

Does Fiscal Policy Influence Economic Growth in Ethiopia? A Review Article

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Abstract

The aim of this literature review-based work is to assess the current arguments regarding the existing consequences of fiscal policy variables on the growth of the economy. The review applied a document review methodology to investigate recent fiscal policy empirical works together with fiscal policy trends in Ethiopia. The reviewed literature has shown that the influence of fiscal policy on countries' growth is not clear-cut. It can be either positive or negative, and some studies even show no discernible effect. Even though the weight of fiscal policy on the growth of the economy is questionable, the findings of the reviewed studies supported that fiscal policy had a positive impact on the growth of the country's economy. The implications for policy of these findings are that fiscal policy is more likely to positively affect the growth of the real sector, especially for developing countries like Ethiopia. This clarifies the confusion among governments and decision-makers regarding the mixed effects of fiscal policy on economic growth. Therefore, policymakers should give due attention while designing a fiscal policy or an economic policy in general, and choosing appropriate fiscal policy tools. Although this review included pertinent scholarly works on the relationship between fiscal policy variables and the growth of the economy of nations, future research would benefit from investigating threshold effects, systematically estimating optimal debt-to-GDP thresholds for Ethiopia and comparable economies, and identifying which institutional dimensions—control of corruption, regulatory quality, or rule of law—most strongly mediate fiscal policy outcomes.

Keywords: *Public Debt, Fiscal Policy, Economic Growth, Government Spending, Government Revenue.*

1. Introduction

After the Great Depression, debates on the intervention of governments in the economy through fiscal policy instruments like taxes, public debt, and spending became a fundamental theme of economic policy around the globe (Al-kasasbeh et al., 2022; Alzghoul et al., 2023). The Keynesian model contributed more to this, confirming that fiscal policy is one of the determining factors of aggregate demand and has the supremacy to expressively influence economic performance in the short term (Chugunov et al., 2021).

Governments around the globe develop economic policies to maintain their economy. Such policies may include fiscal policy, credit and monetary policy, trade policy, and exchange rate policy. Among these and other policies, fiscal policy holds a significant position since it can contribute more to the accomplishment of the various goals of the national economy (Dosi et al., 2015). Fiscal policy is how the government affects the domestic economy to preserve inclusive economic stability and contend with its issues (Farhi and Werning, 2016).

As indicated in Ayana (2022), the linkage between fiscal policy tools and the growth of the economy has garnered much consideration over time as researchers and policymakers have attempted to determine how fiscal policy affects growth. Because there is disagreement over the findings and conclusions drawn, the results of their work have been more ambiguous than beneficial. Many questions about the factors influencing economic growth remain unanswered, but they remain an important and compelling area of research in the field of public finance. The central question here is whether fiscal policy tools affect the growth of a nation's economy or not.

Growth of the economy and fiscal policy are closely related, and this relationship becomes more important when policymakers are faced with difficulties in detecting potential economic development and guaranteeing a stable economy for their countries. The connection between fiscal and macro policy tools like public debt, taxes, spending, and economic growth has also been the subject of numerous studies. Several research projects conducted worldwide have extensively examined the aforementioned themes; the majority of these studies have focused on fiscal parameters. Scholars who contributed to these include (Abueid et al., 2018; Al-Kasasbeh et al., 2022; Alawneh, 2017; Audu, 2012; Gale et al., 2015; Herndon and Pollin, 2014; Karagöz and Keskin, 2016; Kia and Mousavi, 2015; Lof and Malinen, 2014; Nursini, 2017; Ugwuanyi and Ugwunta, 2017).

The goal of each of these and similar studies was to define how fiscal policy parameters and growth in the economy are related. Multiple variables are commonly cited as influencing the performance of the economy, including consumption of energy; trade worldwide, financial progress, population density, and financial regulation. Additionally, as evidenced by the research conducted by Atilgan et al. (2017), d'Agostino et al. (2018), and Stoilova and Patonov (2013), recent studies have focused on examining the effects of financial factors on the expansion of the economy. Because of the aforementioned factors, the researchers determined that fiscal policy is an essential tool for advancing economic development.

Ethiopia is among the world's least-developed countries due to its well-known insecurity, drought, emergencies of humanity, and conflict. There has been a continued conflict in the country for many years and the elevated cost of living—one of the most common and likely forecasts for the state of the economy during a war—is confirmed by the sharp increase in inflation. It is also widely recognized that government spending skyrockets during a war. To finance increased spending, the government is probably going to knock on the doors of creditors. Most frequently, the debtor nations ask for relief or reschedule payments that they are unable to make to their creditors, which is a sign that their economies are stagnating. Furthermore, deferring payments to a later date will undoubtedly result in an increased debt load, which is an additional burden. Ethiopia is presently listed among the poor countries with high levels of debt (Geda and Yimer, 2023). Because of this, it is important to critically examine how Ethiopia's fiscal policy instruments affect the economy, as the present financial situation suggests the need for more fiscal policy measures than ever.

Furthermore, the impact of fiscal policy variables on growth has been less investigated empirically in Ethiopia. The existing empirical works used either public expenditure, public revenue, or public debt (mostly public spending as a proxy of fiscal policy) separately to analyze the effect of fiscal policy on economic growth. Researchers argued that there is no strong correlation between the three policy variables (public expenditure, public revenue, and public debt) and economic growth when studied individually (Ocran, 2011; Levine and Renelt, 1992). Additionally, these empirical works in the field have not provided concluding remarks about these relationships. By combining recent empirical studies, this work seeks to close the empirical gap in the literature in the area and increase the depth of available information on Ethiopia's growing economy.

