



European  
Research Area

# EUROPEAN POLICY BRIEF

## SPINTAN – Policy Brief No. 6

**SPINTAN**  
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**The long-run effect of fiscal consolidation on economic growth: Evidence from quantitative case studies\***

March 14, 2016

### SUMMARY

#### Objectives of the research

The purpose of this research is the investigation of the long-run effect of fiscal consolidation on economic growth, i.e., we investigate whether fiscal consolidations depress economic growth or contribute to an expansionary (so called non-Keynesian) effect.

#### Scientific approach / methodology

The analysis is based on six quantitative case studies of OECD countries. We use the synthetic control method, which offers the chance to investigate the hypothetical post-consolidation economic growth trajectory in the consolidating country in the absence of a fiscal consolidation.

#### New knowledge and/or European added value

Our results do not offer clear-cut evidence on the long-run effect of fiscal consolidation on economic growth. Half of the case studies point to a positive effect with the other half indicating a negative effect on economic growth trajectories. We further do not find a specific effect of the strength of the fiscal adjustment and the type of consolidation.

#### Key messages for policy-makers, businesses, trade unions and civil society actors

There is no clear evidence for long-run negative effects of fiscal consolidation on economic growth, however, country specific circumstances seem to be important and should be investigated in further research.

\* This Policy Brief is based on the SPINTAN Working Paper No. 6: Kleis, M. and M.D. Moessinger (2016): 'The long-run effect of fiscal consolidation on economic growth: evidence from quantitative case studies', available on the SPINTAN website <http://www.spintan.net/c/working-papers/>.

**Objectives of the research**

The budgetary problems in many European countries which emerged as a consequence of the financial and economic crisis directly point towards the need of fiscal consolidation. However, due to the economic recession, also the implementation of growth enhancing (or, at least, growth preserving policies) looms large. Given this trade-off, the austerity debate in Europe centres around the question whether fiscal consolidation undermines the prospects for (long-run) economic growth. We contribute to this debate by investigating the long-run effect of fiscal consolidation on economic growth in six case studies for OECD countries. In particular, we are interested in whether fiscal consolidations depress economic growth in the long-run or whether they may contribute to an expansionary effect (so called non-Keynesian effect).

**Scientific approach / methodology**

We rely on a quantitative case study approach, i.e., to investigate the long-run effect of fiscal consolidation on economic growth we ideally need to identify what would have happened in a consolidating country in the absence of a fiscal consolidation. While this comparison is not possible using standard panel estimators, the synthetic control group (SCM) offers the chance to make this comparison. In a nutshell, this method uses information from other untreated units to construct the exact counterfactual situation. The economic growth trajectory of the estimated synthetic control unit is comparable to the economic growth trajectory of the consolidating country in the pre-treatment period (i.e., before the implementation of a fiscal consolidation) and thus allows for a comparison of the post-consolidation growth effects for the same unit of observation.

**New knowledge and European added value**

In contrast to recent studies that reject the hypothesis of non-Keynesian effects, our results do not offer clear-cut evidence on the long-run effect of fiscal consolidation on economic growth. Half of the case studies point to a positive effect with the other half indicating a negative effect on economic growth trajectories. We further do not find a specific effect of the strength of the fiscal adjustment and the type of consolidation, i.e., whether the consolidation is rather based on expenditure cuts or revenue increases. For each consolidation, so far undetected country specific features may play a role too and should be investigated in further research.

**Key messages for  
policy-makers,  
businesses,  
trade unions and  
civil society actors**

There is no clear evidence for long-run negative effects of fiscal consolidation on economic growth, however, country specific circumstances seem to be important and should be investigated in further research.

## SPINTAN – Smart public intangibles

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|-----------------------------|---|
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| <b>Website</b>              | <a href="http://www.spintan.net">www.spintan.net</a>  |
| <b>Further reading</b>      |   |
| <b>Related websites</b>     |   |
| <b>For more information</b> | <a href="mailto:info@spintan.net">info@spintan.net</a> or <a href="mailto:matilde.mas@ivie.es">matilde.mas@ivie.es</a>  |