

The Mechanism of Fiscal Policy Transfer in the Economy: Evidence of the Asymmetric Behavior of the Fiscal Expenditure Multiplier During Business Cycles

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Abstract

The circumstances following the financial and economic crisis in 2008 revealed some fundamental divergence in the economic literature on the effects of fiscal policy. On one hand, some economists have defended the adapting of countercyclical fiscal policy measures, while, others have expressed doubts about the effectiveness of enacting such fiscal policy measures. This study by using 62 countries' data over the period 1960-2019, applying panel smooth transition regression, and considering the fiscal multiplier as a transition variable, examines the nonlinear relationship between the explanatory variables and economic growth in one hand, and the behavior of fiscal policy during the recession and expansion among the sample countries, applying LPM approach on the other hand. In addition, the main issue is to examine the size of the fiscal multiplier during the recession. The results show that since fiscal policy shocks have a stronger effect during a recession than an expansion period; hence, asymmetric effects are confirmed. Also, based on the research findings, it is observed that the countercyclical fiscal policy is relatively effective in smoothing production fluctuations, while the procyclical policy worsens production fluctuations. Finally, Estimates in this study indicate a procyclical behavior for developing countries and a countercyclical behavior for developed countries.

Keywords: Fiscal Policy Transmission Mechanism; Business Cycles; Fiscal Multiplier; Panel Smooth Transition Regression; LPM Model.

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