Based on this context, the objective of this study is to evaluate the empirical works available to date on the effect of fiscal policy on the growth of the economy in Ethiopia. The aim of this literature review-based work is to assess the current arguments regarding the existence of consequences of fiscal policy variables on the growth of the economy and, in situations where a relationship between these important variables is established, to further investigate the question of whether the empirical relationship between fiscal policy variables (public spending, public revenue, and public debt) and economic growth in Ethiopia is positive or negative.

This study contributes to the existing literature in three distinct ways. First, it systematically evaluates and synthesizes disparate empirical perspectives on how fiscal policy affects economic growth across studies conducted in Ethiopia, offering a ranked assessment of findings. Second, it provides actionable policy recommendations for Ethiopian policymakers concerning the potential growth effects of fiscal policy instruments. Third, it serves the research community by organizing and critically analyzing the relevant literature, thereby establishing a coherent foundation that facilitates future empirical investigations in this domain.

A descriptive document review methodology was applied to meet the study's objective. Various recognized journals have conducted empirical research on the effect of fiscal policy on economic growth in Ethiopia. Based on their findings, the literature was further grouped into three categories. The studies in the first group examined the connection between public spending and economic growth, those in the second section scrutinized the effect of tax revenue on economic growth, and those in the final group looked at the effect of government debt on economic growth. Tables for every fiscal variable provided a more detailed summary of the review's findings. It continues by reviewing the concepts and trends in fiscal policy and economic growth, followed by the methodology. The reviewed empirical works are then presented, after which the findings are discussed. The paper concludes with policy recommendations.

2. The Concept and Trends of Fiscal Policy and Economic Growth

Fiscal policy is the tool that governments use to control and influence a country's economy, which limits the amount of money that the government spends. It is commonly said to be associated with growth, or more accurately, it is believed that suitable fiscal policies implemented in certain situations can promote economic development and growth (Brahmbhatt and Canuto, 2012; Khosravi and Karimi, 2010; Revol, 2018; Zhattau, 2013).

Fiscal policy is a key constituent in achieving sustainable economic growth. Its short-term impact is intended to affect the economy's aggregate demand. By boosting the economy's capacity, fiscal policy can have a longer-term impact on the supply side of the economy in addition to its short-term goal of influencing aggregate demand. The indicator quantity of the achievement of a country's improvement is economic growth as a process of raising production from moment to moment. Governments use fiscal policy to modify tax and spending levels to manage and affect a nation's economy (Aisyah et al., 2024). Anaele and Ayenke (2021) outline fiscal policy as the use of government revenue and expenditure to influence the state of the economy.

Additionally, according to Enyoghasim et al. (2022), fiscal policy is the way a government adjusts how much money it spends to keep an eye on and manage the economy of a nation. In a similar vein, Ojimadu and Ogu (2012) described fiscal policy as how the government modifies its revenue and spending to affect the overall state of the economy.

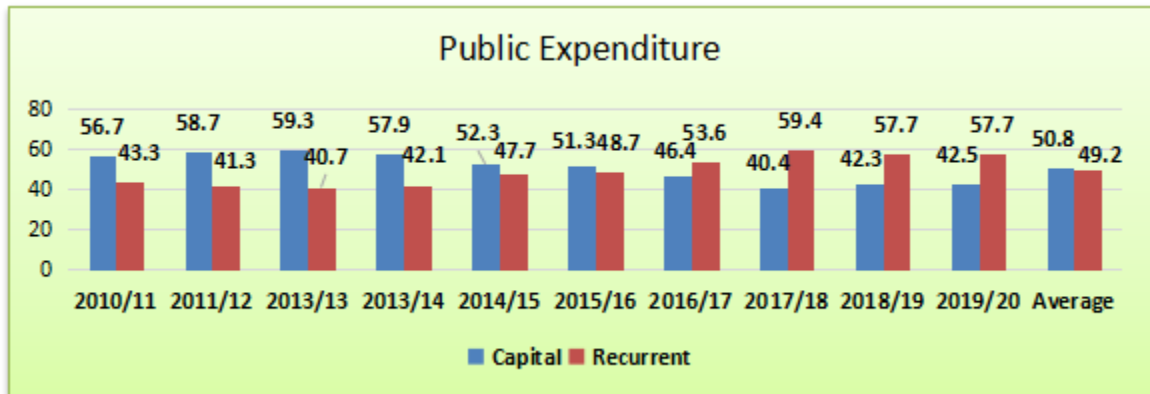
Fadare's (2010) empirical work as cited in Chinwoke et al. (2024) described fiscal policy as the government's intentional use of borrowing, taxes, and spending to affect macroeconomic variables in a desired direction. These alterations are implemented by the different instruments of fiscal policy, which are used differently in different situations. In other words, we can say that fiscal policy is executed through fiscal mechanisms, also called fiscal handles, fiscal instruments, and fiscal levers. Fiscal instruments are variables that governments at their discretion can maneuver and sometimes change due to changes in economic forces. The major fiscal instruments include government spending, public revenue, and public debt.

Public Expenditure

Overheads incurred by public authorities, such as the federal, regional, and local governments, are referred to as public or government expenditures. These expenditures are made to address shared needs that cannot be effectively met by individuals. Public spending is used to fulfill societal demands. Regarding the nature and extent of public expenditures and activities, it represents the decisions made by the executive and legislative branches. Public spending is an important factor that has a significant impact on the growth of the economy. The concept of public expenditure has evolved in the context of economic dialog, and numerous academic publications have studied this subject. The phenomenon of public expenditure is complicated and comprehensive, involving various theoretical and practical as indicated in (Mahmood and Zouari, 2023). Public expenditure characterizes the entire government spending to accomplish the preset macro-economic objectives of the countries by filling the gaps left by a free-market economy, for example, by creating public goods domestically (Victor and Sa'Id, 2023).

