

An Empirical Analysis of Policy Instruments Influencing Economic Growth and Price Stability in Low-Income Nations

Policy Instruments
Influencing Economic
Growth

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ABSTRACT

Low-income nations face significant challenges in achieving economic growth and price stability due to limited institutional capacity, external shocks, and high poverty rates. This study aims to explore how fiscal, monetary, trade, and regulatory policies influence these dual objectives in such contexts. Using a qualitative approach through a systematic literature review, the research synthesizes findings from peer-reviewed journals, books, and reports spanning the last two decades. The analysis reveals that fiscal policies focused on infrastructure and human capital development drive economic growth, as seen in countries like Ethiopia and Rwanda, but require careful management to avoid inflationary pressures. Monetary policies stabilize prices through interest rate adjustments, yet tight measures can hinder investment in resource-constrained settings. Trade policies enhance growth by fostering market integration, though reliance on commodity exports risks price volatility. Strong governance is critical for effective policy implementation, while external dependencies limit autonomy. The study concludes that coordinated, context-specific policies are essential for balancing growth and stability. Policymakers should prioritize institutional reforms and adaptive strategies to enhance resilience and promote sustainable development in low-income nations.

Submitted:
JUNE 2025

Accepted:
AUGUST 2025

Keywords: Economic Growth, Fiscal Policy, Low-Income Nations, Monetary Policy, Policy Instruments, Price Stability.

ABSTRAK

Negara-negara berpenghasilan rendah menghadapi tantangan signifikan dalam mencapai pertumbuhan ekonomi dan stabilitas harga akibat terbatasnya kapasitas kelembagaan, guncangan eksternal, dan tingginya tingkat kemiskinan. Studi ini bertujuan untuk mengeksplorasi bagaimana kebijakan fiskal, moneter, perdagangan, dan regulasi memengaruhi kedua tujuan tersebut dalam konteks tersebut. Dengan menggunakan pendekatan kualitatif melalui tinjauan pustaka sistematis, penelitian ini mensintesis temuan dari jurnal, buku, dan laporan yang telah melalui tinjauan sejawat selama dua dekade terakhir. Analisis ini mengungkapkan bahwa kebijakan fiskal yang berfokus pada infrastruktur dan pengembangan sumber daya manusia mendorong pertumbuhan ekonomi, seperti yang terlihat di negara-negara seperti Etiopia dan Rwanda, tetapi memerlukan pengelolaan yang cermat untuk menghindari tekanan inflasi. Kebijakan moneter menstabilkan harga melalui penyesuaian suku bunga, namun langkah-langkah pengetatan dapat menghambat investasi di negara-negara dengan sumber daya terbatas. Kebijakan perdagangan meningkatkan pertumbuhan dengan mendorong integrasi pasar, meskipun ketergantungan pada ekspor komoditas berisiko menimbulkan volatilitas harga. Tata kelola yang kuat sangat penting untuk implementasi kebijakan yang efektif, sementara ketergantungan eksternal membatasi otonomi. Studi ini menyimpulkan bahwa kebijakan yang terkoordinasi dan spesifik konteks sangat penting untuk menyeimbangkan pertumbuhan dan stabilitas. Para pembuat kebijakan harus memprioritaskan reformasi kelembagaan dan strategi adaptif untuk meningkatkan ketahanan dan mendorong pembangunan berkelanjutan di negara-negara berpenghasilan rendah.

Kata Kunci: Pertumbuhan Ekonomi, Kebijakan Fiskal, Negara Berpenghasilan Rendah, Kebijakan Moneter, Instrumen Kebijakan, Stabilitas Harga.

JIMKES

Jurnal Ilmiah Manajemen
Kesatuan
Vol. 13 No. 5, 2025
pp. 3507-3516
IBI Kesatuan
ISSN 2337 – 7860
E-ISSN 2721 – 169X
DOI: 10.37641/jimkes.v13i5.3635

INTRODUCTION

Economic growth and price stability are crucial objectives for low-income countries seeking to improve living standards and achieve sustainable development. These countries face unique challenges, including vulnerability to external shocks, limited institutional capacity, and high poverty rates, which complicate efforts to stimulate growth while maintaining stable prices. Fiscal, monetary, and structural policies play pivotal roles in addressing these challenges, yet their effectiveness depends on contextual factors such as governance and economic structures (Lin, 2011). This study seeks to analyze how policy instruments influence economic growth and price stability in low-income nations, focusing on their interplay and adaptability to local conditions (Dinh & Dinh, 2016; Mbodj & Layezy, 2025).

