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The Role of Green Fiscal Policy in Supporting Green Governance and Green Economic Development

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ABSTRACT

This article examines the strategic role of green fiscal policy in supporting governance and green economic development in Indonesia. This research uses a descriptive qualitative approach with data collection techniques through semi-structured interviews and documentation studies. The findings indicate that the implementation of green fiscal policy in Indonesia has progressed through instruments such as carbon taxes, green sukuk issuance, and climate budget tagging. These policies not only aim to restructure the fiscal structure towards sustainability but also encourage more transparent, accountable, and collaborative governance. Although still facing challenges such as resistance to reducing fossil fuel subsidies and limited regional capacity, significant opportunities open up through the potential of the national green sector and global financing support. This study concludes that synergy between fiscal instruments, institutional reform, and cross-sectoral governance is key to realizing an inclusive and sustainable green economy.
Keywords: *green fiscal policy, governance, green economy, climate budget tagging, sustainable development.*

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INTRODUCTION

In the ever-evolving dynamics of global development, a purely quantitative focus on economic growth is no longer considered adequate. High economic growth without balanced environmental protection and social welfare guarantees will only result in ongoing multidimensional crises ranging from climate change and natural resource scarcity to increasing social inequality. Therefore, the direction of modern development must integrate economic, social, and environmental dimensions in a balanced, measurable, and sustainable manner. The concept of a green economy emerged as a response to these challenges. A green economy not only emphasizes the importance of efficiency and innovation in production and consumption but also champions the transition to a low-carbon economic system that is resilient to environmental risks and upholds intergenerational equity (Tampubolon et al., 2025).

There are five principles of green economy-based economic development. First, a green economy must be able to create prosperity for all people. Second, it must be able to create equality across generations. Third, it must be able to maintain, restore, and invest in various natural resource-based activities. Fourth, it is expected to support sustainable consumption and production levels. Fifth, it must be supported by a strong, integrated, and accountable system (Anwar, 2022).

Amidst the urgency of this transition, green fiscal policy plays a strategic role. This policy encompasses various fiscal instruments, both on the state revenue side, such as carbon taxes, plastic excise taxes, or levies on activities that pollute the environment; and on the state expenditure side, such as renewable energy subsidies, fiscal incentives for green industries, and financing conservation projects and sustainable infrastructure (Setiaji & Harfianto, 2023). The primary objective of this policy is not only to secure state revenue sources and maintain budget discipline, but also to direct market, business, and societal behavior in line with the green development agenda. In other words, green fiscal policy is a crucial mechanism for internalizing the negative external impacts of economic activity and creating incentives that encourage the adoption of more environmentally friendly technologies and practices (Aulia et al., 2025).

In the Indonesian context, the implementation of green fiscal policy is increasingly relevant given the potential for environmental damage resulting from uncontrolled exploitation of natural resources. Indonesia is one of the countries with the highest biodiversity in the world, but it is also among countries with high carbon emissions, massive deforestation, and significant ecological pressures. The Indonesian government, through the Ministry of Finance, has demonstrated its commitment to integrating sustainability principles into the national fiscal system, including through the implementation of climate budget tagging, the partial elimination of fossil fuel subsidies, the issuance of green sukuk (Islamic bonds), and carbon tax planning. These efforts demonstrate that green fiscal policy is not merely an economic instrument but also a reflection of modern, responsive, and accountable governance to environmental challenges (Masia & Mopangga, 2025).

Governance plays a central role in the successful implementation of green fiscal policy. Fiscal policy cannot be effective without the support of a transparent, coordinated, and participatory government system. In the context of green fiscal policy, the effectiveness of state financial management is largely determined by the government's ability to integrate environmental issues into the various sectors and institutions involved in budget formulation and implementation (Fathia, 2025). This includes strengthening institutional capacity to manage environmentally sensitive budgets, as well as involving civil society in the planning, implementation, and oversight of public budgets. One important innovation in green fiscal governance is the implementation of climate budget tagging and performance-based budgeting based on green indicators, which enable the identification and evaluation of budget allocations based on their contribution to climate goals and sustainable development (Zein, 2023).

