



The Impact of Public Expenditure on Economic Growth in Developing Countries

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Abstract

This study examines how public expenditure mix and institutional quality affect economic growth in developing nations. Public expenditure is often seen as a key fiscal tool for economic growth, especially in nations with structural constraints, weak private sectors, and poor infrastructure. Theoretical and empirical literature disagrees on whether government spending sustains economic growth. The qualitative study uses peer-reviewed academic papers, textbooks, policy studies, government publications, and relevant news articles. A topical synthesis of research focuses on capital and recurrent expenditure, transmission mechanisms, and institutional issues affecting fiscal effectiveness. Endogenous growth theory provides the analytical framework for understanding how public investment in human capital and infrastructure boosts long-term growth. When invested in productive areas like infrastructure, education, and healthcare, public investment boosts economic growth. The success of such expenditure depends on governance, budgetary discipline, and resource allocation efficiency. In many emerging nations, large recurring expenditure and institutional inefficiencies reduce government spending's growth potential. According to the report, properly allocated public spending and strong institutions maximise effectiveness. The report suggests additional capital investment, better public financial management, accountability, and project monitoring. It emphasises the need of public-private partnerships in addressing fiscal constraints and expanding development finance in developing nations.

Original Research Article

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Introduction

Public expenditure is considered a fundamental tool of fiscal policy, especially in developing nations where private sector involvement frequently falls short of addressing extensive developmental requirements (Islam et al., 2024). It pertains to the financial resources designated by the government for the delivery of public goods and services, including infrastructure, education, healthcare, defence, and social welfare programs. In economic discussions, its significance is in its ability to affect aggregate demand in the short term and to determine productive capacity in the long term. The degree to which public expenditure influences economic growth continues to be a topic of ongoing theoretical and empirical discussion.

In numerous emerging economies, government expenditure is rationalised due to structural restrictions that impede the efficacy of market systems. This encompasses poor banking

institutions, insufficient infrastructure, elevated unemployment rates, and pervasive poverty. In these settings, the state is anticipated to assume a corrective and developmental role by investing in areas that augment production and diminish inequality. From a Keynesian viewpoint, public expenditure serves as a stabilising mechanism that enhances demand, particularly during economic recessions, consequently boosting output and employment (Parui, 2022). Conversely, neoclassical economists contend that excessive government intervention can distort market signals, diminish private sector investment due to crowding-out effects, and lead to fiscal instability if inadequately handled.

The theoretical connection between public expenditure and economic growth is consequently intricate and multifaceted. Wagner's Law posits that as economies progress, government

size often enlarges in response to escalating social, administrative, and infrastructural requirements, indicating a long-term correlation between state activity and economic growth (Jalles, 2019). Endogenous growth theory reinforces this viewpoint by highlighting the need of government investment in human capital development, technical advancement, and infrastructure enhancement as essential catalysts for sustained growth. Public choice theory presents an alternative perspective, emphasising the inefficiencies inherent in governmental actions, such as bureaucratic delays, corruption, and resource misallocation, which may undermine the growth-promoting impacts of public expenditure.

Empirical research on the correlation between public expenditure and economic growth in emerging nations yields inconsistent and perhaps contradictory results. Although numerous studies indicate a favourable correlation, especially when spending is allocated to productive sectors like education, health, and infrastructure, some research reveals weak or even adverse effects, particularly in contexts where recurrent expenditure predominates in government budgets (Foster et al., 2022). The variability of these findings is frequently ascribed to disparities in institutional quality, budgetary discipline, economic structure, and the scientific approaches employed in different studies. Panel data analysis commonly demonstrate that capital investment exerts a more robust and consistent influence on growth than recurrent expenditure, which is typically linked to consumption and administrative costs. Notwithstanding the abundant research on fiscal policy and economic growth, considerable gaps persist. Numerous current studies depend on aggregated metrics of government spending, which hide critical sectoral differences and constrain the accuracy of policy recommendations (Wang et al., 2025). Moreover, there is insufficient focus on country-specific institutional and governance elements that affect the efficacy of public resource utilisation. These limits indicate the necessity for a more sophisticated and context-sensitive analysis, especially in developing countries where structural constraints are more evident.

This study aims to analyse the effect of public expenditure on economic growth in emerging nations, emphasising the influence of various components of government spending on economic performance. It also evaluates the efficacy of expenditure allocation and the institutional elements that influence the relationship between fiscal policy and growth results.

