers heterogeneity in multipliers across countries and time, cautioning that pooled estimates can mislead when institutional quality, openness, and macroeconomic regimes differ substantially (Kitsios & Patnam, 2016). More recent IMF evidence explicitly integrates informality into the multiplier discussion, suggesting that larger informal sectors may weaken conventional transmission channels and, by extension, reduce the growth impact of discretionary fiscal actions relative to more formalised economies (Colombo, Furceri, Pizzuto, & Tirelli, 2022). This body of research supports a more nuanced premise: fiscal expansions are not inherently growth-promoting unless the underlying conditions for effective absorption, procurement, and private-sector complementarity are present.

Public investment quality and efficiency constitute another prominent theme, given the centrality of infrastructure deficits in development strategies. A key argument is that the growth payoff from higher capital spending depends less on headline expenditure levels and more on how effectively spending is transformed into productive public capital. Work by

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Berg and colleagues challenges simple assumptions that scaling up investment mechanically produces growth, emphasising project selection, absorptive capacity, and the efficiency of public investment management as decisive mediators of long-run outcomes (Berg et al., 2015). The implication for developing-country growth is that fiscal policy debates cannot be reduced to the expansion-versus-austerity dichotomy; rather, they must consider the efficiency frontier of public spending. Related contributions connect this efficiency logic to structural transformation, arguing that fiscal policy can facilitate reallocation and productivity upgrading but may also entrench low-productivity structures if spending supports unproductive rents or fails to resolve labour-market and capacity constraints (Skott, 2021).

Fiscal space, debt dynamics, and non-linear effects are central to understanding why similar fiscal stances may be associated with different growth outcomes across developing countries. A recurring finding is that the growth impact of deficits and debt is conditional, with threshold-type dynamics emerging when sustainability concerns affect borrowing costs, expectations, and macroeconomic stability. Panel evidence for developing countries indicates that the relationship between fiscal balances and economic activity may shift across deficit and surplus ranges, implying that both excessive deficits and certain surplus positions can coincide with weaker growth depending on investment conditions and macroeconomic context (Slimani, 2016). The fiscal multiplier literature also identifies fiscal position as a conditioning variable: multipliers appear weaker when debt is high and financing constraints are acute, suggesting that credibility and market perceptions can attenuate the growth effects of discretionary stimulus (Huidrom, Kose, Lim, & Ohnsorge, 2016). At a more structural level, analyses linking debt and governance highlight that weak public financial management and debt administration can translate borrowing into leakage rather than productive capital, thereby impairing growth even when fiscal expansions are sizeable (Musa, Adamu, & Shittu, 2023).

A further set of studies examines the cyclicality and volatility of fiscal policy, given persistent evidence that many developing countries struggle to conduct counter-cyclical policy. A meta-analytic approach finds that fiscal policy in developing countries tends to lean pro-cyclical on average, and that spending policies in particular may amplify business-cycle fluctuations more than tax policies, partly because planned counter-cyclicality often fails to materialise in outcomes (Heimberger, 2023). Consistent with this, cross-country work revisiting counter-cyclicality emphasises heterogeneity in how budget components respond to the cycle and the relevance of crisis episodes, which can shift fiscal behaviour sharply (Jalles et al., 2023). Beyond cyclicality, the volatility of fiscal policy itself has been identified as a growth-reducing factor. Evidence focusing on emerging markets and developing economies suggests that fiscal policy is more volatile than in advanced economies and that this volatility is associated with lower growth, particularly in commodity exporters where revenue instability and political economy pressures generate stop-go fiscal patterns (Arroyo Marioli, Fatás, & Vasishtha, 2023). These contributions collectively imply that the growth impact of fiscal policy is not solely about "more" or "less" spending but also about the stability and timing of fiscal actions across the cycle.

