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THE EFFECTIVENESS OF FISCAL POLICY AND GOVERNMENT STIMULUS IN MAINTAINING DOMESTIC CONSUMPTION AND INVESTMENT: A LITERATURE REVIEW

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Abstract
This article aims to review the effectiveness of fiscal policy and government stimulus in maintaining domestic consumption and investment, particularly during periods of economic crisis. Through a literature review, it was found that fiscal policy instruments such as government spending, tax incentives, and social assistance play a significant role in maintaining people's purchasing power and encouraging investment recovery. The success of stimulus measures is highly influenced by the speed of distribution, targeting accuracy, and the fiscal capacity of the country concerned. However, the implementation of fiscal policies also faces various challenges such as limited fiscal space, the risk of rising public debt, bureaucratic weaknesses, and the need for transparent governance. The review emphasises the importance of adaptive stimulus design, synergy with monetary policy, and continuous evaluation to ensure that fiscal policy remains effective and sustainable in the face of future global and domestic economic dynamics.
Keywords: fiscal policy, government stimulus, domestic consumption, domestic investment, literature review, policy effectiveness

Introduction

Fiscal policy is one of the important instruments used by the government to encourage economic growth and maintain national economic stability. In times of economic uncertainty, such as crises or economic slowdowns, the role of fiscal policy becomes increasingly vital to maintain domestic consumption and investment levels so that they do not experience significant contraction.

The government, through various fiscal stimulus measures, seeks to maintain people's purchasing power and encourage private investment so that the economy continues to run (Timuno, 2020). Fiscal stimulus can take the form of various policies, such as increased government spending, tax cuts, subsidies, and cash transfer programmes, with the aim of providing a direct boost to the real economy.

In the Indonesian context, fiscal stimulus is an important response, especially during crises such as the COVID-19 pandemic, which has put significant pressure on economic activity. The government has provided fiscal and monetary easing and stimulus as part of its national economic recovery efforts aimed at maintaining consumption and investment (Carlino & Inman, 2013).

The effectiveness of fiscal policy and government stimulus depends heavily on the accuracy of programme targeting, speed of implementation, and coordination with monetary policy. Timely and targeted stimulus measures can help accelerate economic recovery and boost business and consumer confidence. Conversely, delays or misalignment of targets can reduce the positive impact of implemented policies (Barrell & te Velde, 2002).

The role of fiscal policy is not merely to increase the flow of funds into the economy, but also relates to how the stimulus can spur household consumption and domestic investment in a sustainable manner. Household consumption is a major component of gross domestic product, while investment is an important factor for increasing production capacity and long-term economic growth (European Central Bank, 2009).

The long-term risks of expansionary fiscal policy are also a major concern, particularly in terms of government debt levels and budget deficits. Fiscal stimulus that is not managed properly can cause economic volatility through inflation or market distortions. Therefore, fiscal policy needs to be designed with consideration of the balance between short-term economic stimulus and fiscal sustainability in the future (Sahm et al., 2011).

Indonesia has implemented various fiscal stimulus programmes during the crisis, which have shown varying degrees of success in maintaining public consumption and domestic investment. These programmes include tax incentives for businesses, direct cash assistance to the poor and vulnerable, and increased spending on health and infrastructure (Emerald JABES, 2023). The impact of these programmes is a key focus in evaluating the effectiveness of fiscal policy. In addition, coordination between fiscal and monetary policies is key to creating a conducive economic climate. Fiscal stimulus accompanied by accommodative monetary policy can reinforce positive effects, particularly through lower interest rates and increased liquidity in financial markets (Blanchard & Perotti, 2002).

Obstacles such as bureaucracy and implementation in the field also determine the success of fiscal stimulus in achieving its objectives. The resilience of the administrative system and efficient distribution mechanisms are important factors in ensuring that assistance and incentives directly benefit the community and business actors (MAS Singapore, 2024).

A review of the literature on fiscal policy and government stimulus shows that the success of these policies is also closely related to macro and microeconomic conditions at the time the policies are implemented. External and global factors such as commodity prices and international trade conditions also influence the success of stimulus (Kim, 2023).

Therefore, fiscal policy and government stimulus are very important tools in maintaining economic stability, especially during a crisis. However, their effectiveness is highly dependent on careful planning, swift and targeted implementation, and long-term risk management to avoid future fiscal problems.

Therefore, further empirical research is needed to measure the long-term impact of fiscal stimulus on consumption and investment, as well as to improve policy design to make it more responsive to rapidly changing economic dynamics. Continuous evaluation through literature reviews is an important foundation for formulating effective and sustainable fiscal policies.

