JEPP
Journal Ekonomi Pembangunan dan Perencanaan
https://journal.psg.ac.id/index.php/jepp

Vol. 1, No. 1, 2026
e-ISSN: XXXX-XXX
pp. 1-11

Fiscal Policy for Inclusive Growth: The Interplay of Social Expenditure, Tax Progressivity, and Regional Inequality

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Article History:
Received: September 2, 2026
Revised: October 13, 2026
Accepted: November 22, 2026

Keywords:
Inclusive Growth; Social Expenditure; Tax Progressivity

Abstract: : *Inclusive growth requires fiscal systems that expand economic opportunity while reducing disparities in disposable income, human development, and regional access to public services. This study develops an integrative framework explaining how social expenditure and tax progressivity interact with regional inequality to shape inclusive growth. An integrative literature review synthesized peer-reviewed studies published between 2022 and 2025, prioritizing Scopus-indexed public economics, development economics, regional science, and fiscal-policy research together with relevant Indonesian evidence. Findings indicate that progressive taxation can reduce post-tax inequality, although growth effects depend on tax design, behavioral responses, administrative capacity, and the structure of the tax base. Social expenditure can strengthen inclusion through education, health, social protection, and labor-market programs, but composition and targeting matter because different categories produce different distributional and growth effects. Regional inequality modifies these relationships because fiscal capacity, infrastructure, service access, demographic structure, and intergovernmental transfers vary spatially. Evidence from Indonesia further suggests that transfer design and productive local expenditure influence convergence and rural-urban disparities. The proposed framework therefore treats inclusive fiscal policy as a coordinated system rather than a choice between taxation and spending. Effective strategies should combine progressive revenue mobilization, high-impact social expenditure, spatially sensitive transfers, and stronger subnational implementation. The study concludes that inclusive growth depends on the joint distributional quality of revenue collection and expenditure allocation across households and regions. This integrated perspective provides a basis for designing fiscal systems that distribute growth opportunities more fairly across households and regions.*

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How to cite:

INTRODUCTION

Inclusive growth has become a central objective of fiscal policy because aggregate economic expansion does not automatically translate into broadly shared improvements in welfare. Contemporary fiscal systems are expected to finance public services, protect vulnerable households, support productive capacity, and moderate excessive inequality without undermining macroeconomic sustainability. Auerbach et al. (2023) show that fiscal progressivity is more accurately understood when taxes and benefits are evaluated

over broader resource measures rather than current income alone. Their analysis highlights an important principle for inclusive growth: redistribution depends on the combined incidence of taxes and public benefits. Fiscal policy should therefore be assessed as an integrated system of revenue collection and expenditure rather than through isolated instruments.

Tax progressivity is one of the principal channels through which governments can alter post-tax income distribution. Jalles and Karras (2024) find that greater tax progressivity in the United States reduces the Gini index, with effects that are gradual but economically meaningful. Creedy and Subramanian (2024) further emphasize that progressivity and tax equitability require attention to the distribution of tax burdens across income groups. These findings suggest that inclusive growth depends not only on the amount of revenue raised but also on who bears the burden. A progressive tax system can create redistributive space, yet its design must account for incentives, compliance, administrative capacity, and the sustainability of the revenue base.

The design of progressive taxation is especially challenging in developing economies, where informality, narrow personal-income-tax bases, capital mobility, and enforcement constraints can weaken redistributive capacity. Bergolo et al. (2023) review evidence from Latin America and show that taxing high-income individuals can contribute to progressivity, although institutional and behavioral constraints remain important. This insight is relevant for emerging economies seeking inclusive growth because statutory progressivity does not guarantee effective progressivity. Tax policy must combine appropriate rates with enforcement, information systems, reduced avoidance opportunities, and credible public spending. Revenue legitimacy also depends on whether citizens perceive that taxation finances valuable and fairly distributed public services.