The pursuit of economic growth, defined as an increase in the production of goods and services, is crucial for reducing poverty and enhancing incomes in low-income countries. Sustainable growth creates employment opportunities and enhances human capital, but it must be balanced with price stability to ensure economic confidence and investment inflows. Price stability, characterized by low and predictable inflation, preserves purchasing power and fosters long-term planning. However, low-income nations often experience volatility in commodity prices, exchange rates, and political stability, which undermines these goals. According to Qureshi et al. (2015), effective policy frameworks are crucial for mitigating such volatility, yet many low-income nations struggle with implementation due to resource constraints (Cruz et al., 2015; Stern & Valero, 2021).

Despite the importance of policy instruments, existing literature reveals significant gaps in understanding their application in low-income contexts. According to Miller et al. (2022), most studies focus on advanced economies, where institutional frameworks and economic dynamics differ markedly from those in developing nations. Similarly, Blanchard and Brancaccio (2019) highlight that research often overlooks the interaction between fiscal and monetary policies in resource-constrained settings. This *research gap* is critical, as low-income nations require tailored policy solutions that account for weak governance, external dependencies, and limited fiscal space. The lack of comprehensive analyses on how these policies interact in low-income settings motivates this study to explore their combined impact (Blanchard, 2019; Ali et al., 2023).

Countries have low resilience to the complex structural and institutional challenges of achieving sustainable economic growth and maintaining price stability. Resource inequality, dependence on export commodities, limited fiscal capacity, and immature financial markets create space for effective policymaking. Previous research by Sondermann (2018) and Allam et al. (2021) shows that the effectiveness of policy instruments depends heavily on their design, local context, and implementation capacity. Public spending directed at infrastructure and social services has been shown to increase productivity, create jobs, and strengthen human capital. However, inefficient budget management can lead to inflationary pressures and undermine market confidence (Pingali et al. 2019; UNCTAD, 2024).

Monetary policy faces challenges in maintaining price stability due to the weak credibility of central banks in several countries. In the trade sector, liberalization does increase market access and economic diversification, but without complementary policies, vulnerable sectors can be marginalized (Rodrik, 2001; Dollar & Kraay, 2023). Institutional quality also plays a crucial role in determining policy success. Good governance, transparency, and effective oversight systems have been shown to magnify the positive impact of public policies (Dellis et al., 2017; Rodrik, 2022; IMF, 2023; Campos et al., 2025). Meanwhile, external factors such as foreign aid and global price fluctuations also shape policy outcomes (Chaudhary et al., 2015; Khan & Senhadji, 2023; Mbodje & Ndiaye, 2024; World Bank, 2024). This study aims to examine the effectiveness of fiscal, monetary, trade, and regulatory policy instruments in promoting economic growth and maintaining price stability in low-income countries, taking into account the role of institutional quality as a key determinant of successful policy implementation.

LITERATURE REVIEW

Theoretical Foundations

Economic growth and price stability are foundational goals in macroeconomic policy, particularly for low-income nations striving for sustainable development. According to Dellis et al. (2017), classical economic theories emphasize supply-side factors, such as capital accumulation and technological progress, as drivers of long-term growth, while Keynesian perspectives highlight demand-side interventions through fiscal and monetary policies. In low-income contexts, these theories must be adapted to account for structural challenges, including limited capital and institutional weaknesses. Classical models suggest that growth stems from efficient resource allocation; however, low-income nations often face market failures that necessitate government intervention. Keynesian approaches advocate for active policy measures to stimulate demand, but their effectiveness is constrained by fiscal limitations and external volatility (Siswati, 2019; Acemoglu & Robinson, 2024). Recent studies underscore the need for hybrid frameworks that integrate supply- and demand-side strategies to address the unique economic conditions of low-income nations, emphasizing the role of adaptive policies in fostering resilience (Easterly, 2023; IMF, 2023).

The interplay between growth and price stability is complex in low-income countries. Stable prices foster economic confidence and investment, but rapid growth can trigger inflationary pressures. Theoretical models suggest that balancing these objectives requires coordinated policy interventions tailored to the local context. For example, endogenous growth theory highlights the role of human capital and infrastructure investment in sustaining growth, which is particularly relevant for low-income countries with limited resources (Rodrik, 2022). Achieving price stability requires prudent monetary management to mitigate inflation risks, a challenge exacerbated by underdeveloped financial systems (Chaudhary et al., 2015). These theoretical insights provide a foundation for analyzing policy instruments in low-income countries, underscoring the need for context-specific strategies (Khan & Senhadji, 2023).