As indicated in MoF (2021), the Ethiopian fiscal policy trend exhibited that government expenditures have played a significant role in driving the country's economy. The trend in government spending was to direct more funds toward creating economic and social structures to decrease poverty and provide basic services. In the past ten years, the government's fiscal policy has also been focused on developing a public expenditure control structure that is both effective and efficient. The annual budget placed a strong emphasis on increasing funding for vital sectors involved in infrastructure development, basic service delivery, and poverty alleviation in light of the above-mentioned broad fiscal policy objectives. As a result, the majority of the financial resources were allocated to capital projects, which are essential for advancing social services. This indicates the government's solid commitment to devoting more funds than current consumption to asset development and poverty alleviation.

However, there have been more recurring expenditures than capital expenditures from 2016–17 to 2019–20. According to Fig. 2.1 below, recurrent expenses made up 57.5% of total expenditures in 2019–20, while capital expenditures accounted for 42.5%. The increase in the percentage of ongoing expenses had several causes. Increases in civil servant salaries, funds for rehabilitation and internal instability, completed capital project salaries, and mounting debt service obligations were the main drivers of higher recurrent expenditures. Still, the underwhelming performance of tax revenue in recent years may be another factor contributing to lower capital expenditures.



Source: Ministry of Finance (2021)

Figure 2.1 Capital and recurrent spending share from 2011 to 2020

Public Revenue

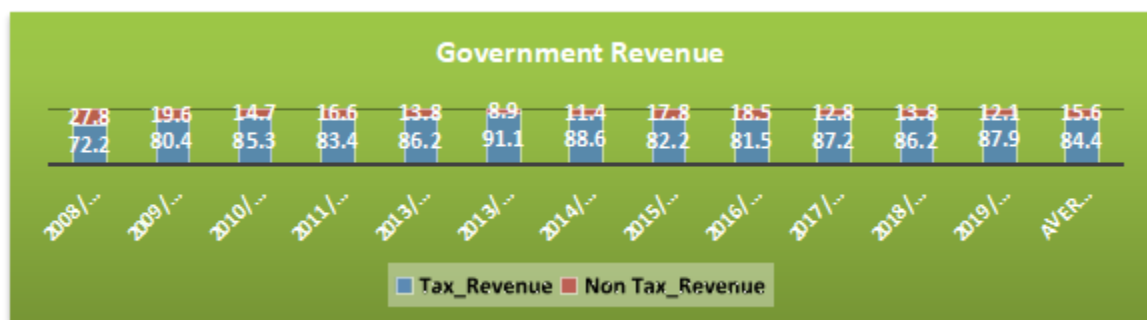
Government revenue is a fundamental concept in public finance. This variable lists the different sources of earnings that the government receives. Dalton (2013) mentioned two forms of public revenue in his "Principles of Public Finance." Public revenue includes the proceeds from taxes, goods and services rendered by public corporations, administrative expenses such as fees and fines, gifts, and grants.

Government revenue is the amount of money that an administration collects from taxes and non-tax sources to fund public spending. To enhance social and economic welfare, the government must carry out several tasks in the fields of political, social, and economic, all of which demand significant financial resources. The term "non-tax revenue" describes the money the government receives from sources other than taxes, as noted by Ngari et al. (2024). Taxation is the primary source of funding for government operations. Public receipts are how countries carry out policies to transfer funds from the private to the public domain (Lateef et al., 2022). According to Eze and Onyedikachi (2020), taxes are a dependable source of funding for the government to carry out its initiatives. These definitions make it abundantly clear that taxes are a means for the government to fund its many initiatives. In addition to being a top priority for tax experts, administrators, and economic policymakers, the effect of taxes on the growth of the economy has long piqued the interest of academics. In this sense, the Ethiopian government works hard to attain economic prosperity in all spheres. In addition, the development project's domestic financing was paid adequate attention.

The primary goals of Ethiopia's fiscal policy, as stated in the MoF (2021), are to increase the country's ability to generate revenue from domestic sources, make efficient use of the resources that are gathered from various sources, and maintain a manageable fiscal deficit to preserve macroeconomic stability. Maintaining macroeconomic and fiscal stability, enhancing poverty reduction efforts, investing in infrastructure, facilitating private-sector growth, and improving service delivery are among how government fiscal policy has been implemented in recent years. Fiscal policy under GTP I, GTP II, currently under the

Homegrown Economic Reform and Ten Years Development Plan, consists of preserving macroeconomic stability, guaranteeing financial prudence through the mobilization of domestic resources, allocating public funds for the best possible impact on public welfare and rapid economic growth, and establishing tax and tariff policies that support the development of export-led manufacturing.

The total amount of revenue raised by the government over the past ten years from both internal and external grants has increased by an average of 21.4%. More precisely, as shown in Figure 2.2 below, the growth rate of external grant flows was roughly 16.1% on average, whereas the average annual growth of domestic sources was 23.5 percent.