Social expenditure constitutes the expenditure-side counterpart of progressive taxation. Ahuja and Pandit (2022) find that social spending can reduce inequality in developing countries and that education and health expenditure may support growth as well as distributional improvement. Quiñonez (2022) similarly reports that higher social spending is associated with lower inequality in Latin America, although effects differ across spending categories and distributional reach. These findings indicate that the quantity of social expenditure is insufficient as a policy criterion. Inclusive fiscal policy must consider composition, targeting, implementation quality, and whether spending reaches households and communities facing the greatest constraints.

Recent evidence further demonstrates that social spending composition matters for the equity-growth relationship. Bação et al. (2024) find heterogeneous effects across nine categories of OECD social expenditure and identify active labor-market policies as particularly relevant for reducing inequality while supporting growth. Miranda et al. (2024) show that social public spending on health, education, and social protection reduces inequality-related losses in human development across a broad international sample. Together, these studies suggest that social expenditure promotes inclusion through both income redistribution and capability formation. Fiscal policy can therefore influence inclusive growth by expanding human capital, health, labor-market participation, and social protection rather than relying solely on cash redistribution.

Regional inequality adds a spatial dimension to fiscal inclusion. Neuhuber and Schneider (2024) demonstrate that the inequality-reducing effects of public social expenditure vary across spatial scales and localities, implying that national averages can conceal important territorial differences. Regions differ in tax bases, demographic needs, service-delivery costs, infrastructure, administrative capacity, and labor-market

opportunities. Consequently, identical fiscal allocations may produce unequal outcomes. Inclusive growth requires spatially informed budgeting that recognizes these differences and uses intergovernmental transfers, public investment, and social spending to reduce gaps in effective access to opportunities.

Indonesia provides a particularly relevant context because fiscal decentralization combines large territorial diversity with significant differences in local revenue capacity and development outcomes. Khusaini et al. (2023) find that fiscal transfers and road infrastructure can reduce rural-urban income inequality, while Ahmad et al. (2024) show that the distribution of transfers across island and non-island provinces has implications for regional inequality. Purwanti (2024) also links fiscal intervention with inclusive economic growth in East Java. These studies indicate that the redistributive effectiveness of fiscal policy depends partly on how central resources are allocated and transformed into productive local services and infrastructure.

Despite extensive research on taxation, social expenditure, and regional disparities, these components are often examined separately. This fragmentation limits understanding of how revenue progressivity, spending composition, and spatial allocation interact to produce inclusive growth. The present study addresses this gap by integrating recent evidence from 2022–2025 into a conceptual fiscal-policy framework. The framework proposes that tax progressivity creates redistributive revenue capacity, social expenditure converts fiscal resources into household and human-development gains, and spatially sensitive transfers address territorial differences in fiscal capacity and need. Inclusive growth is expected to be strongest when these three mechanisms are coordinated and supported by effective public institutions.

THEORETICAL FOUNDATION

The theoretical framework combines fiscal incidence theory, redistributive public finance, and spatial equity. Fiscal incidence theory evaluates how taxes and government spending alter the distribution of economic resources. Redistributive public finance emphasizes the trade-offs and complementarities between efficiency, revenue mobilization, and equity. Spatial equity extends these ideas by recognizing that households experience fiscal policy within regions that differ in tax capacity, infrastructure, prices, public-service access, and administrative quality. In this framework, tax progressivity affects disposable-income distribution, social expenditure affects both current welfare and long-term capabilities, and intergovernmental fiscal arrangements influence territorial opportunity. Inclusive growth emerges when these channels jointly broaden participation in economic progress while limiting persistent household and regional disparities.

The proposed model contains three interacting policy mechanisms. First, tax progressivity determines how the financing burden is distributed and how much redistributive revenue can be mobilized. Second, social expenditure determines whether revenue is converted into education, health, social protection, labor-market support, and other capability-enhancing services. Third, regional fiscal allocation determines whether resources reach territories with weaker tax bases, higher service costs, or greater development deficits. Institutional capacity, targeting quality, fiscal sustainability, and local governance moderate all three mechanisms. The framework therefore rejects a simple tax-versus-spending dichotomy and instead evaluates the distributional quality of the entire fiscal system across income groups and geographic regions.