This study's importance resides in its capacity to influence policy and scholarly discussion. It offers policymakers information on optimising government expenditure to improve growth and development results. It aids scholars in the ongoing discourse over the efficacy of fiscal policy in emerging economies by integrating theoretical and empirical viewpoints.

The study's scope is confined to developing nations and

primarily examines the correlation between public expenditure and economic growth, emphasising capital and recurring expenditure. It recognises possible limits, including data constraints, disparities in institutional quality among countries, and difficulties in establishing unequivocal causality.

Conceptual Framework

The link between public spending and economic growth is based on the idea that government spending affects aggregate demand and productive capacity (Sardoni, 2024). Public expenditure includes all government expenditures on products, services, and transfers to achieve economic and social goals. However, economic growth is the steady increase in a country's output of goods and services, measured by GDP or GDP per capita.

Public spending is usually capital or recurrent. Capital expenditure includes government investments in infrastructure, roads, power, schools, and hospitals (Ahmad et al., 2025). These investments boost productivity, lower transaction costs, and enable private sector development, boosting growth. Salary, administrative, subsidy, and maintenance costs are recurring expenditures. Recurrent expenditure is essential to government, but its direct contribution to long-term growth is often overlooked, especially when it is excessively high relative to capital investment (Foster et al., 2022).

Public spending affects economic growth through numerous avenues. Key channels include infrastructure development. Adequate infrastructure lowers production costs, improves market access, and boosts public and private sector efficiency (Hussain, 2025). In underdeveloped countries, infrastructural shortfalls can limit economic growth, making government investment in this sector crucial.

Other key channels include human capital development. Government spending on education and healthcare boosts productivity, creativity, and labour force quality. Human capital theory says that sustainable economic growth requires investing in people as well as physical capital (Kanval et al., 2024). Public spending in these industries helps reduce inequality and boost long-term growth in many emerging nations.

Public spending affects aggregate demand and economic growth. Government expenditure boosts consumption and investment, especially during low private sector activity, according to Keynesians. This demand-side effect is especially important in developing countries with turbulent economic cycles and insufficient private investment to sustain growth (Usman et al., 2022). Public expenditure efficacy depends on institutional quality, governance, and resource allocation efficiency (Khan et al., 2024). In circumstances with corruption, inadequate accountability, and bad fiscal management, public spending may not yield results. Instead, inefficient expenditure, fiscal

imbalances, and macroeconomic instability may undermine growth goals.

Thus, this study implies that public expenditure and economic development are conditional. It depends on expenditure composition, implementation efficiency, and fiscal policy's institutional context. This understanding allows us to compare capital and recurring expenditure on growth in emerging countries.

Theoretical Review

This study relies on Paul Romer's Endogenous Growth Theory (1986; 1990). The theory was developed to address the criticisms of the neoclassical growth model, particularly its assumption that technological development drives long-term economic growth. Endogenous growth theory holds that deliberate investment in human capital, innovation, knowledge, and infrastructure drives economic growth. This concept holds that policy decisions, including public spending, shape an economy's long-term growth.

Romer's model assumes that knowledge and human capital have non-diminishing returns, hence investing in them can boost production. Education, health, and technology investments can assist the economy, unlike physical capital, which has declining returns. In underdeveloped nations, where private sector investment in such sectors is generally insufficient due to high costs, risk, and low immediate profitability, government assistance is crucial.

The endogenous growth paradigm relies on public expenditure as a key way for governments to invest in productive sectors. Investment in education boosts labour quality, skill acquisition, and innovation. Healthcare investment reduces morbidity and increases life expectancy, boosting the effective workforce. Infrastructure investing on roads, energy, and communication lowers production and transaction costs, boosting private sector activity and economic efficiency.

This hypothesis is especially relevant in developing nations due to structural constraints that impede private capital accumulation. Poor financial institutions, credit shortages, and poverty hinder individuals and enterprises' ability to invest in productive activities. Public spending drives economic transformation in such cases. Governments can fix market flaws and foster sustainable growth by investing directly in critical sectors.

Public spending efficiency and composition determine its effectiveness under the endogenous growth paradigm. Romer's theory assumes investments go to productive applications with positive externalities. In many emerging economies, a large part of public spending goes to wages, administrative expenditures, and subsidies, which may not boost productivity. This misallocation reduces government spending's long-term economic impact.

Institutional quality also determines whether public spending boosts growth. Endogenous growth theory posits efficient governance systems that allocate and use resources efficiently. Public investment is hindered by corruption, bureaucratic inefficiency, and insufficient accountability in many developing nations. The predicted spillover benefits of government spending are typically reduced or delayed.

