

Fiscal Multipliers in Developing Economies: Evaluating the Economic Impact of Infrastructure vs. Social Transfer Spending

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Abstract

Fiscal multipliers—defined as the change in national income resulting from a change in government expenditure—play a central role in shaping macroeconomic policy in developing economies. Yet, the magnitude and effectiveness of these multipliers vary significantly depending on the type of spending undertaken. This manuscript evaluates the comparative economic impact of infrastructure spending and social transfer spending in developing countries, drawing on empirical evidence, theoretical frameworks, and cross-country experiences. While infrastructure investment often yields higher long-run multipliers due to productivity gains and crowd-in effects, social transfers generate immediate consumption-driven multipliers that are crucial during downturns and crises. The study argues that the optimal fiscal strategy for developing economies requires a balanced approach that recognizes the complementary nature of both spending types. The paper concludes with policy recommendations for designing countercyclical fiscal interventions that maximize growth, equity, and resilience.

Keywords: Fiscal multipliers; Developing economies; Infrastructure spending; Social transfers; Public investment; Economic growth; Countercyclical policy; Poverty alleviation; Macroeconomic stabilization

1. Introduction

Fiscal policy remains one of the most powerful tools available to governments in developing economies, where structural constraints, limited private investment, and persistent inequality often weaken market-driven growth. The concept of fiscal multipliers is central to understanding how government spending influences economic activity. In simple terms, fiscal multipliers measure how much output increases when the government increases expenditure by one unit. However, the size of multipliers is not uniform; it varies across countries, economic conditions, and—most importantly—the type of spending undertaken.

Developing economies face unique challenges such as infrastructure deficits, high informality, limited financial inclusion, and vulnerability to external shocks. These structural features shape the effectiveness of fiscal interventions. Infrastructure spending, for instance, can alleviate supply-side bottlenecks and enhance long-term productivity, while social transfers can stabilize consumption and reduce poverty in the short run. Understanding the relative strengths of these spending categories is essential for designing effective fiscal strategies.

This manuscript examines the comparative impact of infrastructure versus social transfer spending in developing economies, analyzing how each influences growth, employment, poverty reduction, and macroeconomic stability. It also explores the conditions under which each type of spending yields higher multipliers, offering insights for policymakers seeking to optimize fiscal interventions.

2. Theoretical Foundations of Fiscal Multipliers

The theoretical foundation of fiscal multipliers in developing economies is rooted in classical and Keynesian macroeconomic thought, where government expenditure is understood as a catalyst for stimulating aggregate demand and influencing overall economic activity (Auerbach & Gorodnichenko, 2012). In contexts marked by structural constraints, liquidity shortages, and underdeveloped financial markets, fiscal multipliers tend to behave differently than in advanced economies (Ilzetzki, Mendoza, & Végh, 2013). Developing countries often exhibit higher marginal propensities to consume, meaning that any increase in government spending—whether through public investment or social transfers—translates quickly into increased household consumption and local market activity. At the same time, supply-side bottlenecks, infrastructural deficits, and institutional limitations shape the long-run effectiveness of fiscal interventions (Ramey, 2019). Infrastructure spending typically generates productivity-enhancing multipliers that unfold gradually, while social transfers produce immediate demand-side multipliers that stabilize consumption. The interplay between these channels forms the conceptual basis for evaluating fiscal strategies in developing economies.

3. Infrastructure Spending and Long-Run Multipliers

Infrastructure spending occupies a central position in fiscal policy because it directly addresses the structural deficiencies that constrain growth in developing economies. Investments in roads, power grids, ports, irrigation networks, and digital infrastructure create long-term productive assets that reduce transaction costs, improve connectivity, and enhance the efficiency of both formal and informal sectors (Calderón & Servén, 2010). Improved infrastructure enhances productivity by enabling firms to access markets more efficiently, reducing logistical delays, and lowering operational costs. It also attracts private investment by creating a more

reliable and predictable business environment, thereby generating a crowd-in effect that amplifies the initial government expenditure (Umama et al, 2021). Infrastructure projects generate employment both directly, through construction activities, and indirectly, through supply chains and ancillary services. Over time, these investments contribute to sustained economic growth, often producing multipliers greater than one, especially when governance quality and project execution are strong (Dabla-Norris et al., 2011). However, the magnitude of infrastructure multipliers depends heavily on institutional capacity, transparency, and the ability to minimize leakages and corruption.

4. Social Transfer Spending and Short-Run Multipliers

Social transfer spending plays an equally important but distinct role in shaping fiscal outcomes in developing economies. Transfers such as cash benefits, food subsidies, pensions, and unemployment assistance have an immediate impact on household consumption, particularly among low-income groups with high marginal propensities to consume (Fiszbein & Schady et al, 2009). Because these households spend a large portion of additional income on essential goods and services, social transfers generate strong demand-side multipliers that stimulate local markets and support small enterprises.