REASERCH METHODS

This study employed an integrative literature review and conceptual synthesis to examine how social expenditure, tax progressivity, and regional inequality interact in shaping inclusive growth. Peer-reviewed studies published from 2022 to 2025 were prioritized, with emphasis on Scopus-indexed research in public economics, development economics, regional science, fiscal federalism, inequality, and social policy together with relevant Indonesian journal evidence. Search concepts included fiscal policy, inclusive growth, tax progressivity, social expenditure, fiscal redistribution, income inequality, regional inequality, intergovernmental transfers, fiscal decentralization, and public spending. The qualitative analytical procedure followed the principles of data reduction, categorization, interpretation, and conclusion development described by Sugiyono (2022).

The synthesis proceeded through three stages. First, studies were coded according to revenue-side mechanisms, particularly tax progressivity, tax incidence, and redistributive capacity. Second, evidence was coded according to expenditure-side mechanisms, including education, health, social protection, labor-market programs, infrastructure, and expenditure composition. Third, studies addressing regional inequality, fiscal transfers, decentralization, and spatial heterogeneity were integrated to identify how territorial conditions modify fiscal effects. No fabricated primary dataset was introduced. The framework is conceptual and evidence-synthesizing, using published empirical results to formulate relationships that can later be tested with household, provincial, or cross-country fiscal data.

Source quality was assessed through publication recency, peer-review status, journal credibility, relevance to the fiscal mechanisms under study, and DOI traceability. International findings were triangulated with Indonesian evidence to strengthen policy relevance for decentralized developing economies. Future empirical research can operationalize tax progressivity through effective tax rates or progressivity indices; social expenditure through functional spending categories; regional inequality through Gini, Theil, Williamson, or spatial disparity measures; and inclusive growth through combined income, poverty, employment, and human-development indicators. Panel regression, spatial econometrics, fiscal-incidence analysis, local projections, and structural equation modeling are suitable methods for testing the proposed interactions.

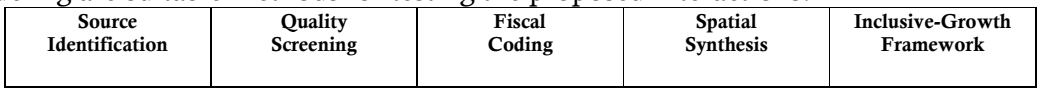

Figure 1. Integrative Review and Fiscal Policy Framework Development

RESULT AND DISCUSSION

The first finding is that fiscal progressivity should be evaluated across taxes and benefits rather than through statutory tax rates alone. Auerbach et al. (2023) demonstrate that measures based on lifetime resources and government benefits can reveal substantially different distributional patterns from current-income comparisons. For inclusive growth, this means that fiscal incidence must consider what households pay and what they receive. A progressive tax schedule may have limited redistributive impact if benefits are poorly targeted, while moderate taxes can produce substantial redistribution when public services and transfers reach disadvantaged groups. Policy evaluation should therefore connect revenue incidence with expenditure incidence. This integrated approach more clearly reveals whether fiscal systems genuinely expand economic opportunity and reduce inequality across households and regions.

Second, tax progressivity can reduce income inequality, but its effects develop over time. Jalles and Karras (2024) use local projections and find that an increase in United States tax progressivity lowers the Gini index gradually and significantly at its peak. This result supports the redistributive role of progressive taxation while cautioning against expecting immediate distributional transformation. Inclusive-growth strategies should therefore evaluate tax reforms over medium-term horizons and consider interactions with labor supply, investment, compliance, and expenditure. The evidence also implies that revenue design matters independently of the overall tax rate. Accordingly, progressive tax reform should be evaluated together with spending priorities, administrative feasibility, behavioral responses, and medium-term effects on household welfare, investment, employment, and economic participation across regions over time.