Institutional frameworks designed to mitigate pro-cyclicality and protect growth-enhancing expenditure have therefore attracted significant attention, particularly fiscal rules and their design features. The literature on “second-generation” fiscal rules argues that newer rule frameworks aim to balance simplicity, flexibility, and enforceability, and that design choices such as escape clauses and operational targets are critical for resilience to shocks (Eyraud, Debrun, Hodge, Lledó, & Pattillo, 2018). A key concern in developing countries is whether rules inadvertently compress public investment during consolidations, undermining long-run growth. Empirical work on “growth-friendly” rule design finds that flexible rules are more likely to safeguard public investment during consolidation episodes than rigid constraints, suggesting that the composition of adjustment is as important as the magnitude (Ardanaz, Cavallo, Izquierdo, & Puig, 2021). Subsequent research examining investment behaviour over the cycle aligns with this emphasis on design and conditionality, reinforcing that rules may protect investment only under particular institutional and macroeconomic settings (Jürgens, 2022). At the same time, other evidence cautions that the institutional environment shapes fiscal behaviour in complex ways; for developing countries, institutional quality may not translate into counter-cyclicality as strongly as it does in advanced economies, implying limits to “institutional fixes” without broader governance improvements (Mackiewicz & Maliszewska, 2023).

Taxation and revenue mobilisation represent another major research area, reflecting the dual need to finance development and maintain incentives for private-sector activity. The literature does not converge on a single growth-maximising tax structure for developing countries, but it repeatedly stresses that distortionary effects depend on the type of tax, administrative capacity, and the behavioural responses of firms and households. Evidence from subnational developing contexts indicates that direct taxes may be more distortionary for growth than indirect taxes in certain settings, though results are sensitive to the structure of local economies and the efficiency of collection (Neog & Gaur, 2020). Cross-country and country-specific studies often find mixed long-run relationships between total tax revenue and growth, reflecting composition effects and the possibility that weak tax administration and narrow bases generate high marginal distortions even at moderate revenue levels (Abd Hakim, Bujang, & Ahmad, 2022). In resource-constrained environments, some evidence suggests that broad-based taxes on goods and services can correlate positively with growth when they support macro stability and public investment, whereas poorly designed income taxation may discourage investment or formalisation (Maganya, 2020). The diversity of findings has shifted emphasis towards the institutional and administrative determinants of tax effectiveness, including compliance, informality, and the credibility of public spending funded by taxation.

Recent literature also extends the growth discussion to micro-level transmission channels, which is particularly important in developing countries where firm dynamics drive employment and productivity change. Firm-level evidence across a wide set of developing countries indicates that fiscal consolidation actions can be associated with weaker firm growth, with heterogeneous impacts across firm size and export orientation, implying that macro fiscal adjustments may propagate through credit conditions, demand expectations, and the operating environment for businesses (Pahula, Tanna, & De Vita, 2024). Related work examining fiscal policy effects on private expenditure in developing countries using panel VAR approaches suggests that the crowding-in or crowding-out of private activity depends on the nature of fiscal shocks and the broader macroeconomic regime, reinforcing the idea that growth outcomes arise from interactions between public policy and private-sector responses rather than from fiscal aggregates alone (Kaharudin, Lau, & Tan, 2022).

Across these strands, several points of convergence and contention emerge. There is broad agreement that fiscal policy can support growth when it expands productive capacity through efficient investment and human-capital formation, but the literature consistently demonstrates that implementation quality, financing constraints, and institutional credibility condition these effects (Berg et al., 2015; Huidrom et al., 2016). There is also increasing agreement that pro-cyclicality and volatility undermine growth by amplifying shocks and weakening investment planning horizons, yet there is ongoing debate about the extent to which fiscal rules and institutional reforms can overcome these tendencies in low-capacity settings (Arroyo Marioli et al., 2023; Eyraud et al., 2018). On the revenue side, the evidence remains fragmented, pointing to the need to distinguish tax composition and administration from overall tax burdens, particularly under high informality and limited enforcement capacity (Colombo et al., 2022; Neog & Gaur, 2020). Taken together, the post-2015 literature motivates an integrated analytical approach in which expenditure composition, investment efficiency, fiscal space, cyclicality, and institutional design are treated as jointly determining the growth impact of fiscal policies in developing countries, rather than as separable policy domains (Ardanaz et al., 2021; Jalles et al., 2023).