The implementation of this mechanism not only increases fiscal transparency and accountability but also shifts the paradigm of state financial management from the conventional budget-absorption-based approach to an environmental and social performance-based approach. This means that the success of a fiscal policy is now measured not solely by the amount of budget absorbed, but by the extent to which the policy impacts emissions reductions, environmental protection, and improving the quality of life of the community. Therefore, good governance is an absolute prerequisite for the success of green fiscal policy in driving the transformation towards a low-carbon, inclusive, and resilient economy (Yuwono, 2025).

A holistic approach that directly links green fiscal policy, governance, and the direction of green economic development. Unlike previous studies that tend to discuss green fiscal policy in a technocratic context or are limited to environmental impacts, this paper seeks to unravel the systemic linkages between the fiscal and governance dimensions in supporting a greener and more sustainable economic transformation. This study aims to demonstrate that the success of green fiscal policy is inextricably linked to the quality of underlying governance. Therefore, strengthening institutional capacity, budget transparency, and policy coordination across levels of government are essential requirements for promoting an inclusive and resilient green development agenda (Amin et al., 2024).

Previous researchers have conducted research on the green economy through literature reviews. Research addressing the green economy focuses on fiscal policy and funding instruments for climate change (Pratiwi, 2024). Kemenangan and Setiawan's research uses a green economy approach through the Sovereign Wealth Fund to improve the economy. In both studies, the green economy is an economic practice that prioritizes short-term profits while optimizing national economic recovery (Sunarti, 2023).

There has been a lot of research on green fiscal policy, but there are still a number of gaps that need to be filled. Most studies only highlight technical aspects such as tax incentives or environmental subsidies without systematically linking them to green governance practices that include transparency, accountability and public participation. In addition, there are limited empirical studies that directly measure the contribution of green fiscal policies to green economic development, especially in the context of developing countries. Many studies also focus on developed countries, while the dynamics and challenges in implementing green fiscal policy in developing countries have not been widely explored. In addition, interdisciplinary approaches that holistically link fiscal policy, environmental governance, and green growth are still rare, even though the interconnectedness of the three is crucial for realizing sustainable economic transformation.

Furthermore, it is crucial to understand that green fiscal policy does not stand alone but is part of a broader national development policy architecture. In this regard, the role of inter-agency coordination, synchronization between central and regional policies, and fiscal integration with medium- and long-term development planning frameworks are crucial. The government needs to ensure that every rupiah spent not only provides added economic value but also supports ecological resilience and social inclusion. Therefore, green fiscal policy can be a strategic instrument to strengthen national economic competitiveness in the long term while addressing global demands for climate action and sustainability (Hafizd et al., 2024).

With the various challenges that accompany it, both technically, institutionally, and politically, this study becomes increasingly important in contributing critical thinking and solutions. This paper will not only evaluate the practices of green fiscal policy that have been implemented, but also offer reflections and recommendations that can provide input for policymakers in designing more inclusive, equitable, and sustainable fiscal governance. With an interdisciplinary and evidence-based analytical framework, this study is expected to enrich the literature on the relationship between fiscal policy and green development, while also opening up a broader discussion about the future of development governance in the green transition era (Aulia et al., 2025).

The purpose of this study is to analyze the role of green fiscal policy in supporting green governance practices and promoting sustainable green economic development. This research aims to identify how fiscal instruments such as environmental taxes, green subsidies, and state spending are directed to strengthen the principles of transparent, participatory, and accountable environmental governance. In addition, this research also aims to evaluate the extent to which green fiscal policies contribute to the growth of green economic sectors, energy efficiency, and emission reduction, particularly in the context of developing countries. Through an interdisciplinary approach, this research is expected to provide a more comprehensive understanding of the synergies between fiscal policy, environmental governance, and green economic development as the foundation for sustainable economic transformation.

METODEOLOGY

This research uses a descriptive qualitative approach aimed at understanding the role of green fiscal policy in supporting governance and green economic development in Indonesia. Data were obtained through semi-structured interviews with key informants from government agencies such as the Ministry of Finance, Bappenas, and the Ministry of Environment, as well as through a documentary review of official documents, policy reports, and relevant academic publications.

The data analysis techniques used were content and thematic analysis, which included data reduction, theme categorization, and interpretation. Data validity was maintained through triangulation of sources and methods, as well as member checking. This research focused on the national policy context and was conducted over a three-month period, encompassing data collection, analysis, and the preparation of the final report.

