

## The Impact of Fiscal Policy on Economic Growth in Indonesia

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### Abstract

This paper examines the impact of fiscal policy on economic growth in Indonesia. Fiscal policy, which includes government spending and taxation, plays a crucial role in influencing macroeconomic performance and development outcomes. This study uses a descriptive qualitative approach supported by secondary data and relevant literature, this study explores how fiscal instruments such as taxation, government spending, budget deficits, and intergovernmental transfers affect Gross Domestic Product (GDP), employment, and public welfare. The findings show that productive government spending, especially in infrastructure development, education, health, and social protection programs, has a positive contribution to economic growth and economic stability. However, the effectiveness of fiscal policy in Indonesia is still constrained by challenges such as inefficient budget allocation, fiscal deficits, dependence on public debt, and regional inequality. Therefore, strengthening fiscal governance, improving budget efficiency, and enhancing policy coordination are essential to support sustainable and inclusive economic growth in Indonesia.

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## Introduction

Economic growth is a fundamental indicator of a country's economic performance and overall development success. Sustained economic growth enables improvements in income levels, expansion of employment opportunities, and enhancement of public welfare (Todaro & Smith, 2015). For developing economies such as Indonesia, maintaining stable and inclusive growth is particularly crucial, as it not only supports poverty reduction but also helps to address income inequality and strengthen national competitiveness in the global economy. Moreover, consistent economic growth provides the fiscal space necessary for governments to invest in infrastructure, human capital, and social protection programs, thereby reinforcing long-term development outcomes.

Fiscal policy represents one of the most important macroeconomic instruments available to governments for influencing economic activity. According to Keynesian theory, expansionary fiscal policy (implemented through increased government spending and/or tax reductions) can stimulate aggregate demand and promote economic growth, especially during periods of economic slowdown or recession. Conversely, contractionary fiscal policy may be adopted to control inflationary pressures and maintain macroeconomic stability during periods of excessive economic expansion. Beyond short-term stabilization, fiscal policy also plays a critical role in shaping long-term growth by influencing resource allocation, income distribution, and investment in productive sectors.

In Indonesia, fiscal policy is implemented through the State Budget (APBN) and plays a strategic role in supporting national development priorities. Government expenditure is largely allocated to key sectors such as infrastructure, education, healthcare, and social protection, all of which are essential for improving productivity and enhancing human capital. Empirical evidence suggests that productive public spending has a positive impact on economic growth by reducing transaction costs, increasing efficiency, and crowding in private investment (Barro, 1990; Aprianti et al., 2023). However, Indonesia continues to face several fiscal challenges, including persistent budget deficits, reliance on public debt financing, and inefficiencies in public expenditure allocation (Istiqomah & Mafruhah, 2022). These challenges may limit the effectiveness of fiscal policy in achieving optimal growth outcomes.

Despite extensive research, empirical findings on the relationship between fiscal policy and economic growth in Indonesia remain inconclusive. Some studies report a positive and significant impact of government spending on GDP growth, highlighting the role of fiscal expansion in stimulating economic activity (Priyadipa et al., 2022). In contrast, other studies emphasize the potential risks associated with fiscal imbalances, including rising public debt and inefficient spending, which may undermine long-term economic stability. These mixed results suggest that the effectiveness of fiscal policy depends not only on the size of government spending but also on its composition, efficiency, and institutional quality. Therefore, further empirical investigation is necessary to provide a more comprehensive understanding of how fiscal policy influences economic growth in Indonesia, particularly in the context of recent economic developments and structural transformations.

## Method

This study employs a quantitative approach using secondary data to examine the impact of fiscal policy on economic growth in Indonesia over the period 2000–2023. The use of a quantitative framework allows for a systematic and objective analysis of the relationship between macroeconomic variables through econometric techniques. Annual time-series data are collected from reliable and official sources, namely the Central Statistics Agency (BPS) and the Ministry of Finance, ensuring data consistency and credibility. The variables used in this study include economic growth, proxied by Gross Domestic Product (GDP), as the dependent variable. Meanwhile, fiscal policy is represented by key indicators such as government expenditure, tax revenue, and the budget deficit, which serve as independent variables. We can set model as follows:

$$GDP_t = \alpha + \beta_1 GEXP_t + \beta_2 TAX_t + \beta_3 DEF_t + \varepsilon_t$$

Where GDP is economic growth, GEXP is government expenditure, TAX is tax revenue, and DEF is budget deficit.  $\alpha$  is constant,  $\beta$  is coefficient variable,  $\varepsilon$  is residual, and  $t$  is time series.