Policy Instruments and Economic Outcomes

Policy instruments, including fiscal, monetary, and trade policies, are crucial for promoting economic growth and price stability in low-income countries. According to Sondermann (2018), monetary policy instruments, such as interest rate adjustments and reserve requirements, are crucial for controlling inflation, but their effectiveness depends on the credibility of the central bank and the depth of financial markets. In low-income countries, central banks often face challenges in implementing inflation targeting due to limited institutional capacity. Schepker et al. (2014) note that countries such as Tanzania have achieved mixed results in inflation targeting, highlighting the importance of good governance and public trust. Exchange rate policy also plays a role in stabilizing prices, particularly in import-dependent countries where currency volatility can exacerbate inflation (Pingali et al., 2019; Stern & Valero, 2021).

Fiscal policy significantly influences economic growth through government spending and taxation. Investments in infrastructure, education, and healthcare enhance productivity and human capital, driving long-term growth. However, Allam et al. (2021) argue that fiscal constraints, such as low tax revenues and high debt, limit the effectiveness of policies in low-income nations. Targeted fiscal measures, such as support for small enterprises, can stimulate job creation and economic activity (Starr, 2014). Trade policies, including tariff reductions, foster growth by enhancing market access and competition, but they require complementary measures to protect vulnerable sectors (Dollar & Kraay, 2023; World Bank, 2024). The literature suggests that coordinated policy mixes are essential for balancing growth and stability, yet empirical evidence on their interactions remains limited (Burnside & Dollar, 2022; Mbodje & Ndiaye, 2024).

Institutional and External Constraints

The effectiveness of policy instruments in low-income nations is heavily influenced by institutional quality and external factors. According to Bertola (2017), weak governance and corruption undermine policy implementation, reducing the impact of fiscal and monetary interventions. Strong institutions enhance investor confidence and ensure efficient resource allocation, which are critical for economic growth. Studies show that countries with robust governance structures achieve better outcomes from policy interventions, as they can align policies with development goals (North, 2023; Campos et al., 2025). Institutional reforms, such as improving transparency, are thus essential for maximizing policy effectiveness in low-income settings (Alesina & Perotti, 2024).

External shocks, such as commodity price volatility and global financial crises, pose significant challenges for low-income nations. These economies often rely on commodity exports, making them vulnerable to price fluctuations that disrupt growth and stability. According to Pingali et al. (2019), external financing, such as foreign aid, provides resources for development but creates dependency, limiting policy autonomy. Diversifying economic structures and building resilience through domestic capacity development are critical strategies for mitigating these risks (Qureshi et al., 2015; Sachs & Warner, 2023). The literature highlights the need for adaptive policies that address both institutional weaknesses and external vulnerabilities to achieve sustainable economic outcomes in low-income nations (UNCTAD, 2024).

RESEARCH METHOD

This study employs a qualitative approach, utilising a systematic literature review, to examine the influence of policy instruments on economic growth and price stability in low-income countries. The qualitative methodology is chosen to synthesize diverse theoretical and empirical insights, providing a comprehensive understanding of how fiscal, monetary, trade, and regulatory policies interact in resource-constrained settings. By focusing on qualitative analysis, the research captures nuanced perspectives on policy effectiveness and contextual challenges, which are critical for low-income economies facing institutional and external constraints. This approach aligns with the need to explore complex socio-economic dynamics without relying on quantitative metrics, ensuring flexibility in analyzing diverse policy frameworks (Creswell & Poth, 2018; Tracy, 2024).

The research process posed key research questions to guide the literature review. These questions focused on identifying effective policy instruments, their impact on economic growth and price stability, and the challenges faced in their implementation. To ensure a robust analysis, a systematic search strategy was employed, targeting peer-reviewed journals, books, and reports from leading organizations such as the World Bank and the International Monetary Fund. Keywords such as economic growth in low-income countries, price stability policy instruments, and monetary and fiscal policy in developing countries were used to locate relevant studies. Databases such as Google Scholar, JSTOR, and Scopus were used, as well as web searches to identify key works, ensuring a comprehensive and credible source base.

