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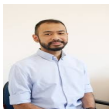
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The Effectiveness of Fiscal Policy in Stimulating Economic Activity
An Empirical Investigation

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Preliminary draft. Comments welcome

Abstract

Recent years have seen a revival of the debate about the role of fiscal policy in stimulating economic activity. The empirical literature suggests that fiscal multipliers are typically positive but small, and while there is some evidence of negative fiscal multipliers, there is no clear consensus on the preconditions for such an outcome. However, most of the empirical evidence is for advanced economies and the effectiveness of fiscal policy in emerging market economies, countries in transition, and developing countries remains largely undocumented. This paper tries to fill this gap by using data for a large number of countries, including developing countries and emerging market economies, to examine whether some of the factors identified in the theoretical literature are indeed important in explaining the effectiveness of fiscal policy in responding to a recession. The focus is on episodes of recession and the associated fiscal policy response. Given the large number of countries and episodes, and differences in the size and composition of fiscal responses, initial conditions, and accompanying policies and developments, the paper explores three different and complementary approaches to try to account for the interactions between fiscal policy and growth during recessions: descriptive analysis, multidimensional statistical analysis, and standard regression analysis.

JEL Classification Numbers: C21, E62, E65, H30

Keywords: Fiscal policy, stabilization, recession, principal components and cluster analysis.

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