Third, tax equitability requires a distribution-sensitive interpretation of progressivity. Creedy and Subramanian (2024) develop a measure that compares tax concentration with benchmark distributions and distinguishes distribution effects from tax-system effects. Their contribution is important because identical statutory schedules can produce different equity outcomes under different pre-tax income distributions. Inclusive fiscal policy should therefore monitor effective burdens across households rather than relying solely on marginal-rate structures. This is especially relevant when deductions, exemptions, informality, or differential compliance alter effective taxation. Distributional monitoring should therefore accompany tax reform so governments can distinguish nominal progressivity from effective equity, identify groups that remain disproportionately burdened, assess behavioral responses, and determine whether additional revenue finances services and transfers that broaden economic opportunity across income groups.

Fourth, developing countries face distinctive constraints when attempting to tax high incomes progressively. Bergolo et al. (2023) review Latin American evidence and emphasize the importance of enforcement, information, behavioral responses, and institutional design for taxing the rich. These constraints matter for inclusive growth because weak enforcement can make statutory progressivity largely symbolic. Governments need third-party information, effective tax administration, reduced avoidance opportunities, and coherent treatment of labor and capital income. Progressivity also gains political legitimacy when additional revenue finances visible public benefits. Thus, tax reform should be designed jointly with expenditure commitments so that redistributive revenue mobilization and inclusive public investment reinforce each other. Progressive taxation is most credible when enforcement capacity and transparent public benefits develop alongside statutory reform.

Fifth, social spending can simultaneously support redistribution and development when it strengthens human capabilities. Ahuja and Pandit (2022) find that social expenditure categories reduce inequality in developing countries and that education and health spending can positively affect growth. This evidence challenges the assumption that equity-enhancing expenditure necessarily sacrifices efficiency. Education and health can improve productivity, labor-force participation, and intergenerational mobility while reducing disparities in access to essential services. Inclusive fiscal policy should therefore distinguish consumption from capability-building expenditure and protect high-return social investments during fiscal consolidation. These findings support protecting well-targeted education and health budgets as productive social investments that can advance equity, intergenerational mobility, labor productivity, and long-term development, especially where disadvantaged households face persistent barriers to essential services.

Sixth, social expenditure has heterogeneous effects across programs and countries. Quiñonez (2022) finds that overall social spending is associated with lower inequality in Latin America but shows that different components vary in effectiveness and that systems can still struggle to reach the bottom of the distribution. This finding underscores the importance of targeting and program design. Expanding expenditure without improving coverage, benefit incidence, or service quality may produce limited inclusion. Governments should therefore evaluate who receives benefits, how programs interact, and whether administrative barriers exclude vulnerable households. Policy design should therefore combine adequate public funding with stronger targeting, accessible delivery systems, administrative coordination, and regular benefit-incidence evaluation so disadvantaged households fully receive intended gains and exclusion errors are systematically reduced.

Seventh, expenditure composition can influence inequality and growth simultaneously. Bação et al. (2024) analyze OECD social expenditure and find that some categories, particularly active labor-market policies, can reduce inequality while supporting economic performance. The implication is that fiscal policy should optimize the portfolio of social programs rather than treating social spending as a homogeneous aggregate. Programs that improve employability, family security, and labor-market attachment can strengthen both distributional and productive outcomes. Inclusive growth therefore depends on the marginal effect of each spending category, interactions among programs, and country-specific institutions. Governments should consequently evaluate the distributional and productive returns of individual programs when reallocating limited fiscal resources across competing social priorities, while monitoring implementation quality, beneficiary coverage, and longer-term labor-market effects.

Eighth, social public spending can reduce inequality in multidimensional human development, not merely monetary income. Miranda et al. (2024) examine 82 developed and developing countries and find that health, education, and social-protection spending reduces inequality-related losses in human development. This broadens the meaning of inclusive fiscal policy. Income redistribution is important, but unequal access to schooling, health, and longevity can persist even when monetary inequality improves. Fiscal strategies should therefore track both disposable-income outcomes and capability indicators. Social expenditure that equalizes access to essential services can produce long-term inclusion by improving human capital and reducing inherited disadvantages. This broader perspective makes capability equality an essential criterion for evaluating whether fiscal policy translates aggregate growth into widely shared improvements in wellbeing.

