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Government investment and fiscal stimulus

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Abstract

Effects of government investment are studied in an estimated neoclassical growth model. The analysis focuses on two dimensions that are critical for understanding government investment as a fiscal stimulus: implementation delays for building public capital and expected fiscal adjustments to deficit-financed spending. Implementation delays can produce small or even negative labor and output responses to increases in government investment in the short run. Anticipated fiscal adjustments matter both quantitatively and qualitatively for long-run growth effects. When public capital is insufficiently productive, distorting financing can make government investment contractionary at longer horizons.

Research Highlights

â–º Implementation delays associated with government infrastructure spending can hinder the beneficial effects of that spending in the short run. â–º Expected fiscal financing of government infrastructure spending can hinder the beneficial effects of that spending in the long run. â–º Implementation delays associated with government infrastructure spending can reduce private investment more and raise labor and output less (or even lower them) in the short run, compared to the case without delays. â–º Distorting fiscal financing of government investment dampens the growth effects of that investment in the long run.

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