

Public Investment and Fiscal Rules in a Low-Interest Rate Environment

One heavily debated topic during the low interest rate period was on the reasonability of debt financed public investment, particularly in fiscally sound jurisdictions. While existing literature mostly focuses on the interaction between fiscal rules and government debt, this paper investigates *whether stringent fiscal rules hamper public investment in a low interest rate environment*. To that end, we use a panel data set for 25 Swiss cantons for the period from 2008 to 2020. Following the literature, we first employ a fixed effects estimation, and subsequently fixed effects vector decomposition (FEVD). To address endogeneity concerns, we use an instrumental variable approach with a generalized method-of-moments (GMM) estimation. We do find an effect of fiscal rule stringency on public investment, although the effect vanishes for more sophisticated methods. Also, we find evidence for a non-linear relationship between fiscal rule stringency and public investment.