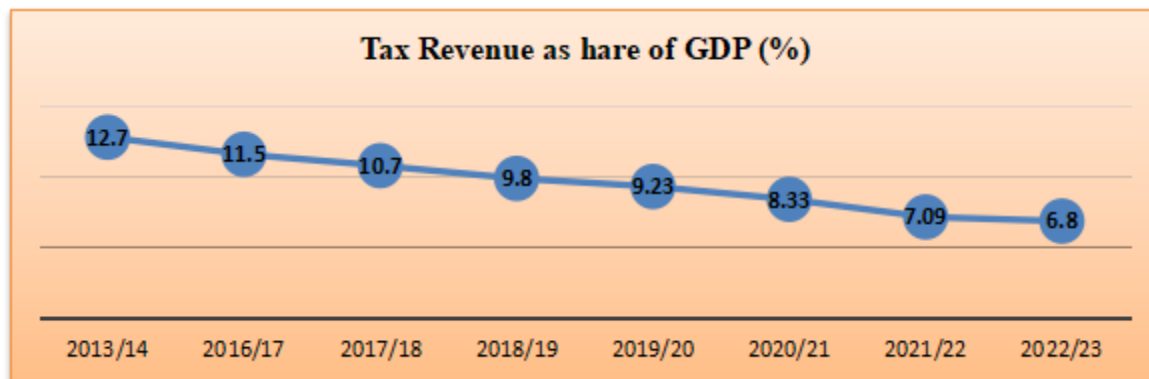


Source: Ministry of Finance (2021)

Figure 2.2 Tax and non-tax revenue share from 2008/9 to 2019/20 (in percent)

The tax-to-GDP ratio provides indicators of economic growth as well as the ratio of a country's tax revenue to GDP (gross domestic product). This is because it provides a useful viewpoint on a country's tax revenue by showing how taxes may be related to the economy. They can also compare the tax revenues of different countries across national borders and observe the overall trajectory of the country's tax policy (Dinh, 2022). Ethiopia has grown steadily and consistently over the past ten years, placing it at the forefront of the world economy. Despite this growth, the nation's tax-to-GDP ratio stays below 6.8%. An economic measure called the tax-to-GDP ratio compares the amount of taxes the government collects to the total amount of revenue the nation receives from economic activity.

As indicated in the Ministry of Plan and Development annual report (2023), the portion of the tax to GDP ratio was 12.7 percent in 2013/14, showing a decline of 5.92 fraction points in 2022/23. This declining trend suggests that even though the quantity of tax collected has significantly increased, the rate of growth was not proportional to the economic growth rate. Furthermore, overall local revenue in terms of GDP for the country continued small, as shown in Fig. 2.3 below. This designates that the tax revenue produced by the economy is not appropriately collected.



Source: Ministry of Planning and Development (2023)

Figure 2.3 Ethiopian Tax Revenue as a share of GDP (in percent)

Public Debt

Public debt serves as a crucial tool for governments to finance their spending in situations where tax increases and spending cuts are unfeasible. This procedure has left most governments with enormous debt loads for many years. The way to accelerate economic growth is through borrowing to fund capital infrastructure development (Ogunjimi, 2019). However, taking on too much debt without making the necessary investment plans could result in high interest costs and a heavy debt load, which could have many negative effects on the economy (Joy and Panda, 2020). Government debt is a financial inducement, but when it accumulates to a very high degree, a fair share of government spending and foreign exchange profits will go toward repaying the debt, which will have a significant opportunity cost for future generations (Okeke et al., 2023).

According to Ajie et al. (2014), external debt is the amount of unpaid external resources that were obtained for the balance of payments support and development but were not able to be repaid when they were due. Stated differently, external debts are sums owed by a nation to foreign institutions, i.e., foreign creditors, the repayment of which would require the depletion of domestic resources in the foreigners' favor.

The total budget deficit in Ethiopia has been reduced to less than 3% of GDP in recent years by the government. The total budget deficit for the 2019–20 fiscal year, including grants, was 2.7% of GDP. Using borrowing instruments, the difference was funded from both domestic (1.3 percent) and foreign (1.9 percent) sources. Over the last ten fiscal years, there have been manageable budget deficits, and funding has been obtained as much as possible through noninflationary means (MoF, 2021).

On the other hand, the country's external debt stock reached USD 27.9 billion in 2021/22, according to the National Bank annual report (2021/22). This represents a 5.4 percent annual decrease, mostly because of a decline in debt to bilateral, multilateral, and commercial creditors. As a result, the nation's stock of external debt relative to GDP was 22%. The proportion of debt service to exports of goods and nonfactor services indicates

the country's external debt burden, which dropped from 22.4 percent to 20.4 percent in the previous year.

Economic Growth

There are ample literature contributions in both developed and developing economies showing the connection between fiscal policy measures and the growth of the economy (Al-Kasasbeh et al., 2022; Gemechu, 2017; Hlongwane, 2023; Mengistu, 2022; Pamba, 2021).

Economic growth is the main indicator that the government uses to assess how far a country has come. The majority of developed countries have high rates of economic growth, except for a small number of oil-producing countries that control their growth rate. Developing nations, on the other hand, usually have very slow growth rates. The growth of the economy is significant because it benefits the nation's economy and society, which encourages new investments, boosts employment, and increases the purchasing power of the populace (Macek and Janků, 2015).

Furthermore, economic growth encompasses all activities that ensure high-income rates for individuals and businesses by depending on the supply and demand dynamics in the local market. Based on the availability of numerous economic factors related to the production process, including capital, labor, machinery, productive resources, and other methods that support economic growth, this results increase in the quantity of goods produced and the provision of services (Dandan, 2011).

Growth of the economy helps nations' economies become more self-sufficient by providing institutions and companies with every chance to support their goods and services in the market and then assessing whether they were able to generate the required revenue in the allocated time frame. Consequently, there is a rise in the market value of goods and services, which leads to continuous economic growth (Cai et al., 2017).