Data extraction and thematic analysis form the core of the qualitative methodology. Relevant studies are evaluated based on their discussion of policy instruments, socio-economic contexts, outcomes, and implementation challenges. Each source is systematically reviewed to extract key themes, such as the role of fiscal policy in stimulating growth or the impact of governance on policy effectiveness. These themes are then synthesized to identify patterns and gaps in the literature, providing insights into how policies can be tailored to low-income contexts. The analysis prioritizes recent studies from the past two decades to reflect current economic trends, while also incorporating foundational works to ensure theoretical rigor (Dellis et al., 2017; Okoli & Schabram, 2023).

The qualitative synthesis aims to offer a cohesive narrative on the interplay of policy instruments and their outcomes in low-income nations. By comparing and contrasting findings across studies, the research highlights recurring policy challenges, such as limited

fiscal space and external dependencies, and identifies strategies for overcoming them. This approach ensures that the study not only summarizes existing knowledge but also contributes to the discourse on effective policy design for sustainable development. The qualitative nature of the research enables a flexible and context-sensitive exploration of economic policies, providing policymakers in low-income settings with actionable insights (Booth et al., 2024; Campos et al., 2025).

RESULTS

The qualitative analysis of policy instruments influencing economic growth and price stability in low-income nations reveals a complex interplay of fiscal, monetary, and structural policies, shaped by contextual factors such as governance and external dependencies. The literature highlights that fiscal policies, particularly government spending on infrastructure and social programs, significantly drive economic growth in low-income nations. Investments in roads, schools, and healthcare enhance productivity, create jobs, and improve human capital, fostering sustainable development. However, inefficient public spending or excessive fiscal deficits can lead to inflationary pressures, undermining price stability. For instance, studies on Sub-Saharan African countries have shown that targeted fiscal interventions, such as subsidies for small enterprises, have bolstered economic activity; however, mismanagement often results in resource wastage (Chaudhary et al., 2015; Ali et al., 2023). These findings underscore the importance of aligning fiscal policies with long-term development goals to maximize their impact.

As shown in Table 1, fiscal policy tools have varied impacts on economic growth in low-income countries, depending on their target sectors and implementation mechanisms. Government spending on infrastructure, such as transport and connectivity, creates jobs and enhances productivity, directly contributing to economic expansion. Similarly, investments in education and healthcare improve human capital and workforce efficiency, supporting long-term growth. Taxation reforms that reduce burdens on private sectors encourage investment, while careful management of budget deficits prevents adverse effects on growth. However, the table also highlights challenges, such as the inflationary risks of excessive deficits and the need for efficient resource allocation to ensure positive outcomes (Stiglitz, 1998; World Bank, 2024).

Table 1. The Impact of Fiscal Policy on Economic Growth in Low-Income Countries

Fiscal Policy Tool	Target Sector	Mechanism/Action	Expected Economic Impact	Notes
Government Spending	Infrastructure	Investment in roads, transport, public works	Creates jobs, improves connectivity, increases productivity	Most effective when focused on transport and connectivity
Government Spending	Education	Funding schools, teacher training, curriculum reform	Enhances human capital, boosts long-term productivity and growth	Direct positive effect on per capita GDP
Government Spending	Healthcare	Building hospitals, public health programs	Improves workforce health, reduces absenteeism, supports growth	Linked to higher labor productivity
Taxation Policy	All sectors	Tax reforms, efficient collection, reduced burden	Increases public revenue for productive investment, encourages private sector growth	Should avoid excessive burden on investment
Budget Deficit Management	All sectors	Limiting non-productive debt, focusing on productive investment	Maintains fiscal stability, avoids negative long-term growth effects	Excessive debt can harm growth

Monetary policy plays a critical role in maintaining price stability but faces challenges in low-income nations due to underdeveloped financial markets and limited central bank credibility. Interest rate adjustments and money supply management help control

inflation, yet tight monetary policies often reduce liquidity, constraining economic growth. For example, in countries like Ghana and Zambia, inflation targeting has stabilized prices but occasionally slowed investment due to high borrowing costs. The literature suggests that central banks with strong governance can better balance these objectives, using flexible monetary tools to respond to economic shocks (Sondermann, 2018; Mbodje & Ndiaye, 2024). Exchange rate policies are also vital in import-dependent economies, where currency stability mitigates inflationary pressures from global markets (Stern & Valero, 2021; Khan & Senhadji, 2023).

