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The effect of government spending on the debt-to-GDP ratio: some Keynesian arithmetic.

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Summary: According to the standard approach to the issue of public debt sustainability, fiscal austerity is the route that many countries must currently follow to reduce their debt-to-GDP ratios back to sustainable paths. We challenge this conventional wisdom and argue that, below full employment, an increase in government spending may paradoxically reduce the debt-to-GDP ratio. This claim is particularly relevant today because with Central Bank interest rates near zero there is no alternative to fiscal policy, and the only argument against increasing government expenditure as a way to fight unemployment is its supposed negative effect on the state of public finances.

MSC:

91B64 Macroeconomic theory (monetary models, models of taxation)
91B82 Statistical methods; economic indices and measures

Keywords:

debt-to-GDP ratio; Keynes; fiscal austerity; increasing government expenditure

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