Research Method

The research method used in this literature review is a literature study by identifying, selecting, and reviewing various scientific sources and credible publications, both national and international, relevant to the theme of the effectiveness of fiscal policy and government stimulus in maintaining domestic consumption and investment (Eliyah & Aslan, 2025). The literature search was conducted through databases such as Google Scholar, Scopus, and ProQuest with inclusion criteria of publications from the last thirteen years and the presence of empirical or conceptual discussions related to the impact of fiscal policy on consumption and investment. The collected literature was analysed narratively to identify key findings, success factors, implementation challenges, and policy implications, which were then synthesised to draw conclusions and strategic recommendations (Green et al., 2006).

Results and Discussion

Fiscal Policy and Stimulus in an International Context

Fiscal policies and government stimulus measures in various countries have become key tools in maintaining economic stability, particularly when facing global crises such as the 2008 financial recession and the COVID-19 pandemic. Governments in both developed and developing countries have utilised public spending, tax cuts, and social assistance to maintain consumption and encourage domestic investment, which declined sharply during the crisis (Kim, 2023).

The effectiveness of fiscal policy depends heavily on each country's economic context, fiscal space, and administrative system. Countries with strong fiscal capacity, such as the United States, Germany, and Japan, were able to launch massive stimulus packages worth trillions of dollars that had a direct impact on improving consumption and investment levels. These stimulus packages usually took the form of cash assistance, tax incentives, and infrastructure spending designed to boost the economy in the short term (Giavazzi & Pagano, 1990). Conversely, developing countries with limited fiscal space tend to be more selective in designing stimulus measures, focusing on priority sectors such as health, education, and social protection. The stimulus provided is often limited to food subsidies, limited cash assistance, or tax reductions for

MSMEs, which, although relatively small, still have an important impact in maintaining consumption among vulnerable groups (Ma, 2022).

In many countries, fiscal stimulus has proven effective in curbing the pace of economic contraction. Studies show that well-timed and targeted stimulus programmes can shorten the duration of recessions and promote faster recovery, especially when central bank interest rates are already low or near zero, thereby limiting the scope for monetary stimulus (Woodford, 2011).

The stimulus measures taken during the COVID-19 pandemic provide a unique case study. Almost all governments around the world rolled out unprecedented large-scale stimulus packages. In Europe, for example, cross-border fiscal spending was combined with monetary stimulus, thereby shortening the recession and making economic recovery more equitable. However, the success of stimulus measures depends heavily on governance, speed of implementation, and transparency. Countries with good governance tend to achieve more optimal results from stimulus measures, while in countries with low bureaucratic capacity, stimulus often arrives late to target groups or is even absorbed by corrupt practices (Brookings Institution, 2025).

In economic theory, the effect of stimulus is measured by the fiscal multiplier: how much the economic output increases due to an increase in government spending. Cross-country research shows that the fiscal multiplier averages around 1, meaning that a 1% increase in public spending tends to increase national output by around 1% as well, although the value varies greatly depending on each country's economic conditions (Afonso & Jalles, 2015).

Policy coordination between fiscal and monetary policies has proven to be a key factor, especially when monetary policy has limited room for manoeuvre. Collaboration between fiscal stimulus and monetary easing creates synergy to stimulate consumption and revive private investment that has been weakened by market panic and credit tightening (van Teijlingen, 2022).

On the risk side, the implementation of large-scale fiscal stimulus carries consequences such as increased public debt and budget deficits. Advanced economies are generally better equipped to withstand medium-term fiscal risks, while developing countries must exercise greater caution to ensure that stimulus measures do not lead to new debt crises and long-term fiscal weakness (Jorren van Teijlingen, 2022). Studies by the IMF, World Bank, and other international institutions conclude that fiscal stimulus is more effective when accompanied by supporting policies such as tax reforms and strengthening social safety nets. These policies help ensure that the benefits of stimulus reach the households and businesses most affected, thereby increasing the economic multiplier and making recovery more inclusive (Leeper et al., 2010).

The experiences of various countries during the crisis also emphasise the importance of the speed of fiscal response. Delays in implementing stimulus often render programmes ineffective because the economy has already entered a deep contraction phase. Therefore, stimulus design must be simple, bureaucracy must be streamlined, and aid distribution must be targeted. In addition to implementation efficiency, it is also important to pay attention to governance so that stimulus does not cause price distortions or exacerbate inequality. Transparency in implementation, public audits, and the involvement of independent supervisory institutions are needed so that stimulus can have the optimal impact in line with its original objectives (Boehm, 2019).

