

Cyclical Government Spending, Income Inequality and Welfare in Small Open Economies

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Abstract:

This paper compares the effects of pro and counter-cyclical government spending on income inequality and welfare in a small open economy. We examine the consequences of alternative government spending rules following shocks to productivity, domestic interest rates, terms of trade and export demand. The simulated results show that the type of spending rule makes negligible difference to welfare, in the face of domestic or external shocks. However, pro-cyclical government spending reduces income inequality by more than counter-cyclical spending behavior across different shocks and alternative relative labour intensities.