Public Debt and Economic Growth – Economic Systems Matter

Markus Ahlborn, Rainer Schweickert

Abstract

Most studies on the relationship between public debt and economic growth implicitly assume homogeneous debt effects across their samples. We –in accordance with recent literature– challenge this view and state that there likely is a great deal of cross-country heterogeneity in that relationship. However, other than scholars assuming that all countries are different, we expect that *clusters of countries differ*. We identify three country clusters with distinct economic systems: *Liberal* (Anglo Saxon), *Continental* (Core EU members) and *Nordic* (Scandinavian). We argue that different degrees of *fiscal uncertainty* at comparable levels of public debt between those economic systems constitute a major source of heterogeneity in the debt-growth relationship. Our empirical evidence supports this assumption. *Continental* countries face more growth reducing public debt effects than especially *Liberal* countries. There, public debt apparently exerts neutral or even positive growth effects, while for *Nordic* countries a non-linear relationship is discovered, with negative debt effects kicking in at public debt values of around 60% of GDP.

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Markus Ahlborn (corresponding author)
Georg-August University Göttingen
Platz der Göttinger Sieben 3
37073 Göttingen, Germany
E-Mail: markus.ahlborn@wiwi.uni-goettingen.de

Rainer Schweickert
Kiel Institute for the World Economy
Kiellinie 66
24105 Kiel, Germany
E-mail: rainer.schweickert@ifw-kiel.de