

This vs That: The Economic Effects of Fiscal Spending Shifts

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Abstract

In this paper, we investigate how redistributing government spending across different spending categories influences the economy. An exogenous increase in spending on a component results in a change in total spending and also a shift in the distribution of spending. Our VAR model decomposes this composite shock into a level shock and a reallocation shock. This allows us to estimate the macroeconomic implications of redistributing spending between two components without a corresponding increase in total spending. We find that a reallocation towards government investment from government consumption increases output and private investment. Conversely, a shift in spending towards military expenditures reduces the output multiplier. Additionally, a higher share of state and local government purchases is beneficial in the short-term.

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