Globalisation and the interconnectedness of the world economy also influence the effectiveness of each country's stimulus. Countries that are highly open to trade and foreign capital must adjust their fiscal policies to global dynamics to prevent excessive capital outflows and exchange rate volatility (Ramey, 2011).

Thus, fiscal stimulus plays a crucial role in reviving domestic consumption and investment, provided it is supported by sound planning, swift implementation, and robust cross-sectoral and cross-national policy coordination. Stimulus cannot stand alone but requires synergy with structural reforms and long-term policies that enhance the economy's resilience to future crises.

Determining Factors for the Success of Fiscal Stimulus

The success of fiscal stimulus in maintaining domestic consumption and investment is highly influenced by various interrelated factors and supported by appropriate policy design and implementation. One of the most important factors is the timeliness of the stimulus. Stimulus that is delivered quickly and in line with economic needs during a contraction can prevent a deeper decline in consumption and investment (Meiyenti et al., 2024). Conversely, delayed stimulus tends to lose its effectiveness because the economy has already deteriorated or the momentum for recovery has been lost. In addition, temporary stimulus is also important so as not to create a long-term fiscal burden. Policies must be designed so that they can be stopped immediately after the economy recovers, thereby preventing the accumulation of government deficits and debt. The next aspect is targeting, whereby stimulus must be directed at the groups or economic sectors most affected so that its impact is optimal in maintaining purchasing power and encouraging investment (Auerbach & Gorodnichenko, 2017).

The government's fiscal capacity is the main determinant of the maximum stimulus that can be provided. Countries with ample fiscal space can provide larger stimulus, while countries with limited fiscal space must be more selective. This fiscal space is influenced by the government debt ratio, primary balance, and market confidence in fiscal management. The quality of governance, transparency, and minimal corruption are institutional factors that greatly determine the effectiveness of stimulus. Countries with efficient bureaucracies and strong administrative systems tend to be able to distribute stimulus quickly and accurately, thereby immediately stimulating consumption and investment (Alesina et al., 1999).

A country's economic structure also influences the effectiveness of stimulus. Countries with open economies, high export dependence, or sensitivity to global capital movements face additional challenges, such as the potential for capital outflows if stimulus is perceived as too risky by foreign investors (Murphy, 2023). The fiscal multiplier, which is the ratio of additional economic output resulting from stimulus, is closely related to the initial state of the economy. The multiplier is generally larger during a recession or when the output gap is large because unused production capacity can be quickly activated through stimulus. However, the multiplier decreases as the economy approaches full capacity due to the risk of crowding out private investment (Baxter & King, 1993).

The design of the stimulus also determines its success. Stimulus based on capital spending and public investment tends to have a stronger and more sustainable impact than tax cuts or short-term cash transfers, as it also increases productivity and economic capacity. However, cash transfers are very effective in maintaining consumption among low-income households (Yusoff, 2013).

Policy coordination between fiscal and monetary stimulus is also important. Collaboration with monetary authorities, such as lowering interest rates and easing liquidity, amplifies the impact of stimulus in boosting consumption and investment. Public confidence in the government is an important psychological factor. If the public believes that stimulus will support recovery, they are more likely to increase consumption and investment. If not, stimulus is more likely to be saved, thereby reducing its impact on economic growth (Dell'Erba et al., 2018).

Regular monitoring and evaluation to ensure that stimulus measures are implemented as planned allows for responsive policy adjustments if ineffectiveness is identified in the field. The global environment also plays a role. Stimulus measures in countries integrated into global trade and finance, such as Malaysia, need to be adjusted to avoid putting pressure on the balance of payments, exchange rates, or foreign investor perceptions. Supporting reforms, such as strengthening social safety nets or tax reforms, are essential to ensure that stimulus measures are more inclusive and their long-term impact is sustained (Giavazzi & Pagano, 1990).

Policy flexibility and the ability to learn quickly from other countries are also important assets in designing effective stimulus measures, given that each crisis has unique characteristics that require different policy responses.

Ultimately, the success of fiscal stimulus depends on a combination of swift response, adaptive design, sufficient fiscal capacity, good governance, and holistic policy support. The interaction of all these factors determines whether stimulus measures can effectively sustain domestic consumption and investment during a crisis and promote sustainable recovery.