Endogenous growth theory provides a solid theoretical platform for understanding how public expenditure affects economic growth in developing nations. It indicates that government expenditure is a strategic tool for productive capacity and long-term development, not just consumption. The theory explicitly supports the idea that capital expenditure, especially in education, health, and infrastructure, should boost economic growth, but inefficient or wasteful recurrent expenditure may have limited or negative benefits.

Policywise, the theory offers essential solutions to the subject under examination. It states that developing countries must prioritise productive investment above unproductive consumption to promote economic growth through public expenditure. This includes investing in infrastructure, human capital, and innovation-driven sectors. It also emphasises institutional reforms to boost public finance management transparency, accountability, and efficiency.

Empirical Review

Villela, & Paredes (2022) found conflicting results on public expenditure and economic growth in developing countries. The variances in findings reflect country circumstances, methodological techniques, time periods, and public spending mix in diverse studies. A large body of research supports the idea that public expenditure, particularly capital expenditure, boosts economic growth, while another study finds weak, insignificant, or even negative relationships depending on fiscal structure and institutional quality.

Several studies have shown that productive government investment boosts growth in Sub-Saharan Africa. Ibrahimov, et al. (2023) found that infrastructure investment boosts GDP by increasing productivity, lowering transaction costs, and improving private sector efficiency. Education and health investment are also key drivers of long-term growth since they develop human capital. Inefficiencies in public financial management, such as corruption and poor project execution, lower the projected impact of expenditure on economic outcomes.

In contrast, Tanjung, & Shimada (2025) found more complex outcomes in developing Asian countries. Capital investment usually boosts economic growth, whereas recurrent expenditure typically does not. Administrative costs, subsidies, and salary bills absorb a large percentage of government funds and do not immediately contribute to productive capacity. However, countries with better

governance and fiscal systems have more consistent favourable public expenditure results.

Rao et al. (2025) show that expenditure-growth relationships are complex in Latin American countries. Some empirical data imply that government expenditure increases stimulate demand and boost short-term economic growth. Long-term growth benefits vary, especially when fiscal expansion causes budget deficits and macroeconomic instability. Some experts believe that efficiency, transparency, and strategic resource distribution are more essential than quantity in expenditure. Many cross-country panel studies have tried to generalise the relationship between public expenditure and economic growth in developing economies. Numerous research use econometric methods including OLS, GMM, and ARDL models (Saygin & İskenderoğlu, 2022). Some findings show a statistically significant positive relationship between total government expenditure and growth, but others show non-linearity, suggesting that public spending's impact may vary depending on GDP and economic development.

Capital vs recurrent spending is a common empirical subject (MUHAMMAD & IBRAHIM, 2024). Due to its direct contribution to productive capacity, capital spending consistently boosts economic growth. However, recurring expenditure yields varied benefits (Abdulkarim & Dengel, 2023). Unless efficiently managed and matched with development goals, public sector pay and subsidies may have short-term demand effects but limited long-term growth.

Another key conclusion in the research is that institutional quality affects public expenditure effectiveness. Government expenditure boosts growth in countries with good governance, little corruption, and good public financial management (OSMOND et al., 2024).

No matter the level of spending, inadequate institutions limit the growth impact of public investment. Despite strong empirical data, numerous limitations exist. Many research use aggregated expenditure data, which hides sectoral variations (Foerster et al., 2022). Others fail to address endogeneity and causation, making it hard to identify whether public spending drives growth or whether economic growth drives government spending (Ahmad et al., 2025). Few recent research have included updated fiscal data and post-financial crisis dynamics in emerging economies.

The empirical research implies that public expenditure and economic growth are context-dependent. Capital expenditure, especially in infrastructure and human capital development, is generally supported, although total public spending has different consequences across countries and time.

Critical Analysis of Literature

Critical analysis of public expenditure and economic growth literature shows conceptual strengths and methodological shortcomings. The literature's vast coverage of locations and economic circumstances has helped scientists find general

expenditure-growth patterns. The continuous observation that capital expenditure boosts growth more than recurrent expenditure can help emerging nations optimise fiscal results (Challoumis, 2024). Recent research have strengthened empirical analysis by integrating ARDL, GMM, and panel regression models.

Despite these strengths, the literature has major findings discrepancies. Some studies show that public spending boosts economic growth, while others find the opposite. Comparing country-specific conditions, model parameters, and historical periods sometimes leads to discrepancies. The link appears to be context-dependent, influenced by institutional quality, fiscal discipline, and macroeconomic stability. Existing theories are less predictive when applied equally across emerging nations due to this lack of unanimity.

