

An empirical note on causality between government spending and debt in South Africa

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Abstract

The causal relationship between government spending and debt is richly debated theoretically, but empirical examination of the causal relationship between them has received little attention. Understanding the debt-spending relationship is important for reforming debt contraction and management strategies. Using quarterly data for the 1965-2019 period for South Africa, the paper tests the causal relationship within the Toda-Yamamoto granger non-causality and non-linear autoregressive distributed lag frameworks. The paper finds that debt granger causes spending and, thus, confirms the public choice hypothesis, while it fails to find evidence in support of the neoclassical and modern monetary theory views. The results suggest that there is no evidence of asymmetrical effects of changes in debt on spending. A long run relationship between debt and spending is found in the context of non-linear autoregressive distributed lag model, but not in the context of the linear autoregressive distributed lag model. This suggests the existence of hidden cointegration between the variables.

Keywords: government spending and debt, nardl, modern monetary theory, functional finance, neoclassical.

JEL Codes: E12, E13, H5, H6

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