Ethiopia's real GDP grew at an average annual rate of 7.6% between 2015/16 and 2022/22, according to the National Bank of Ethiopia annual report (2021/22) as indicated in Table 2.1 below. The yearly average growth rates for the industry, services, and agriculture sectors were 7.8 percent, 11.4 percent, and 4.6 percent, respectively. In a similar vein, the economy of the nation expanded by 6.1% in 2021/2022. Agriculture, industry, and services all experienced growth during that time of 6.1%, 4.9%, and 7.6%, respectively. Agriculture, industry, and services contributed 2%, 1.4%, and 3% of the total GDP growth rate in the fiscal year 2021/2022.

Table 2.1 Major Economic Sector Annual GDP Growth (in Percent)

Sectors	2010/11 to 2014/15 Average	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2015/16- 2021/22 Average
GDP Growth	10.1	8	10.1	7.7	9	6.1	6.3	6.1	7.61
Agriculture	6.6	2.3	6.7	3.5	3.5	4.3	5.5	6.1	4.6
Industry	19.8	20.6	12.7	12.2	12.6	9.6	7.3	4.9	11.4
Service	11	8.7	7.5	8.3	11.2	5.3	6.3	7.6	7.8

Source: NBE (2021/22)

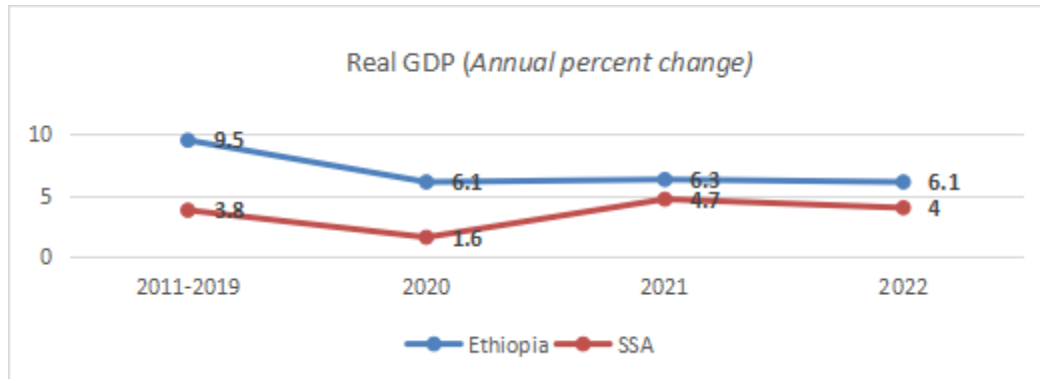
Between 2010/11 and 2014/15, the industry sector exhibited the highest average sectoral share of GDP growth, contributing 19.8 percentage points to GDP growth. The service and agriculture sectors followed, contributing 11 and 6.6 percentage points to GDP growth, respectively. However, the contributions to GDP growth of the industry, service, and agricultural sectors declined on average to 11.4, 7.8, and 4.6%, respectively, from 2015/16 to 2021/22 as indicated in Table 2.2 below. The average reduction in the contribution of these sectors to the growth from the previous average years reflects the greatest adverse consequence of the COVID-19 pandemic on accomplishments, the internecine civil conflict that continued for several years, the diplomatic pressure caused by these conflicts, global wars and the political tension in East Africa.

Table 2.2 Sector-specific GDP Growth Contribution (in Percent)

Sectors	2010/11 - 2014/15 Average	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2015/16- 2021/22 Average
GDP Growth	10.1	8	10.1	7.7	9	6.1	6.3	6.1	7.61
Agriculture	2.8	0.9	2.5	1.3	1.3	1.4	1.8	2	1.60
Industry	2.3	3.1	4.7	3.1	3.4	2.6	2.1	1.4	2.91
Service	5	4	2.9	3.3	4.3	2.1	2.4	3	3.14

Source: NBE (2021/22)

Despite the aforementioned issues, the nation's economy rose at a pace of 9.5 percent, in comparison to the 3.8 percent average growth forecast for Sub-Saharan Africa from 2011 to 2019. Similarly, the country's economy has continued to progress in recent years, with annual growth rates of 6.1%, 6.3%, and 6.1% in 2020, 2021, and 2022, respectively, compared to 1.6%, 4.7%, and 4%, respectively, in the same years for sub-Saharan countries, as indicated in



Source: IMF, World Economic Outlook database. Sectoral Contribution to GDP Growth (in percent)

Figure 2.4 below **Figure 2.4 Ethiopia and Sub-Saharan Africa GDP growth (percentage)**

3. Methodology

3.1 Review design and framework

Review design: The study employed descriptive document review methodology, showing that the research design, sample design, and data collection methods used in this review are all expressed in the reviewed empirical.

Framework: the process loosely follows elements of SALSA (Search, Appraisal, Synthesis, Analysis) due to the inclusion of search steps, quality control via exclusion criteria, and data extraction.

3.2 Data sources and search strategy

Data Source: Information was taken from electronic databases, such as Google Scholar, Research Gate, and academia, to compile the empirical data for this review. Additionally, Google search engines and institutional repositories of Ethiopian universities were examined. Original research articles reporting the association between fiscal policy variables and economic growth in Ethiopia were included. An additional three annual reports from concerned sectors, Annual reports from the Ministry of Finance (MoF, 2021), Ministry of Plan and Development (MoPD, 2023), and National Bank of Ethiopia (NBE, 2021/22) were included to internalize the reviewed empirical.

Search strategy: The study employed descriptive document review methodology, showing that the research design, sample design, and data collection methods used in this review are all expressed in the reviewed empirical. By employing two-stage screening procedures such as full-text screening and screening for titles and abstracts, the researchers used a hand-searching method with key search terms from the internet. Numerous papers on the same subject were found. Twenty-nine papers were deemed relevant as per the objective of the study. The response variable, Economic Growth, is a function of various economic variables. For this review article, however, the main bases of economic growth are both aggregate and disaggregate components of public expenditure, public revenue, and public debt. Furthermore, as indicated in the exclusion criteria above, only original

research papers published in reputable journals were selected to ensure the quality of the selected kinds of literature.