Overreliance on aggregated public expenditure measures is another literature limitation. The effects of government spending's components are often ignored in research (Chu et al., 2020). This approach hides substantial capital and recurrent expenditure differences and limits policy suggestions. For instance, combining infrastructure investment and administrative spending may diminish the growth benefit of productive expenditure.

Methodological issues remain a serious concern. Many studies fail to address endogeneity, where public investment and economic growth may be causally linked in both directions. Economic growth can enhance government revenues and spending capacity, making causality unclear (Rahman, 2023). Omitted variable bias is widespread because many models ignore institutional quality, technological innovation, and external economic shocks, which drive growth. These shortcomings make some empirical conclusions unreliable.

Despite their importance in public expenditure efficiency, governance and institutional frameworks are neglected in the research. Corruption, bureaucratic delays, and insufficient accountability systems diminish government expenditure effectiveness in many developing nations (Ferraz & Finan, 2025). These aspects are frequently considered secondary rather than explanatory. This limits many empirical investigations' explanations.

Lack of sector-specific analysis is another weakness. Education, health, and infrastructure are often cited as growth factors, but few studies break down their contributions. This makes it hard to establish which public investment areas produce the maximum returns in diverse developmental scenarios. Policies are too broad to implement without such granularity.

Although fragmented and methodologically inconsistent, the literature offers useful insights. More refined analysis that distinguishes expenditure types, accounts for institutional differences, and uses stronger econometric methods to address causality problems is needed. These gaps must be

filled to better understand how public expenditure affects emerging country economic growth.

Research Gap

Despite the vast literature on public expenditure and economic growth, numerous key gaps persist, particularly in emerging nations. These inadequacies limit how well previous research can assist fiscal policy planning and implementation. The direction and magnitude of the relationship between public expenditure and economic growth are still debated. Capital spending studies show a high positive association, whereas others show weak or insignificant impacts. The relationship's inconsistency shows that it may depend on country-specific factors including institutional strength, budgetary discipline, and macroeconomic stability. Many research fail to clearly integrate contextual variables into their analytical frameworks, leaving observed outcomes unexplained.

Second, most empirical research use aggregated public expenditure data, which hides structural variations across expenditure categories. By merging capital and recurring expenditure into one variable, many assessments miss their economic impacts. This aggregation difficulty makes it difficult to determine which government spending is most productive and under what conditions. Policy recommendations from such research are sometimes too generic and unhelpful for developing economies.

Thirdly, institutional quality and governance's impact on public expenditure effectiveness is understudied. Institutional variables are secondary or excluded in many empirical models, even though efficient institutions increase government spending productivity. Corruption, insufficient accountability, and inefficient public financial management are common in developing nations and can limit fiscal policy's growth impact.

Fourthly, causation methodology is lacking. Many studies neglect the bidirectional relationship between governmental spending and economic growth. Government spending can boost growth, but economic growth also boosts government revenue by allowing more spending. Incorrectly accounting for this simultaneity biases estimates and undermines policy recommendations. To accurately isolate causal effects, more robust econometric methods are needed.

Fifthly, there are few current, context-specific research on developing economies' fiscal realities. Most of the work uses obsolete datasets that don't account for post-financial crisis budgetary adjustments, COVID-19 expenditure growth, and changing development goals. Theoretical understanding and policy settings differ.

Finally, sector-specific analysis is lacking. Education, health, and infrastructure are commonly recognised as growth factors, but few studies compare their effects. This hinders policymakers' capacity to prioritise spending based on sectoral efficacy.

Methodology

Qualitative research using primary and secondary sources examines the relationship between public expenditure and economic growth in emerging countries. Qualitative research is helpful since the goal is to understand how government expenditure affects economic performance conceptually and contextually. Secondary data will come from respectable academic journals, books, policy studies, government publications, international development groups, and newspapers. These sources will give theoretical and empirical evidence from developing economies, providing a full synthesis of existing knowledge.

Written expert opinions, policy discussions, and documented interviews can provide primary insights in addition to secondary sources. The data will be evaluated using thematic analysis, which determines, compares, and synthesises literature topics. Public expenditure mix, institutional quality, fiscal efficiency, and growth outcomes will be key themes. This method provides for systematic interpretation of multiple perspectives while maintaining analytical depth. The study employs qualitative evidence to describe patterns, correlations, and policy implications in a nuanced and context-sensitive manner, avoiding the limits of econometric modelling.