Fiscal Policy Challenges and Risks

Fiscal policy faces various challenges and risks that could affect its effectiveness and sustainability in the short and long term. One of the main challenges is balancing the need for economic stimulus with the risk of a growing budget deficit. When the government pushes for large-scale spending to prevent economic contraction, the budget deficit tends to increase, which ultimately adds to public debt and limits fiscal space for future policies (Chugunov & Pasichnyi, 2021).

Limitations in tax collection are also a major constraint. Low government revenues limit the government's capacity to finance fiscal stimulus programmes. The dominance of the informal sector in the economy and suboptimal tax administration keep tax ratios low in many developing countries, thereby limiting fiscal space (Taylor, 2014).

Another major risk is the reliance on debt to cover deficit financing. Excessive dependence on borrowing, including foreign loans, can make fiscal conditions highly vulnerable to external shocks, global interest rate changes, and exchange rate volatility. The next challenge is the potential for inflationary pressures from expansionary fiscal policies. Increased spending or subsidies that are not matched by productivity growth can drive excessive demand, triggering inflation that could burden household purchasing power (Gherghina, 2024).

In addition to inflation, large fiscal policies also carry the risk of market distortions. Fiscal subsidies or incentives that are too long-term or non-selective can disrupt market mechanisms, create dependencies, and reduce efficiency and innovation in the private sector. The implementation of fiscal policies also faces challenges related to bureaucracy and governance capacity. The distribution of stimulus packages, which involves various administrative stages, often results in slow, inaccurate, and even corrupt distribution of aid, thereby reducing the stimulus effect on the economy (Kinyua & Ocharo, 2023).

The next challenge is fiscal sustainability in the long term. Fiscal policies that do not take into account the debt profile and interest payment capacity can pose sustainability risks, where the burden of debt payments accumulates and erodes productive spending in the future. The state's fiscal policy must also be able to adapt to global pressures and dynamics, such as changes in commodity prices, international financial crises, and geopolitical turmoil. This requires flexible yet disciplined fiscal governance to avoid slipping into excessive deficits or debt crises (Pang, 2022).

Fiscal policy also often faces political challenges, particularly in democratic systems where budget priorities can be influenced by pressure from certain groups, making the decision-making process less than optimal and prone to short-term populist programmes rather than long-term productive policies. Long-term liability risks, such as government guarantees for infrastructure projects or financially troubled state-owned enterprises, can also burden the fiscal position if these obligations come due (Kinyua & Ocharo, 2023).

Transparency and accountability in fiscal management are key to maintaining market confidence. If the government fails to demonstrate credible fiscal governance, investor confidence in government bonds may decline, leading to higher borrowing costs and increased pressure on the domestic currency. During periods of global monetary tightening, fiscal policy faces increasing external pressure. Interest rate hikes in advanced economies can trigger capital outflows from developing countries, raising government borrowing costs and narrowing the scope for domestic fiscal stimulus (Chugunov & Pasichnyi, 2021).

Another long-term risk is the declining efficiency of government spending if fiscal policy is used suboptimally, for example, allocating too much to consumption subsidies rather than productive investment, infrastructure, or human resource development. This hinders economic growth potential and reduces national competitiveness (Carlino & Inman, 2013).

Ultimately, fiscal policy must balance short-term stabilisation functions with long-term fiscal sustainability objectives. The government requires systematic risk mitigation mechanisms, including fiscal rules, strengthened debt management, ex-ante and ex-post oversight, and protection for vulnerable groups to ensure that fiscal responses remain adaptive, efficient, and credible in the eyes of the public and financial markets.

Conclusion

Fiscal policy and government stimulus play an important role in maintaining domestic consumption and investment, especially during an economic crisis. Fiscal instruments such as government spending, tax incentives, and social assistance have proven effective in boosting people's purchasing power and restoring business confidence. The success of stimulus measures is greatly influenced by the speed of distribution, the accuracy of targeting, and the fiscal capacity of the country concerned.

However, the effectiveness of fiscal policy is not without challenges, such as limited fiscal space, risks of rising debt and budget deficits, and weaknesses in bureaucracy and governance. Literature indicates that well-designed stimulus measures supported by transparent governance and monetary policy coordination can amplify the economic multiplier effect and accelerate recovery. Conversely, misdirected or delayed stimulus risks triggering inflationary pressures, market distortions, and long-term fiscal crises.

Therefore, fiscal policy and government stimulus are crucial in sustaining domestic consumption and investment, but require responsive, adaptive design and cross-sectoral coordination to ensure effectiveness and sustainability. Continuous evaluation and improvement based on empirical data are essential to ensure that fiscal policy remains a reliable tool in addressing both global and domestic economic dynamics in the future.

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