Ninth, the spatial effectiveness of social expenditure is heterogeneous. Neuhuber and Schneider (2024) show that the inequality-reducing effects of municipal and provincial social spending in Austria vary across locations and spending categories, with social protection showing particularly strong effects. Their spatial multilevel analysis demonstrates why national averages can be misleading. Regional fiscal policy should account for local demographic structures, service costs, labor markets, and baseline inequality. A uniform per-capita allocation may not achieve equal outcomes when territorial needs differ. Spatially differentiated budgeting can therefore improve equity by matching expenditure intensity and program design to local needs, service-delivery costs, administrative capacity, demographic structure, and baseline disadvantage, while using comparable outcome indicators to identify territories where additional intervention or support remains necessary.

Tenth, inclusive growth can be strengthened by adjusting the structure of fiscal expenditure. Wu et al. (2025) find that social-security and ecological-protection expenditure positively affect inclusive green growth in China, while other expenditure categories display nonlinear effects. Although the study focuses on environmental inclusion, its broader fiscal lesson is relevant: composition and context determine whether spending supports inclusive development. Governments should avoid assuming that all public expenditure contributes equally to inclusion. Expenditure reviews can identify categories with weak distributional returns and redirect resources toward social, human-capital, infrastructure, or environmental investments that expand opportunity. Public expenditure reform should consequently prioritize categories with demonstrable inclusive returns while preserving fiscal sustainability, implementation quality, and flexibility to adapt allocations to different regional development conditions.

Eleventh, budget reallocation can reduce inequality even when governments cannot increase total spending. Isiaka et al. (2025a) examine middle-income countries and find that reallocating expenditure toward education is associated with lower inequality across the income distribution. This is especially relevant for fiscally constrained developing economies facing debt limits or weak revenue mobilization. Inclusive fiscal policy can improve distributional outcomes through expenditure prioritization, not only through larger budgets. However, reallocation decisions should consider country-specific needs and potential trade-offs across health, social protection, agriculture, and infrastructure. Distributional impact assessment should therefore become a routine component of medium-term budgeting and expenditure reviews. Where fiscal space is limited, expenditure reallocation can become an effective practical redistributive strategy if efficiency and service quality remain protected.

Twelfth, tax and spending shocks have different distributional effects across levels of development. Isiaka et al. (2025b) find that education spending shocks are particularly effective in middle-income countries, whereas health spending and tax shocks have stronger favorable distributional effects in high-income economies. This heterogeneity cautions against universal fiscal prescriptions. Inclusive-growth strategies should reflect the structure of public services, tax capacity, demographic conditions, and existing welfare institutions. For middle-income countries, strengthening education expenditure may generate particularly important distributional gains, while revenue reforms remain necessary for sustainable financing. These differences imply that governments should calibrate fiscal packages to national development conditions rather than mechanically importing tax and expenditure combinations from wealthier economies, while continuously evaluating distributional responses, implementation constraints, and financing sustainability.

Thirteenth, Indonesia's fiscal-transfer system can reduce spatial inequality when transfers and infrastructure address local constraints. Khusaini et al. (2023) find that fiscal transfer policies and road infrastructure contribute to reducing rural-urban income inequality. This result demonstrates the importance of combining intergovernmental finance with productive public investment. Transfers alone may not generate convergence if local governments lack infrastructure, implementation capacity, or appropriate spending priorities. Inclusive regional policy should link transfer formulas to fiscal need while strengthening incentives for service delivery and productive investment. Transfer policy is therefore most effective when equalization resources are accompanied by infrastructure, local administrative capacity, accountable expenditure, performance monitoring and

development programs that expand market access, public services, mobility, and economic opportunity across rural and urban communities.

