

CONDITIONS THAT MAY INVALIDATE THE PREDICTIONS OF THE EXPANSIONARY AUSTERITY POLICIES

George D. Demopoulos and Nicholas A. Yannacopoulos

September 2015

The expansionary austerity policies predict that fiscal consolidation implemented mainly by a tax increase may signal that tax cuts have to be expected in the future, Consumers respond to tax cut increase by raising their estimate of their lifetime resources; as a result, they may raise consumption with corresponding positive effects in aggregate demand. The main channel through which fiscal consolidations may stimulate economic activity is that of the expectations view, which is based on two fundamental assumptions: that the horizon index of the consumer has to be infinite, and secondly that his tax expectations have to be elastic in the Hicksian sense. However, since the assumptions are not satisfied in a world characterized by uncertainty and liquidity constraints, the expansionary effects of fiscal austerity policies (through the expectations channel) fail.

The full working paper can be found [here](#).