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Glauco De Vita, Emmanouil Trachanas, Yun Luo

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Revisiting the bi-directional causality between debt and growth:
Evidence from linear and nonlinear tests

Glauco De Vita ¹, Emmanouil Trachanas ², Yun Luo ^{3,*}

¹ *Centre for Business in Society, Coventry University, Priory Street, Coventry CV1 5FB, UK. Tel.: +44(0)2476887688. E-mail: glauco.devita@coventry.ac.uk.*

² *Department of Accounting, Economics and Finance, Oxford Brookes University, Oxford OX3 0BP, UK. Tel.: +44(0)1865485671. E-mail: etrachanas@brookes.ac.uk.*

³ *Centre for Business in Society, Coventry University, Priory Street, Coventry CV1 5FB, UK. Tel.: +44(0)2476887688. E-mail: yun.luo@coventry.ac.uk * **Corresponding author.***

ABSTRACT

We revisit the bi-directional causality between public debt and the rate of GDP growth for 10 EMU countries alongside the US, UK and Japan, over sample periods spanning from 1970 up to 2014 whilst accounting for the nonlinear properties of both the individual time series, and their relation in both directions. Our results indicate that the causal relation between debt and growth, in either direction, is weak at best. For most of the countries in our sample, we find no robust evidence of a long-run causal effect using bi-variate Granger causality tests. Bi-directional causality is detected only for Austria, while for France, Luxembourg and Portugal, causality runs solely from debt to growth, but the estimated effects are very small. In Finland, Spain and Italy, Granger causality (from growth to debt in the former two and debt to growth in Italy) appears to be present in the short-run. Our findings cannot be taken as evidence that a high level of public indebtedness is not risky for the economy or as invalidating hypotheses postulating effects in either direction in the relation between debt and growth.

JEL: C22; F34; H63; O40; O57

Keywords: Public debt; economic growth; Granger causality; nonlinear causality; SYS-GMM

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