RESULTS AND DISCUSSION

Implementation of Green Fiscal Policy in Indonesia

The implementation of green fiscal policy in Indonesia has shown progress through the integration of fiscal instruments to support sustainable development. The government has adopted various measures, such as a carbon tax, the issuance of green sukuk (Islamic bonds), and the implementation of climate budget tagging (CBT) to ensure budget allocations align with climate change mitigation targets. Interviews with Ministry of Finance officials revealed that these policies focus on strategic sectors such as energy, forestry, and transportation, to encourage the transition to a low-carbon economy (Putra et al., 2025).

The implementation of green fiscal policy in Indonesia represents a strategic effort by the government to integrate environmental considerations into its fiscal and economic planning (Kartiko, 2023). This policy approach involves the use of fiscal instruments such as environmental taxes, removal of harmful subsidies, provision of incentives for renewable energy, and increased budget allocation for sustainable infrastructure and climate-resilient programs. The goal is to shift the economic structure toward low-carbon development while promoting environmental protection and resource efficiency (Valencia & Martínez, 2025).

In the Indonesian context, green fiscal policy also serves as a tool to fulfill international commitments such as the Paris Agreement and the Sustainable Development Goals (SDGs), particularly in areas related to climate action, clean energy, and sustainable cities (Jaelani et al., 2024). Despite several initiatives already in place such as the carbon tax and green sukuk challenges remain in terms of policy coherence, institutional capacity, and the alignment of national and sub-national agendas. Therefore, the effective implementation of green fiscal policy in Indonesia requires not only regulatory and financial innovation but also strong political will and stakeholder collaboration to ensure long-term environmental and economic sustainability (Idris et al., 2024).

Fiscal incentives are also provided to businesses operating in environmentally friendly sectors, including in the form of green project financing through the PPP scheme. However, policy implementation remains centralized at the national level and is suboptimal at the regional level due to limited fiscal, technical, and regulatory capacity. Therefore, synergy between the central and regional governments, as well as strengthening institutional capacity, is crucial to expanding the reach and effectiveness of green fiscal policies across Indonesia (Wibowo, 2022).

Impact on Governance

From a governance perspective, green fiscal policy has significantly contributed to strengthening the principles of transparency, accountability, and cross-sectoral policy integration. Not only does it serve as an environmental management instrument through fiscal mechanisms, it also serves as a gateway for institutional reform and innovation in public governance. One prominent innovation is the implementation of climate budget tagging (CBT), which enables the classification and tracking of state budgets based on their contribution to climate change mitigation and adaptation activities. CBT is a crucial instrument in building an evidence-based planning and budgeting system, while simultaneously increasing transparency in public budget use and strengthening social oversight of sustainability-oriented state spending (Novita & AP, 2025).

Furthermore, the implementation of CBT has driven a shift in fiscal planning patterns, from a sectoral and bureaucratic approach to a more collaborative and responsive approach. Field findings indicate that green fiscal policy has facilitated collaboration across ministries and agencies, including the Ministry of Finance, Bappenas, and the Ministry of Environment and Forestry (KLHK), in developing integrated environmental policies. This marks a shift in decision-making structures from a centralized model to a more dialogic, participatory, and consensus-based governance model (Palis, 2025).

The integration of environmental aspects into national development planning systems such as the RPJMN, as well as the synchronization of annual and long-term policies, reflects a shift in governance paradigm from an administrative to a co-constructive approach. The involvement of local governments, civil society, and the private sector is increasingly strengthened, creating a collaborative space to ensure that green fiscal policy is not only top-down but also contextual and inclusive. Thus, green fiscal policy acts as a catalyst in establishing governance that is adaptive to environmental and social challenges, while simultaneously promoting bureaucratic efficiency, cross-sectoral policy integration, and improving the quality of public services in the transition to a green economy.

