

rates are stable over the long term, mechanisms are developed to lessen the negative effects of inflation. Indexation is one mechanism. The dollarization of an economy is another coping strategy. Unstable inflation rates (and higher rates are often unstable in practice) create more of a problem since firms and individuals may drastically alter the ways in which they allocate resources. Empirical evidence, however, fails to establish a significant negative relationship between inflation and long-term growth rates in cross-country studies.⁴⁶

What about government expenditures? Do they lead to sustained economic expansion as posited by Keynesian economic theory? Figure 5 fails to show a strong relationship between economic growth and the government expenditure share of GDP. Other evidence, however, is mixed. Barro presents evidence to show that government consumption has a detrimental effect on growth.⁴⁷ He also concludes that government investment programs have a small positive (but statistically insignificant) effect on growth. Khan and Reinhart conclude that private investment tends to have a greater positive affect on long-term economic growth than government investment.⁴⁸ They also note, however, that these results should not be misinterpreted. Government investment may not be directly productive. For example, improving the infrastructure will not directly lead to growth, but rather could indirectly lead to new investments by the private sector which would in fact enhance longer-term growth prospects. Likewise, indirect growth benefits may occur as a result of government investment in human resources such as education and health, despite the fact that the aggregate data fail to reflect this.⁴⁹ Ram concludes that the size of the government does have a positive effect on economic growth especially in smaller countries, largely as a

⁴⁶See Ross Levine and Sara J. Zervos, "What We Have Learned About Policy and Growth from Cross-Country Regressions?" *American Economic Review*, Vol. 83, No. 2 (May 1993), 426-30, and Levine and Renelt, *op. cit.*

⁴⁷Barro, *op. cit.*

⁴⁸Moshin S. Khan and Carmen M. Reinhart. "Private Investment and Economic Growth in Developing Countries," *World Development*, Vol. 18, No. 1 (January 1990), 19-27.

⁴⁹Otani and Villanueva, *op. cit.*