Methodology

This study adopts a qualitative, descriptive research methodology based on a systematic review and synthesis of secondary data. The analysis draws exclusively on peer-reviewed journal articles, working papers, and institutional studies indexed in Google Scholar and published from 2015 onwards, with a specific focus on developing countries. Relevant literature was identified using key terms related to fiscal policy, government expenditure, taxation, public debt, and economic growth. Studies employing cross-country panel data, time-series analysis, and firm-level datasets were prioritised to ensure empirical robustness. The selected sources were critically analysed to identify recurring empirical patterns, numerical ranges, and contextual conditions influencing the growth effects of fiscal policy. Rather than conducting new econometric estimations, the methodology emphasises comparative interpretation of existing findings to assess how fiscal outcomes vary across institutional settings, macroeconomic conditions, and policy designs. This approach enables a comprehensive evaluation of fiscal policy effectiveness while maintaining consistency with the study's scope and data constraints.

Results and Discussion

The results emerging from the reviewed empirical and analytical literature indicate that the impact of fiscal policies on economic growth in developing countries is highly conditional

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rather than uniform. Across studies using cross-country panels, time-series analyses, and firm-level data, fiscal policy is shown to influence growth through multiple interacting channels, with outcomes shaped by fiscal composition, macroeconomic conditions, institutional capacity, and financing constraints. Expansionary fiscal policies are associated with positive growth effects primarily when government spending is directed towards productive uses and implemented efficiently. In several developing-country settings, increases in public investment have been linked to higher output growth, but only where investment efficiency is sufficiently high and absorptive capacity constraints are not binding. Where these conditions are weak, higher public spending often translates into cost overruns, delays, or leakage, thereby diluting its growth impact and, in some cases, exacerbating debt vulnerabilities (Berg et al., 2015; Skott, 2021). These findings suggest that the growth response to fiscal expansion depends less on the scale of spending and more on the quality of fiscal execution.

Fiscal policy dimension	**Indicative numerical evidence from secondary studies**	**Observed growth implication in developing countries**	**Discussion based on literature**
Government expenditure growth	A 1 per cent increase in total government spending is associated with 0.1–0.3 per cent increase in GDP growth in the short run	Weak to moderate positive impact	The modest growth response reflects low spending efficiency and leakages, particularly in countries with weak public financial management systems (Berg et al., 2015; Kitsios & Patnam, 2016)
Public investment efficiency	Only 50–65 per cent of public investment translates into productive capital on average	Reduced long-term growth payoff	Inefficiencies in project selection and execution significantly dilute the growth impact of higher capital expenditure (Berg et al., 2015; Skott, 2021)
Fiscal multipliers	Short-run multipliers range between 0.3 and 0.8	Lower output response compared to advanced economies	High trade openness, informality, and financing constraints limit demand-side transmission of fiscal stimulus (Shen et al., 2018; Colombo et al., 2022)
Public debt levels	Debt above 60–70 per cent of GDP is	Negative growth effect beyond	Debt sustainability concerns raise risk premia and crowd

