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Positive Correlation between Government Expenditure and Real Interest Rate: Testing Ramsey Model based on American and Chinese Data

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ABSTRACT

In the classical Ramsey Model, temporary increase of government expenditure will raise real interest rate. On the one hand, by using the data of American expenditure on national defense and the interest rate of 10-year constant maturities from 1959 to 2002, on the other hand, by carrying on an empirical analysis based on the Chinese data from 1989 to 2004, the paper points to the conclusion of positive correlation between government expenditure and real interest rate that temporary increase of government expenditure will surely lead to a rise in real interest rate, and also discovers that this model conforms to China's situation very well.

KEYWORDS Ramsey Model; Government Expenditure; Real Interest Rate