
Public Capital Expenditure and Debt Dynamics: Evidence from the European Union

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Abstract

This paper investigates the relationship between public capital expenditure and public debt in the European Union (EU) on a panel of fifteen countries in 1980-2013. We find robust evidence of a negative cointegrating relation, whereby increases in the capital expenditure-GDP ratio cause reductions in the long-run debt-GDP ratio. Our empirical results suggest that current EU fiscal austerity can trigger upward debt spirals if cuts in total expenditure disregard its composition. The findings appear to give support to the view, consistent with the "golden rule of public finance", that EU fiscal rules should allow for higher levels of capital expenditure in order to foster debt consolidation through growth dividends.

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