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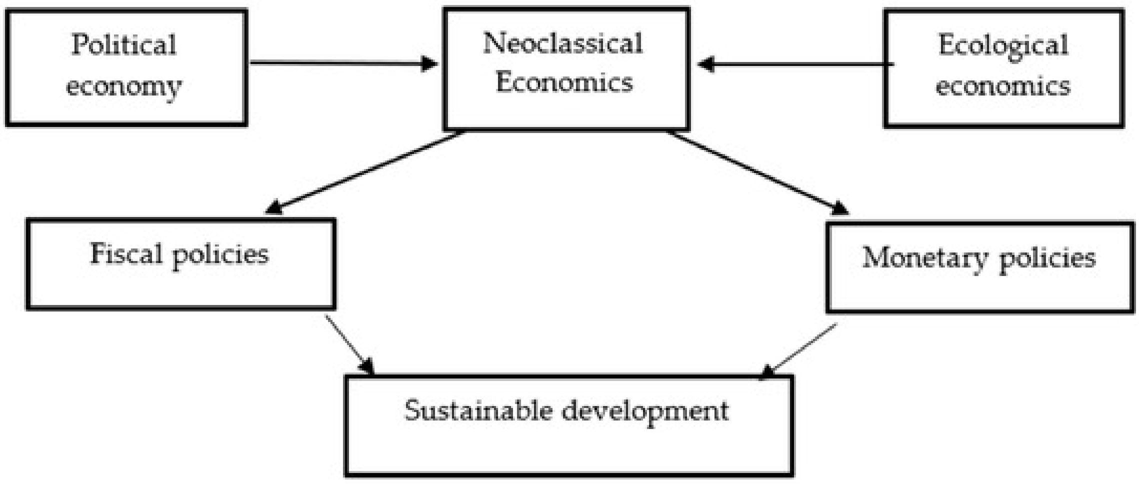
	associated with a 0.2–0.5 percentage point reduction in annual growth	thresholds	out private investment in many developing economies (Huidrom et al., 2016; Musa et al., 2023)
Fiscal deficits	Deficits of 3–5 per cent of GDP show neutral to mildly positive growth effects	Conditional positive impact	Growth benefits materialise only when deficits finance productive expenditure and are perceived as sustainable (Slimani, 2016)
Fiscal cyclicality	More than 60 per cent of developing countries exhibit pro-cyclical fiscal behaviour	Growth volatility and weaker long-term performance	Pro-cyclicality amplifies economic shocks and disrupts investment planning (Heimberger, 2023; Jalles et al., 2023)
Fiscal volatility	A one standard deviation increase in spending volatility reduces growth by 0.4–0.6 percentage points	Statistically significant negative impact	Stop–go fiscal policies increase uncertainty and discourage private-sector investment (Arroyo Marioli et al., 2023)
Fiscal rules adoption	Countries with flexible fiscal rules experience 10–20 per cent lower output volatility	Indirect support to growth	Well-designed rules help stabilise fiscal outcomes and protect public investment (Eyraud et al., 2018; Ardanaz et al., 2021)
Tax revenue to GDP ratio	Tax ratios between 15–20 per cent of GDP show no robust negative growth effects	Growth-neutral on average	The growth impact depends on tax structure and spending efficiency rather than overall tax burden (Abd Hakim et al., 2022)
Tax composition	Shifting 1 per cent of GDP from direct to indirect taxes raises growth by 0.1–0.2 percentage points	Mild positive growth effect	Broad-based consumption taxes are generally less distortionary in high-informality settings (Neog & Gaur, 2020; Maganya, 2020)
Firm-level effects of consolidation	Fiscal consolidation episodes reduce firm sales growth by 1–2 percentage points annually	Negative indirect growth effect	Tightening affects growth through credit constraints and weakened demand, especially for small firms (Pahula et al., 2024)

The discussion on fiscal multipliers further reinforces this conditionality. Evidence indicates that fiscal multipliers in developing countries tend to be smaller and less persistent than those observed in advanced economies, reflecting openness to trade, limited domestic financial depth, and large informal sectors. Studies incorporating informality into macroeconomic models find that a significant share of fiscal stimulus may bypass formal production channels, weakening demand transmission and reducing observed growth effects (Colombo et al., 2022). At the same time, multiplier estimates vary substantially across countries and periods, with higher multipliers observed during economic downturns and when fiscal expansions are financed in a sustainable manner. This variability highlights the difficulty of applying uniform fiscal prescriptions across developing economies and underscores the importance of macroeconomic context when evaluating growth outcomes (Shen et al., 2018; Kitsios & Patnam, 2016).



