The Macroeconomic Consequences of Government Spending (Re)Allocation

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Abstract

In this paper, we examine whether changes in the composition of government purchases impact macroeconomic outcomes. To do this, we employ a Factor-augmented Vector Autoregression (FAVAR) model across six spending categories, aiming to estimate the slope and curvature factors that represent the distribution of spending. Specifically, we concentrate on the slope factor, known as the reallocation factor, which captures shifts in spending proportions across categories. Our findings indicate that a reallocation from state and local government consumption to other fiscal components results in an increase in total spending and a modest rise in output, all without exacerbating the fiscal deficit. These results underscore the significance of the composition of spending in shaping fiscal policy outcomes.

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