The significance of these transfers becomes clearer when viewed through the lens of social invisibility and marginalization. Literary critic Mukherjee T., in her analysis of Tagore's *Subha*, notes that "Tagore poignantly points out how Subha's inability to hear and speak lends her an invisibility of existence in society" (Mukherjee, T., 2024).). This observation underscores how vulnerable individuals—whether due to disability, poverty, or social exclusion—often remain unseen within dominant economic structures. In fiscal terms, social transfers function as

corrective mechanisms that counteract this invisibility by providing direct support to populations who are otherwise excluded from formal economic participation.

Beyond immediate consumption effects, social transfers contribute to human capital development by improving nutrition, health, and educational outcomes, thereby enhancing long-term productivity (Ravallion, 2016). During economic downturns, pandemics, or natural disasters, social transfers act as automatic stabilizers that prevent demand collapse and support recovery (IMF, 2020). Their effectiveness, however, depends on accurate targeting, efficient delivery systems, and the ability to minimize leakages. While social transfers may not produce the same long-run productivity gains as infrastructure spending, their short-run multipliers are often substantial and essential for maintaining economic stability.

5. Comparative Analysis: Infrastructure vs. Social Transfers

A comparative analysis of infrastructure and social transfer spending reveals that the effectiveness of each depends on the broader economic context. During periods of economic expansion, infrastructure spending tends to yield higher multipliers because it enhances productive capacity and encourages private investment (Barro, 1991). In contrast, during recessions or crises, social transfers produce stronger multipliers by stabilizing consumption when private demand is weak (Clements, Gupta, & Nozaki, 2013). In low-income regions where liquidity constraints are severe, social transfers generate immediate economic activity, while infrastructure investments provide long-term structural benefits. Governance quality also plays a decisive role; countries with strong institutions and efficient project management derive greater benefits from infrastructure spending, whereas those with weaker institutions may rely more on transfers to achieve short-term impact (Berg & Ostry, 2011). Ultimately, infrastructure and

social transfers should not be viewed as substitutes but as complementary tools that address different dimensions of economic development.

6. Empirical Evidence from Developing Economies

Empirical evidence from developing economies demonstrates significant variation in fiscal multipliers across regions and spending categories. Infrastructure multipliers often range between 1.2 and 2.0, particularly in countries where transport and energy deficits are severe and where public investment directly alleviates supply-side constraints (Gechert, S. & Rannenberg, 2018). Latin American countries have shown strong transfer multipliers due to well-designed cash-transfer programs, while African economies exhibit high infrastructure multipliers where basic connectivity improvements dramatically enhance productivity. South Asian economies present mixed results, with infrastructure multipliers rising when governance improves and social transfers becoming more effective when delivered through digital platforms (Batini, Eyraud, & Weber, 2014). These empirical patterns highlight the importance of tailoring fiscal strategies to country-specific conditions, institutional capacities, and developmental priorities.

7. Policy Implications for Developing Economies

The policy implications of fiscal multiplier analysis in developing economies underscore the need for a balanced and context-sensitive approach to public spending. Governments must adopt dual-track fiscal strategies that combine long-term infrastructure investment with targeted social transfers to maximize both supply-side and demand-side effects (IMF, 2020). Strengthening governance and project management is essential for enhancing the effectiveness of infrastructure spending, ensuring that projects are executed efficiently and transparently. Digital delivery systems should be expanded to improve the accuracy and efficiency of social transfers, reducing leakages and ensuring that benefits reach intended recipients (Fiszbein &

Schady, 2009). Fiscal policy should also be countercyclical, with social transfers scaled up during downturns and infrastructure investment intensified during periods of economic expansion (Auerbach & Gorodnichenko, 2013). Additionally, investments in human capital—education, health, and skill development—should complement both spending categories to enhance long-term productivity and resilience. These policy directions collectively support sustainable growth, equity, and macroeconomic stability in developing economies.

8. Conclusion

Fiscal multipliers are a powerful lens through which to evaluate the economic impact of government spending in developing economies. Infrastructure spending generates high long-run multipliers by enhancing productivity and attracting private investment, while social transfers produce strong short-run multipliers by stabilizing consumption and reducing poverty. The optimal fiscal strategy is not an either-or choice but a balanced approach that recognizes the complementary nature of both spending types. Developing economies must tailor fiscal interventions to their structural conditions, governance capacity, and macroeconomic environment to achieve sustainable growth and inclusive development.

Conflict of Interest: The corresponding author, on behalf of all the authors, declares that there are no conflicts of interest regarding the publication of this article.

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