Fiscal sustainability emerges as a critical moderating factor in the relationship between fiscal policy and growth. The results across multiple studies point to non-linear effects of fiscal deficits and public debt on economic performance. Moderate deficits that finance productive expenditure can support growth, particularly when fiscal space exists and borrowing costs remain contained. However, when debt levels rise beyond certain thresholds, concerns about sustainability and credibility tend to dominate, increasing risk premia and constraining private investment. Empirical evidence from developing-country panels shows that high debt burdens are often associated with weaker growth, especially in economies with limited institutional capacity to manage debt and weak revenue mobilisation (Huidrom et al., 2016; Musa et al., 2023). This does not imply a simple negative relationship between debt and growth, but rather that fiscal policy effectiveness diminishes when sustainability constraints become binding.

The cyclical behaviour of fiscal policy also plays a significant role in shaping growth outcomes. A consistent result in the literature is that fiscal policy in developing countries remains predominantly pro-cyclical, with government spending rising during booms and contracting during downturns. This pattern tends to amplify business-cycle fluctuations rather than stabilise them, undermining long-term growth by increasing uncertainty and discouraging private investment. Empirical analyses indicate that expenditure-based pro-cyclicality is particularly damaging, as cuts during recessions often fall disproportionately on public investment and social spending, which are critical for productivity and human capital formation (Heimberger, 2023; Jalles et al., 2023). Fiscal volatility, closely related to pro-cyclicality, is also shown to be negatively associated with growth, as unstable fiscal environments weaken planning horizons for both the public and private sectors (Arroyo Marioli et al., 2023).

Institutional arrangements, especially fiscal rules, are frequently discussed as mechanisms to address these cyclical and volatility-related challenges. The results from studies on fiscal rule adoption in developing countries suggest that rules can contribute to improved fiscal discipline and reduced volatility, but their growth implications depend strongly on design features and enforcement. Flexible rules that allow for counter-cyclical responses and protect capital expenditure appear more compatible with growth objectives than rigid deficit or debt ceilings. Evidence shows that poorly designed rules may induce pro-cyclical consolidation and compress public investment, thereby weakening long-term growth prospects (Eyraud et al., 2018; Ardanaz et al., 2021). Moreover, institutional quality conditions the effectiveness of fiscal rules, as weak enforcement and political economy pressures can limit their practical impact in low-capacity settings (Mackiewicz & Maliszewska, 2023).

On the revenue side, the results indicate that the growth effects of taxation in developing countries are heterogeneous and closely linked to tax structure and administrative capacity. Studies examining total tax revenue often find no robust long-run relationship with growth, reflecting offsetting effects of improved public finances and increased tax distortions. More disaggregated analyses suggest that indirect taxes, particularly broad-based consumption taxes, are less harmful to growth than direct taxes in many developing contexts, provided that revenues are used productively and administration is effective (Maganya, 2020; Abd Hakim et al., 2022). Conversely, reliance on narrow tax bases and poorly administered income taxes can discourage investment and formalisation, weakening growth. These findings reinforce the view that revenue mobilisation strategies must be evaluated not only by their yield but also by their incentive and compliance effects within largely informal economies (Neog & Gaur, 2020).

Recent firm-level evidence adds depth to the discussion by illuminating transmission mechanisms that aggregate studies may obscure. Results from multi-country firm datasets indicate that fiscal consolidations are associated with slower firm growth, particularly among small and domestically oriented firms, suggesting that fiscal tightening may affect growth through credit constraints, demand expectations, and operating costs (Pahula et al., 2024). This micro-level perspective supports the argument that fiscal policy influences growth indirectly by shaping the business environment, not merely through aggregate demand or investment channels. At the same time, some studies find that well-communicated and credibility-enhancing fiscal adjustments can mitigate adverse firm-level effects, again highlighting the role of institutions and expectations (Kaharudin et al., 2022).