3.3 Inclusion and exclusion criteria

Study type: Original research articles reporting the association between fiscal policy variables and economic growth in Ethiopia were included. Additional three annual reports from concerned sectors Annual reports from the Ministry of Finance (MoF, 2021), Ministry of Plan and Development (MoPD, 2023), and National Bank of Ethiopia (NBE, 2021/22) were included to internalize the reviewed empirical.

Study year: The review used studies conducted between 2014 and 2023 in Ethiopia. The reason behind the selection of the period is just to add knowledge to the latest argument in the economic literature on fiscal policy and the growth of the economy.

Exclusion Criterion: We excluded research articles that use other variables rather than the measure macroeconomic fiscal policy variables such as public expenditure, public revenue, and public debt to proxy fiscal policy. Furthermore, case reports, book chapters, working papers, conference papers, all types of review papers, and case studies were not included.

3.4 Study selection process

By employing two-stage screening procedures such as full-text screening and screening for titles and abstracts, the researchers used a hand-searching method with key search terms from the internet. Numerous papers on the same subject were found. Twenty-nine papers were deemed relevant as per the objective of the study. The response variable, Economic Growth, is a function of various economic variables. For this review article, however, the main bases of economic growth are both aggregate and disaggregate components of public expenditure, public revenue, and public debt. Furthermore, as indicated in the exclusion criteria above, only original research papers published in reputable journals were selected to ensure the quality of the selected kinds of literature.

3.5 Data Extraction Process

Relevant data were extracted from each eligible study using a standardized and customized Microsoft Excel 2016 form that included the author, publication year, study methodology, dependent variables, and major outcomes. The investigators evaluated the information that was obtained and determined the level of evidence. Among the selected works of literature, twelve studies concentrate on the relationship between public spending and fiscal policy, ten empirical studies deal with public debt and fiscal policy, and the remaining seven studies emphasize the relationship between public debt and fiscal policy. The studies conducted between 2014 and 2023 were selected for convenience of sampling and to be rational, as the main aim of the paper is to obtain very recent evidence on the subject matter in the country.

3.6 Quality assessment

The quality of the included studies was evaluated using several criteria. First, methodological rigor was ensured by excluding non-original research, which included case reports, book chapters, working papers, conference papers, all types of review papers, and case studies. Second, the investigators independently assessed the extracted material from each qualifying study and determined the amount of evidence each presented.

4. Description Reviewed Empirical

The following section displays an overview of earlier studies on the effect of fiscal policy variables—such as public expenditure, public revenue, and public debt—on economic growth

Table 4.1 An overview of earlier studies on the impact of public spending on the growth of the economy

	Public Spending and Growth of the Economy in Ethiopia				Name of the Journal
	Author/s	Data & study areas	Methodology	Major Findings/Impacts	
1	Hailu Abera and Mohammed Beshir (2018)	Time series (1970-2019), in Ethiopia	Unrestricted Error Correction Model (UECM) and ARDL	Capital spending (-) in short-run (+) in long-run Recurrent spending (+) in short-run (-) in long-run	AJSI Vol. 6, Issue 1
2	Girma Mulugeta Emeru (2023)	Time series (1980-2018), in Ethiopia	Johansen co-integration test and the vector error correction model (VECM)	Education expenditure (+) Agriculture expense (-) in long-run (+) in short-run Investment expenditure (-) in short-run (+) in long-run Defense expense (+) in the short and long-run Health expenditure (+) in the short and long-run	The Scientific World Journal Volume 2023,
3	Temesgen Yaekob (2016)	Time series (1980-2013), in Ethiopia	VECM & ARDL	Overall spending (+)	International Journal of Current Research Vol. 8, Issue, 12, pp.43215-43221, December, 2016
4	Endaylalu Solomon (2019)	Time series (1982-2016), in	VAR Model	Overall expenditure (+) in long-run	International

		Ethiopia		(- -) In the short except for education and road expenses Education and road expenses (-) in short-run (+) in long-run	Journal of Business and Economics Research 2019; 8(4): 211-219
5	Emebet Ferede (2023)	Time series (1988-2022), in Ethiopia	ARDL Approach to Co-integration	Education expenditure (+) both in short and long-run	Horn of Africa Journal of Business and Economics (HAJBE), 2023, 6(2).
6	Solomon Tilahun Mengistu (2022)	Time series data (1985-2019), in Ethiopia	ARDL Approach to Co-integration	Productive expenditure (+) Nonproductive (neutral)	Cogent Economics & Finance, 10:1, 2104779
7	Abdu Mohamod (2014)	Time series data (1975-2011), in Ethiopia	Co-integration error correction model (VECCM)	Health and total capital expenditure (+) Agriculture, education, transport and communication, urban development and housing, and total recurrent Expenditure (- -)	Journal of Economics and Sustainable Development. Vol.5, No.9, 2014
8	Getachew Petros Osebo (2017)	Time series data (1974/75-2013/14), in Ethiopia	VAR, VECM	Capital expenditure (+)	International Journal of African and Asian Studies. Vol.38, 2017

Keywords: (-) Means negative impact on the growth of the economy, (+) Means positive impact on the growth of the economy, and (- -) Means no relationship/insignificant effect on the growth of the economy

Table 4.2: An overview of earlier studies on the impact of public revenue on the growth of the economy

Public Revenue and Growth of the Economy in Ethiopia					Name of the Journal
	Author/s	Data & study areas	Methodology	Major Findings/Impacts	
1	Deresse Dalango (2021)	Time series data (1980-2018), in Ethiopia	ARDL, VECM	(+) both in the short and long-run	Journal of Science and Inclusive Development.

