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Economic growth and government expenditure: evidence from a new test specification

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Abstract

A new test specification of Wagner's Law of Public Expenditure has been formulated. The aim is to disentangle the effects of accelerating and decelerating economic growth on growth in government expenditure. Two alternative proxies for the state of the economy are experimented with. The first defines the current state of the economy by relating it to its historical mean growth rate, while the second defines it relative to a pooled time-series/cross-sectional mean growth rate. This distinction is then explicitly incorporated into an error correction model that parameterizes the bivariate relation between government expenditure and economic growth for alternative OECD country groupings. The results suggest that government expenditure increases less than proportionately with accelerating economic growth and decreases more than

proportionately with decelerating economic growth. There is only a limited support for Wagner's Law.



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