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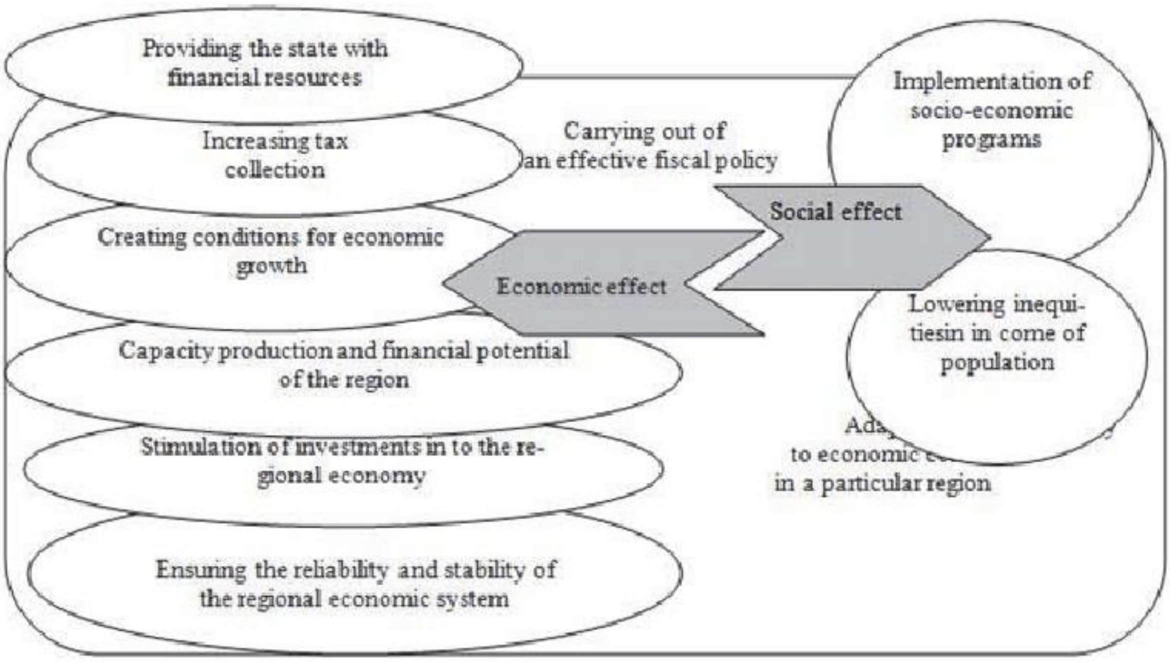

The discussion of results suggests that fiscal policy can contribute to economic growth in developing countries, but only under specific configurations of policy design, institutional capacity, and macroeconomic conditions. Productive expenditure, efficient public investment management, sustainable financing, and reduced fiscal volatility consistently emerge as factors associated with positive growth outcomes. In contrast, pro-cyclical behaviour, high debt under weak institutions, and distortionary taxation tend to weaken the growth impact of fiscal actions. These findings collectively point towards a contextual and composition-focused understanding of fiscal policy effectiveness, moving beyond aggregate measures to consider how fiscal instruments interact with the structural characteristics of developing economies.

Conclusion

This study examined the impact of fiscal policies on economic growth in developing countries by synthesising post-2015 empirical and analytical evidence. The findings indicate that fiscal policy influences growth in complex and highly context-dependent ways, shaped by expenditure composition, revenue structure, fiscal sustainability, and institutional capacity. Government spending contributes positively to growth primarily when it is directed towards productive investment and human capital formation and when implementation efficiency is sufficiently high. Conversely, poorly targeted or inefficient expenditure tends to weaken growth outcomes and may intensify debt vulnerabilities. The evidence also shows that fiscal multipliers in developing countries are generally modest, reflecting structural characteristics such as informality, trade openness, and limited financial depth.

The analysis further highlights that fiscal sustainability and stability are central to the growth effects of fiscal policy. Moderate deficits can support growth when fiscal space exists, but high debt levels and persistent pro-cyclical behaviour undermine long-term performance by

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increasing uncertainty and discouraging private investment. Institutional mechanisms such as fiscal rules can mitigate these challenges, but their effectiveness depends on flexibility, design, and enforcement capacity. On the revenue side, the growth impact of taxation is found to depend more on tax composition and administrative efficiency than on overall tax levels, with broad-based and less distortionary taxes showing relatively favourable outcomes. The study underscores the need for context-sensitive and composition-focused fiscal strategies to support sustainable economic growth in developing countries.

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