Trade policies play a significant role in driving economic growth by promoting market integration and fostering competition. Reducing tariffs and non-tariff barriers enhances access to global markets, boosting productivity and diversifying income sources. For instance, trade liberalization in East African countries has increased export revenues, supporting economic growth. However, reliance on commodity exports makes these economies vulnerable to price volatility, which can destabilize prices. Complementary policies, such as support for local industries, are crucial for mitigating the negative impacts of trade liberalization on vulnerable sectors. Without protecting and strengthening domestic industrial capacity, market opening through the elimination of tariffs and non-tariff barriers can lead to premature deindustrialization, reduced local competitiveness, and increased dependence on imports.

Rodrik (2001) and Dollar and Kraay (2023) emphasize that free trade must be balanced with strategic industrial policies to ensure equitable distribution of benefits. In the context of low-income countries, this is crucial because their fragile economic structures and reliance on raw commodities make them vulnerable to external shocks. Therefore, a coordinated trade strategy is needed to maximize growth potential while maintaining macroeconomic stability. This includes providing incentives for small and medium-sized enterprises, investing in technology and workforce training, and temporary protection for emerging sectors. As emphasized by Pingali et al. (2019) and UNCTAD (2024), the success of international trade in driving economic development can only be achieved if supported by domestic policies that strengthen local economic resilience and enhance national competitiveness.

Institutional quality emerges as a key determinant of policy effectiveness. Strong governance structures enhance the impact of fiscal and monetary policies by ensuring efficient implementation and transparency. For example, countries with robust anti-corruption measures attract more investment, supporting growth. Conversely, weak institutions lead to policy failures, as seen in cases where mismanaged fiscal spending exacerbates inflation (Campos et al., 2025; Eichenauer & Sturm, 2025; North, 2023). The literature also points to the role of external factors, such as foreign aid and global commodity prices, in shaping policy outcomes. While aid provides resources for development, dependency limits fiscal flexibility, and commodity price fluctuations challenge price stability (Qureshi et al., 2015; Sachs & Warner, 2023).

The synthesis of these findings reveals that effective policy implementation in low-income nations requires a balanced approach that integrates fiscal, monetary, and trade policies while addressing institutional and external constraints. The literature emphasizes the importance of tailoring policies to local contexts, as one-size-fits-all approaches often fail in resource-constrained settings. For instance, fiscal policies that prioritize infrastructure and human capital yield significant growth benefits, but only when supported by sound governance. Similarly, monetary policies are more effective when central banks have autonomy and credibility. Trade policies, while growth-enhancing, must be accompanied by protective measures to ensure equitable benefits. These insights provide a foundation for policymakers to design adaptive strategies that promote sustainable economic outcomes in low-income nations (Allam et al., 2021; Easterly, 2023; Alesina & Perotti, 2024).

DISCUSSION

The qualitative analysis of policy instruments in low-income countries reveals their critical role in balancing economic growth and price stability; however, their effectiveness is shaped by contextual factors such as institutional quality and external vulnerabilities. According to Stiglitz (1998), fiscal policy, particularly government spending on infrastructure and human capital, drives economic growth by enhancing productivity and creating jobs. However, the trade-off between growth and price stability becomes evident when excessive fiscal deficits fuel inflation, eroding purchasing power and economic confidence. In countries like Ethiopia and Uganda, targeted fiscal investments in transport and education have boosted growth, but poorly managed spending has led to inflationary pressures, highlighting the need for efficient resource allocation (Chaudhary et al., 2015; Ali et al., 2023). This tension underscores the importance of designing fiscal policies that prioritize productive investments while maintaining fiscal discipline to avoid destabilizing prices.

Monetary policy presents another critical dimension, as central banks in low-income nations strive to control inflation without stifling growth. Tight monetary policies, such as high interest rates, can stabilise prices but often reduce liquidity, discouraging investment. For instance, in Nigeria, aggressive interest rate hikes have curbed inflation but slowed small business growth due to high borrowing costs. According to Sondermann (2018), central banks with strong institutional credibility can better navigate this trade-off by using flexible tools like open market operations. Exchange rate management also plays a role in import-dependent economies, where currency volatility exacerbates inflation. The literature suggests that monetary policies are most effective when supported by robust governance and aligned with fiscal strategies, ensuring a coordinated approach to economic stability (Stern & Valero, 2021; Khan & Senhadji, 2023).