Findings and Discussion

Public expenditure and economic growth in emerging nations are generally positive but conditional, according to literature and policy evidence. Multiple studies and policy reports suggest that government investment on productive areas like infrastructure, education, and healthcare boosts economic performance. Public spending boosts productivity by enhancing human capital formation, lowering transaction costs, and facilitating private sector activity. Countries with capital investment in these sectors have more steady and persistent growth trajectories than those with recurrent expenditures (Crescenzi & Iammarino, 2018). The analysis also shows that inefficient and inadequate institutional frameworks reduce public expenditure's growth-enhancing effect. Many poor countries dedicate a large amount of their budgets to recurrent expenses like administrative expenditures, wages, and subsidies. Such spending is vital for government operations, but without adequate capital investment, it has little effect on long-term growth. Overspending on recurrent expenses can cause budget deficits and impede productive investment. This is especially true in countries with poor fiscal discipline and inefficient governmental sectors.

Another important result is that institutional quality determines public expenditure effectiveness. According to comparative evaluations, countries with greater governance, accountability, and corruption convert public spending into economic development better. In contrast, institutional inadequacies reduce government expenditure advantages

through leakages, misallocation, and poor project implementation (Salah, 2025). This supports the idea that fiscal policy results depend on both government spending and the quality of institutions overseeing it.

The findings show that public spending affects economic growth through demand- and supply-side mechanisms. In the short term, government expenditure boosts aggregate demand, output, and employment. Over time, supply-side effects grow increasingly important, especially through infrastructure and human capital investments. These investments boost productivity and economic growth. These effects vary by country depending on macroeconomic stability, policy consistency, and public investment management system efficiency (Bilan et al., 2019).

The discussion implies that public expenditure is required but not sufficient for emerging country economic progress. How resources are allocated, sectors prioritised, and the institutional context affect fiscal policy's efficacy. Countries that link public spending with long-term development goals and implement efficiently are more likely to prosper sustainably. Where expenditure is dominated by non-productive uses and weak governance, growth is limited or inconsistent.

Conclusion

This study examined how government spending composition and efficiency affect economic growth in developing countries. The evidence presented shows that public expenditure affects economic performance, but the strength and direction differ. Due to its ability to boost productivity and human capital, capital spending, particularly in infrastructure, education, and health, drives long-term growth.

The analysis also demonstrates that public expenditure benefits are not automatic. Institutional quality, budgetary discipline, and resource allocation efficiency determine how much government expenditure boosts economic growth. In many developing nations, large recurrent expenditure and inadequate governance diminish public spending benefits. Inefficiency, misallocation, and insufficient accountability systems often limit fiscal policy's contribution to sustainable economic growth.

The study concludes that public expenditure is essential for economic growth in underdeveloped nations, but its efficacy is conditional. Fiscal policy must turn toward productive investment and better governance to fulfil its developmental goals. To maximise public expenditure's growth-boosting potential, institutions must be strengthened and resources allocated efficiently.

Recommendations

1. First, governments in developing countries should prioritise capital expenditure over recurrent expenditure in their budgetary allocations. Increased investment in infrastructure such as roads, electricity, water systems, and digital connectivity is

essential for improving productivity and reducing the cost of doing business.

2. Second, there is a need to strengthen institutional quality and public financial management systems. Effective implementation of public expenditure depends not only on the amount spent but also on how efficiently resources are managed. Governments should therefore enhance transparency, accountability, and anti-corruption mechanisms to ensure that public funds are utilised for their intended developmental purposes.
3. Third, policymakers should adopt a more sector-targeted expenditure strategy, ensuring that priority is given to education, healthcare, and productive infrastructure. Investment in these sectors enhances human capital development, improves labour productivity, and supports innovation.
4. Fourth, governments should implement fiscal discipline frameworks to manage recurrent expenditure effectively. Controlling excessive wage bills, administrative costs, and non-productive subsidies will help reduce fiscal imbalances and free up resources for development-oriented investment.
5. Fifth, there is a need to enhance monitoring and evaluation systems for public projects. Regular assessment of government-funded projects will ensure that funds are spent efficiently and that projects deliver intended outcomes.
6. Lastly, developing countries should promote public-private partnerships (PPPs) to complement government spending. Given fiscal constraints, collaboration with the private sector can help bridge infrastructure gaps, improve service delivery, and reduce the burden on public finances.

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