The long-run effects of government expenditure on private investments: a panel CS-ARDL approach

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Abstract

We re-explore the link between government expenditure and private investments within a modern econometric framework. Performing a dynamic analysis on a panel of 28 OECD countries over 1990–2019, we account for nonstationarity, country- heterogeneity, and cross-sectional dependence. By estimating an ECM version of the novel CS-ARDL model, we find robust evidence of both short-run and long- run adverse effects of aggregate government expenditure on private investments. Increases in *productive* expenditure have no significant effect on the long-run dynamics of private investments, whereas reallocating public resources towards *pro- ductive* expenditure enhances them. By contrast, both level increases and shifts of resources towards *unproductive* expenditure discourage capital formation in the pri- vate sector. Using the government budget constraint (GBC) system, we observe that the effects of government expenditure depend on how it is financed. In most cases, the short-run fall in private investments is mainly associated with tax-financed expenditure, while debt-financed expenditure appears to be the most detrimental in the long-run.

Keywords CS-ARDL · Fiscal policy · Government expenditure · Panel data · Private investments

JEL Classification C33 · E22 · E62 · H50 · H60