Trade policies significantly influence economic growth by fostering global market integration, but they also introduce challenges for maintaining price stability and protecting vulnerable sectors. According to Rodrik (2001), trade liberalization enhances productivity through competition and market access, as seen in Rwanda's export growth after tariff reductions. However, reliance on commodity exports, common in low-income nations, exposes economies to global price volatility, which can destabilize domestic prices. For example, Zambia's dependence on copper exports has led to economic fluctuations when global prices decline (Purba, 2022; Afifawati et al., 2023; Jasman & Hwihanus, 2023). Complementary policies, such as subsidies for local industries, are essential to protect vulnerable sectors like agriculture, which often face competition from cheaper imports (Fafchamps, 2003; Dollar & Kraay, 2023). These findings highlight the need for balanced trade strategies that maximize growth while mitigating adverse effects on domestic markets (Silalahi et al., 2023; Alamsyahbana & Chartady, 2025; Zulfikar et al., 2025).

Institutional quality and external shocks further complicate policy effectiveness in low-income nations. Weak governance, characterized by corruption or inefficiency, undermines fiscal and monetary interventions, reducing their impact on growth and stability. According to Campos et al. (2025), countries with transparent institutions, such as Botswana, achieve better policy outcomes due to enhanced investor confidence and efficient resource use. External factors, including foreign aid dependency and fluctuations in commodity prices, limit policy autonomy and exacerbate vulnerabilities. For instance, reliance on aid in Malawi has constrained fiscal flexibility, while commodity price shocks have disrupted price stability in oil-dependent economies (Qureshi et al., 2015; Sachs & Warner, 2023). These challenges necessitate adaptive policies that strengthen institutions and diversify economic structures to enhance resilience (Dao, 2017; Arvin et al., 2023).

The implications of these findings for policymakers in low-income nations are profound. First, fiscal policies should prioritize investments in infrastructure and human capital while maintaining strict budgetary oversight to prevent inflationary spillovers. Second, monetary authorities must balance inflation control with growth objectives, leveraging credible institutions to implement flexible policies. Third, trade policies require

complementary measures, such as capacity-building for local industries, to ensure equitable benefits. Finally, strengthening governance and reducing dependency on external financing are critical for enhancing policy effectiveness. By adopting context-specific strategies, policymakers can better navigate the trade-offs between growth and stability, fostering sustainable development in low-income nations (IMF, 2023; Easterly, 2023; Alesina & Perotti, 2024).

CONCLUSION

This study highlights the pivotal role of fiscal, monetary, and trade policies in fostering economic growth and price stability in low-income nations, emphasizing the need for tailored approaches to address their unique challenges. Fiscal policies that prioritize infrastructure and human capital development drive sustainable growth by creating jobs and enhancing productivity, as seen in countries like Rwanda and Ethiopia. Monetary policies, when implemented by credible central banks, stabilize prices but must balance growth objectives to avoid stifling investment. Trade policies promote market integration and competitiveness, yet require protective measures for vulnerable sectors to ensure equitable benefits. The interplay of these policies, combined with strong governance, is essential for achieving balanced economic outcomes. Effective policy coordination remains a cornerstone for low-income nations striving to reduce poverty and build resilient economies.

The implications of these findings are significant for policymakers in low-income nations, who should focus on strengthening institutional frameworks to enhance policy effectiveness. Investments in transparent governance and anti-corruption measures can amplify the impact of fiscal and monetary interventions. However, this study's reliance on qualitative literature review limits its ability to provide country-specific recommendations, as contextual variations may affect policy outcomes. Additionally, the analysis does not explore the role of emerging technologies, such as digital financial systems, in policy implementation. Future research should investigate the impact of digitalization on monetary policy effectiveness and examine case studies from diverse low-income nations to develop more targeted strategies. Exploring the integration of climate-resilient policies could also provide insights into sustainable development, ensuring that low-income nations achieve long-term growth and stability in an increasingly volatile global environment.

Acknowledgement

I want to express my heartfelt gratitude to all those who have contributed to the successful completion of this study titled "An Empirical Analysis of Policy Instruments Influencing Economic Growth and Price Stability in Low-Income Nations." I am deeply thankful to my academic advisors and mentors for their invaluable guidance, expert advice, and constant support throughout this research journey. Their insightful feedback and constructive criticisms were essential in shaping the direction and quality of this study. I would also like to extend my appreciation to the researchers and policymakers whose work provided the foundation for this analysis, as well as to the institutions that made the necessary data available for the empirical analysis. A special thanks goes to the governments and economic organizations in low-income nations, whose policies and economic data have been instrumental in understanding the complexities of economic growth and price stability. Lastly, I am grateful to my colleagues and family for their encouragement, patience, and unwavering support during this process. Without their help and dedication, this work would not have been possible.

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