					Vol. 3, No. 1,
2	Getachew Petros Osebo (2017)	Time series data (1974/75 – 2013/14), in Ethiopia	VAR, VECM	(+) in the long-run	International Journal of African and Asian Studies. Vol.38, 2017
3	Biruk Birhanu (2016)	Time series data (1974/75-2013/14), in Ethiopia	VAR, Granger causality test, and VECM	(--) both in the short and long-run	Journal of Economics and Sustainable Development. Vol.7, No.9, 2016
5	Solomon Tilahun Mengistu (2022)	Time series data (1985-2019), in Ethiopia	ARDL Approach to Co-integration	distortionary taxes (-)	Cogent Economics & Finance, 10:1,2104779
7	Amina Ahmed (2023)	Time series data (1990-2021), in Ethiopia	ARDL	Tax revenue components (+) in short-run (-) in long-run	Journal of African Development Studies Volume 10, No. 2, Dec. 2023

Keywords: (-) Means negative impact on the growth of the economy, (+) Means positive impact on the growth of the economy, and (- -) Means no relationship/insignificant effect on the growth of the economy

Table 4.3 An overview of earlier studies on the impact of public debt on the growth of the economy

	Public Debt and Growth of the Economy in Ethiopia				Name of the Journal
	Author/s	Data & study areas	Methodology	Major Findings/Impacts	
1	Chala Amante Abate (2023)	Time series data (1982–2018), in Ethiopia	Nonlinear ARDL and multiple thresholds nonlinear ARDL	(+)	Cogent Economics & Finance, 11:2, 2231226
2	Berhanu Getinet & Fikadu Ersumo (2020)	Time series data (1983-2018), in Ethiopia	ARDL	(-) in both the short and long-run	Journal of Economics and Sustainable Development. Vol.11, No.11, 2020
4	Alemayehu Geda	Time series	ARDL	External debt	Journal of

	& Addis Yimer Yimer (2023)	data (1980 to 2021), in Ethiopia		(+) in short-run (-) in long-run	Applied Economics, 27:1, 2398908
5	Wondatir Atinafu (2020)	Time series data (1970-2017), in Ethiopia	ARDL	External debt (-) in long-run	Economics, Management and Sustainability, 5(2), 6-27
6	Garedew Aweke Gizaw Taddele Ferede (2020)	Time series data (1981-2014), in Ethiopia	ARDL	External debt (-) in the long run External debt servicing (--)	Journal of Economics and Sustainable Development, Vol. 10, No.13, 2020.
7	Jimmy Alani (2020)	Time series data (1992 – 2018), in Ethiopia	Regression analysis	External debt (+) External debt serving (-)	MPRA, Munich Personal RePEc Archive
8	Teklu Kassu, Professor D.K Mishra and Melesse Asfaw (2014)	Time series data (1970-2013), in Ethiopia	VAR, VECM	External debt (--) in short-run (-) in long-run	Journal of Economics and Sustainable Development. Vol.5, No.15 2014
9	Desalegn Beksisa Emana (2021)	Time series data (1991-2019), in Ethiopia	ARDL bounds testing approach	(-)	Applied Journal of Economics, Management, and Social Sciences, 2021, 10–15

Keywords: (-) Means negative impact on the growth of the economy, (+) Means positive impact on the growth of the economy, and (- -) Means no relationship/insignificant effect on the growth of the economy.

5. Discussion

The empirical studies examined show significant variability in the relationship between fiscal policy variables and economic growth in Ethiopia. The findings are presented below by fiscal category. The impact of government spending on growth varies depending on the type of spending and the time horizon (Abera & Beshir, 2018; Emeru, 2023; Osebo, 2017). In general, capital (investment) expenditure has a negative or insignificant effect in the short run but a positive effect in the long run. This is consistent with the fact that infrastructure and capital projects take time to materialize into productive capital.

Conversely, recurrent expenditure follows the reverse pattern—positive in the short term but negative in the long run (Abera & Beshir, 2018), implying that excessive consumption-oriented spending may drown out productive investment over time. Education and health expenditures had generally favorable benefits over both time horizons (Emeru, 2023; Ferede, 2023), showing substantial human capital returns. However, agricultural expenditure has a negative long-run effect (Emeru, 2023), which may be due to inefficiencies in agricultural policy execution.

The impact of government revenue on growth is widely debated. Several research show favorable impacts (Dalango, 2021; Hadush et al., 2023), while others show negative (Ayana et al., 2024) or inconsequential (Birhanu, 2016) connections. Notably, distortionary taxes (e.g., high corporation or trade taxes) appear to have a detrimental impact on growth (Mengistu, 2022), whereas government revenue combined with great institutional quality produces favorable results (Ayana et al., 2024). This shows that how revenue is raised and under what governance structure is more important than revenue volume itself.

The debt-growth nexus is primarily negative in the long run. Most studies employing Ethiopian time-series data find that external debt hinders long-term growth (Getinet & Ersumo, 2020; Geda & Yimer, 2023; Atinafu, 2020; Emanu, 2021). However, Abate (2023) finds a positive benefit using a nonlinear ARDL model, implying that debt may be growth-enhancing up to a certain point after which it becomes detrimental. Short-run effects are mixed: some studies demonstrate favorable short-run effects (Geda & Yimer, 2023), consistent with a Keynesian demand boost, but these fade or reverse in the long run due to debt-service constraints.