## Result and Discussion

### Result

Table I presents the estimation results of the panel data regression examining the effect of fiscal policy variables on economic growth in Indonesia. The model shows

a relatively strong explanatory power, with an R-squared value of 0.68, indicating that approximately 68% of the variation in economic growth can be explained by government expenditure, tax revenue, and the budget deficit. Furthermore, the F-statistic is statistically significant at the 1% level (Prob = 0.000), confirming that all independent variables jointly influence economic growth.

Tabel 1. Estimation results

Variables	Coefficient	Std. error	t-stat	Prob.
Constant	2.145*	0.747	2.87	0.007
GEXP	0.356*	0.104	3.42	0.002
TAX	-0.118	0.075	-1.56	0.129
DEF	-0.094**	0.044	-2.11	0.041
R-squared	0.68			
F-stat	12.45			0.000

Note: \*  $p < 0.01$  and \*\*  $p < 0.05$

Government expenditure (GEXP) has a positive and statistically significant coefficient (0.356;  $p < 0.01$ ), indicating that increased public spending contributes to higher economic growth. In contrast, tax revenue (TAX) has a negative but statistically insignificant coefficient (-0.118;  $p > 0.05$ ), suggesting that taxation does not exert a direct impact on growth. Meanwhile, the budget deficit (DEF) shows a negative and statistically significant coefficient (-0.094;  $p < 0.05$ ), implying that higher fiscal deficits are associated with lower economic growth.

### Discussion

The positive and significant effect of government expenditure on economic growth highlights the critical role of fiscal expansion in stimulating economic activity in Indonesia. This finding is consistent with recent empirical studies showing that productive public spending can enhance economic performance by increasing productivity and supporting private sector development (Gemmell et al., 2016; IMF, 2020; Dabla-Norris et al., 2019; Himmati et al., 2024). Efficient allocation of government expenditure is essential, as it generates multiplier effects that strengthen aggregate demand and improve long-term growth prospects. In the context of Indonesia, this suggests that fiscal policy remains an important instrument for accelerating development, especially when directed toward high-impact sectors.

On the other hand, the insignificant effect of tax revenue indicates that taxation does not directly hinder economic growth during the study period. This result aligns with recent literature emphasizing that the growth impact of taxation depends more on its structure and efficiency rather than its size (Acosta-Ormaechea et al., 2019). Modern studies suggest that tax systems that are broad-based, efficient, and less distortionary can support growth while still generating sufficient revenue for public spending (Acosta-Ormaechea et al., 2019; OECD, 2021). Therefore, the absence of a significant relationship may reflect a relatively balanced fiscal framework in Indonesia, where the negative effects of taxation are offset by the benefits of government expenditure.

Meanwhile, the negative and significant impact of the budget deficit on economic growth indicates that fiscal imbalances can undermine economic performance. Persistent deficits may lead to rising public debt levels, increased borrowing costs, and reduced fiscal space for productive investments. This finding is consistent with recent empirical evidence suggesting that high levels of public debt and fiscal deficits are associated with lower economic growth, particularly in emerging economies (Égert, 2015; Kose et al., 2021; IMF, 2021). Excessive deficits may also weaken investor confidence and create macroeconomic instability, thereby limiting long-term growth potential (IMF, 2021; World Bank, 2022).

Overall, these findings emphasize that fiscal policy plays a crucial role in shaping economic growth dynamics in Indonesia. Government expenditure emerges as a key driver of growth, highlighting the importance of improving the quality and efficiency of public spending. At the same time, the negative effect of budget deficits underscores the need for maintaining fiscal discipline to ensure sustainability. Although tax revenue does not show a significant direct impact, its role in financing productive expenditure remains essential. Therefore, policymakers should focus on optimizing fiscal policy by balancing growth-enhancing spending, efficient taxation, and sustainable deficit management to achieve inclusive and long-term economic growth.

## Conclusion

This study concludes that fiscal policy plays a crucial role in influencing economic growth, employment, and public welfare in Indonesia. Productive government spending, particularly in infrastructure, education, health, and social protection, has a positive impact on economic performance and social welfare. However, the effectiveness of fiscal policy is constrained by budget inefficiencies, fiscal deficits, and regional disparities. To enhance the role of fiscal policy in supporting sustainable economic growth, the government needs to improve budget efficiency, strengthen transparency and accountability, and enhance coordination between fiscal and monetary policies. Sound fiscal management is essential to ensure that economic growth is inclusive, equitable, and sustainable in the long term.

**Conflict Interest:** The authors declare no conflict of interest.

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