

ABSTRACT

Literature studies show that fiscal policies tend to be procyclical in developing countries, while they tend to be countercyclical in advanced economies. This raises a question: What makes them different? The commonly proposed argument explaining this is the financial constraint argument. However, subsequent findings suggest that the quality of institutions or politics is a key factor that can explain this phenomenon. Based on the literature, there are studies finding that institutional quality is a crucial factor in explaining the cyclical policy, but there are also conflicting research results. The contrast in research outcomes regarding the factors influencing the procyclicality of fiscal policies indicates a disagreement in the literature regarding the role of institutional quality in affecting the cyclical policy.

Therefore, this study aims to explore the role of institutions in explaining the cyclical policy in developing (EMEs) and advanced (AEs) economies. This research employs panel regression methods to analyze the influence of institutional quality on the cyclical policy. Secondary data from 68 countries, including Advanced and Emerging Economies (2002-2020), are utilized for this study.

The main research findings indicate that institutional quality affects the cyclical policy. Furthermore, if we compare the result between Advanced Economies (AEs) and Emerging Market Economies (EMEs), the findings show different outcomes. Institutional quality has a significant impact on the cyclical policy, particularly within the group of AEs. However, within the group of EMEs, the influence of institutional quality is not significant. These research findings provide further insight into the complexity of factors influencing the cyclical policy.

Keywords: Fiscal policy, Cyclical policy, Institutional Quality

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