Implementation Challenges and Opportunities

The implementation of green fiscal policy in Indonesia, despite showing positive progress, still faces a variety of complex structural and technical challenges. The most fundamental challenge lies in resistance to reducing fossil fuel subsidies, which is not merely a fiscal issue but also involves political and social sensitivities. Subsidy reform is often delayed due to concerns about its impact on inflation, public purchasing power, and socio-political stability. Energy subsidies, long perceived as a form of government protection for the people, make reductions vulnerable to public resistance, especially if not accompanied by fair and effective compensation policies. Furthermore, uneven fiscal and technical capacity at the regional level is a major obstacle. Many local governments lack an adequate understanding of green fiscal policy, lack supporting regulations, and are limited in the human resources and environmental data needed to develop evidence-based policies (Damanik et al., 2025).

Amid these obstacles, Indonesia actually has a significant opportunity to strengthen green fiscal policy as an integral part of its sustainable development strategy. The significant potential of renewable energy sectors such as geothermal, solar, and biomass, as well as forestry and sustainable agriculture, can be optimized through more innovative and targeted green fiscal incentives. Furthermore, collaboration with the private sector and international financial institutions opens up opportunities for the use of financing instruments such as green bonds, carbon pricing, carbon trading, and blended finance.

Global momentum is also growing, with international forums such as the COP and the G20 exerting positive pressure on the integration of environmental aspects into national fiscal governance. Indonesia's commitments to these international agreements can be leveraged as a bargaining chip to obtain green technology and funding (Ammar et al., 2024). At the domestic level, increasing regional capacity through technical training, institutional strengthening, and regulatory harmonization between the central and regional governments are strategic steps. Continuously improving green fiscal literacy among stakeholders is also crucial in building public support for the green economy transition agenda. By strategically managing challenges and capitalizing on available opportunities, green fiscal policy can be a key instrument in driving structural reforms towards a more inclusive, resilient, and sustainable economic system (Muhammad Azizi et al., 2025).

Synthesis: Direction of Fiscal Transformation and Green Development

Overall, the results of this study indicate that green fiscal policy not only functions as a tool for managing state revenues and expenditures, but has also developed into a strategic instrument in directing the vision and direction of national development towards a greener, more inclusive, and sustainable transformation. In this context, green fiscal policy plays a dual role: on the one hand, it serves to internalize the external costs of environmentally damaging economic activities through disincentive instruments such as carbon taxes and the removal of fossil fuel subsidies; on the other hand, it provides incentives to sectors committed to green economy principles, such as renewable energy, energy efficiency, low-emission transportation, and sustainable agricultural practices (Nugraha et al., 2024).

In addition to leveraging environmentally friendly investment, green fiscal policy also plays a role in strengthening governance through more transparent, measurable, and participatory mechanisms. The use of climate budget tagging, environmental results-based reporting, and public involvement in the budget planning process are crucial elements in creating a government system that is accountable and responsive to climate change. This policy also encourages institutional reform and bureaucratic culture, where environmental issues are no longer considered a separate sector but rather an integral part of the entire national development process (Hadi, 2024).

To achieve this, close synergy is needed between fiscal policy, medium- and long-term development planning, and governance systems at the central and regional levels. This transformation requires cross-sector collaboration, strong political commitment, and support from civil society and business actors. Strengthening regional fiscal capacity, harmonizing cross-sectoral regulations, and engaging the private sector in innovative financing are key strategies for expanding the positive impact of green fiscal policy. With a comprehensive and long-term approach, green fiscal policy can become the primary foundation for realizing a green economy that is resilient to crises, socially just, and ecologically sustainable (National, 2023).

CONCLUSIONS

This study concludes that green fiscal policy plays a role not only as an instrument for state financial management but also as a key driver of the transformation towards sustainable green economic development. Through instruments such as carbon taxes, green sukuk, and climate budget tagging, fiscal policy has laid the foundation for a new direction for development that is more inclusive, low-emission, and based on environmental justice. Furthermore, this policy has encouraged improvements in governance, particularly in terms of transparency, cross-sector integration, and strengthening public accountability.

However, the implementation of green fiscal policy still faces significant challenges, such as socio-political resistance to subsidy reform, limited local government capacity, and regulatory gaps. On the other hand, significant opportunities exist through strengthened international cooperation, the potential of domestic renewable energy, and the continued growth of innovative financing. Therefore, the synergy between fiscal policy formulation, institutional reform, and multi-stakeholder participation needs to be continuously strengthened. With a comprehensive and collaborative approach, green fiscal policy can become a key pillar in realizing a resilient, equitable, and sustainable green economy in Indonesia.

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