Fourteenth, transfer design should recognize geographic characteristics that influence fiscal need. Ahmad et al. (2024) examine fiscal-transfer disparities between island and non-island provinces in Indonesia and show that different transfer components have different implications for regional inequality. Their analysis highlights a structural challenge in decentralized systems: allocation formulas based on conventional indicators may understate the higher costs of service delivery in geographically dispersed territories. Inclusive fiscal policy should therefore incorporate spatial accessibility, infrastructure gaps, population dispersion, and local revenue capacity into equalization mechanisms. Equalization formulas should recognize geographic cost disadvantages while preserving transparent allocation rules, local accountability, efficient service delivery, and measurable access standards across provinces, especially where remoteness and population dispersion increase the cost of providing essential public services.

Fifteenth, subnational fiscal intervention can support inclusive growth when it is aligned with poverty, inequality, and employment objectives. Purwanti (2024) analyzes East Java and emphasizes the relationship between inclusive economic growth and fiscal intervention. The study reinforces the need to evaluate regional budgets through multiple welfare outcomes rather than output growth alone. Local governments influence inclusion through education, health, infrastructure, social protection, and economic-support programs, but effectiveness depends on allocation quality and local implementation. The integrated framework developed here therefore combines progressive revenue mobilization, high-impact social expenditure, and spatially sensitive fiscal transfers. Taken together, the evidence supports coordinated national and subnational fiscal strategies that connect redistribution, social investment, regional equalization, implementation quality, institutional accountability and more broadly shared economic participation.

Table 1. Integrated Fiscal Policy Framework for Inclusive Growth

Fiscal dimension	Primary mechanism	Distributional channel	Inclusive-growth outcome
Tax progressivity	Progressive effective burdens and revenue mobilization	Post-tax income redistribution	Vertical equity and fiscal capacity
Social expenditure	Education, health, protection, labor-market support	Capabilities and disposable resources	Human development and participation
Regional allocation	Transfers, equalization, infrastructure	Spatial redistribution of fiscal resources	Regional convergence and service access
Institutional quality	Administration, targeting, compliance, implementation	Conversion of budgets into effective benefits	Fiscal effectiveness and trust
Integrated policy	Coordinated revenue, spending, and spatial design	Household and territorial redistribution	Sustainable inclusive growth

CONCLUSION

This study concludes that fiscal policy promotes inclusive growth most effectively when tax progressivity, social expenditure, and regional allocation are designed as complementary components of one redistributive system. Progressive taxation can reduce post-tax inequality and create fiscal space, but effective progressivity depends on enforcement, tax-base structure, and administrative capacity. Social expenditure transforms revenue into human development, social protection, and productive opportunity, while regional transfers and public investment determine whether these gains reach territories with weaker fiscal capacity and higher development needs. Inclusive growth therefore requires attention to both interpersonal and spatial distribution.

The reviewed evidence shows that expenditure composition and territorial context matter as much as aggregate fiscal size. Education, health, social protection, labor-market programs, infrastructure, and ecological expenditure generate different distributional and growth effects across countries and regions. Governments should institutionalize

distributional impact assessment within budgeting, tax reform, and intergovernmental transfer design. In decentralized economies such as Indonesia, equalization formulas should reflect geographic costs, infrastructure deficits, fiscal capacity, and service needs while maintaining incentives for effective local implementation. Coordinated fiscal design can reduce the risk that national growth coexists with persistent regional exclusion.

Future research should empirically test the proposed framework using household fiscal-incidence data combined with provincial or district fiscal indicators. Studies can examine whether tax progressivity has stronger inclusive-growth effects when social spending is well targeted and whether regional inequality weakens national redistributive outcomes. Spatial panel models, local projections, microsimulation, decomposition analysis, and multilevel models can identify heterogeneous effects across income groups and territories. Longitudinal research should also assess fiscal sustainability, behavioral responses, tax compliance, and the quality of public services. Such evidence can support fiscal strategies that expand economic opportunity while improving distributional fairness across households and regions.

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