The central research question asks how fiscal policy variables—public spending, revenue, and debt—relate to economic growth in Ethiopia. Findings show no universal answer. For public spending, the effect depends on spending composition and time horizon. For public revenue, outcomes hinge on tax structure and institutional quality. For public debt, the long-run relationship is predominantly negative, with potential nonlinear threshold effects. Overall, fiscal policy is not inherently growth-enhancing or growth-inhibiting; context, design, and implementation quality mediate the results.

To compare the findings with existing theories, Keynesian Economics predicts that more government expenditure boosts aggregate demand and growth in the short run. This is reinforced in part by research indicating that both recurrent and total spending have short-run positive benefits (Abera & Beshir, 2018). However, the long-run negative impacts of recurrent expenditure defy Keynesian projections and are more consistent with neoclassical crowding-out theories. Similarly, the Neoclassical Growth Theory (Solow-Swan) holds that fiscal policy produces only transient growth impacts unless it increases productivity. This view is supported by the long-term positive effects of capital, education, and health expenditures (Emeru, 2023; Ferede, 2023) because these are investments that increase productivity.

Furthermore, the findings that human capital expenditures (education, health) have a beneficial effect on growth in both the short and long run is consistent with endogenous growth theories (Romer, Lucas), in which investment in knowledge and health drives long-term growth. In the same fashion, the prevalence of negative long-run debt consequences lends support to the debt overhang theory, which holds that excessive external debt discourages private investment and decreases growth. The nonlinear positive discovery of Abate (2023) is compatible with the debt Laffer curve hypothesis, which states that debt is advantageous only up to a sustainable threshold. Lastly, the negative effect of distortionary taxes (Mengistu, 2022) is consistent with supply-side economics, which contends that taxes on capital and labor disincentivize productive activities under the Tax Distortion Theory.

6. Conclusions and Policy Recommendations

This article reviews fiscal policy trends in Ethiopia based on empirical literature reviews. The paper investigated the impact of fiscal policy variables on economic growth by examining related empirical works by different scholars in Ethiopia.

One of the main conclusions from the literature review was that it was impossible to determine how fiscal policy variables such as government expenditure, tax revenue, and public debt would affect economic growth. There were three possible outcomes concerning the impact of government expenditure, tax revenue, and public debt on economic growth: some results had a positive impact, others had a negative impact, and the rest had no impact. All three outcomes received empirical and theoretical support. Additionally, the study revealed that the relationship between fiscal policy and economic growth varied significantly based on the methodology employed, the fiscal policy proxy, the relative size of the public sector, institutional quality, the composition, the selected control variables, and the study period considered. The study further revealed that studies have used time series data since time series-based methodologies have gained power, which is commendable.

Even though the effect of fiscal policy on economic growth is inconclusive, the findings of the reviewed studies supported that fiscal policy had a positive impact on the growth of the country's economy. Among the eight reviewed empirical studies on the effect of public expenditure on economic growth, the majority concluded that productive government spending has a positive effect on economic growth in the long run and that economic growth causes public expenditure. Two of them showed that government recurrent and nonproductive spending does not affect economic growth. The rest confirmed its negative effect on economic growth in the short run.

Similarly, the findings that show the effect of tax revenue on the growth of the economy in the country are also mixed. Some results stated that discretionary taxes adversely affect economic growth. A few findings confirmed that government revenue does not affect economic growth. However, the majority of findings advocated that government revenue positively affects the growth of the economy in the study area. Most of the findings of the studies concerned with the relationship between public debt and economic growth

confirmed that public debt has a negative effect in the short run. The study's findings suggest that, while it is not possible to fully accept the assumption that fiscal policy promotes economic growth, it is generally acceptable.

This study makes key contributions by systematically evaluating and ranking disparate empirical findings on fiscal policy–growth linkages in Ethiopia. Additionally, it offers actionable policy recommendations for Ethiopian policymakers, and it also organizes and critically analyzes the literature to provide a coherent foundation for future research. Having these contributions, the review included only studies conducted in Ethiopia and limited the search period to 2014–2023. This restricts generalizability to other developing economies and excludes potentially valuable earlier empirical works that could inform long-term trends, together with limited data sources may be the potential limitations of this review article.

Policy recommendations

- Policymakers should shift budget composition toward capital, education, and health expenditures, which have strong long-term benefits, while limiting the increase of recurrent (consumption) spending.
- Avoid distorting taxes (such as excessive corporation or trade taxes) that impede growth. Instead, extend the tax base and improve compliance to increase income while minimizing disincentives.
- Given the constant long-term negative effects of external debt, Ethiopia should seek concessional borrowing, increase debt transparency, and deploy borrowed funds solely in high-return initiatives. A debt sustainability framework with explicit thresholds should be implemented, acknowledging the nonlinear (threshold) character of the debt-growth connection.
- Because government resources only have a beneficial impact on growth when combined with strong institutions (Isubalew Daba Ayana et al., 2024), institutional reforms such as anti-corruption measures, fiscal governance, and the rule of law are required for efficient revenue mobilization.
- Based on the findings, future researchers should pursue two key directions. First, investigate threshold effects: following positive debt finding using nonlinear methods, systematically estimate optimal debt-to-GDP thresholds for Ethiopia and comparable economies. Second, examine institutional mediation: identify which specific institutional dimensions—control of corruption, regulatory quality, or rule of law—most strongly mediate fiscal policy outcomes.

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Declaration

Ethical Approval

- Not Applicable

Statement of Funding

- No funds, grants, or other support were received.

Conflict of Interest Statement

- The authors have no relevant financial or non-financial interests to disclose and has no competing interests to declare that are relevant to the content of this article.

Data Availability Statement

- The author confirms that all data generated or analyzed during this study are included in the content of the paper.