

The Role of Government Spending Components: a re-Examination of the Effects of Military Spending on Private Consumption

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Abstract

In this paper we re-examine the magnitude of government spending multiplier by a new-Keynesian approach focusing on the role of military spending in changing the aggregate impacts on economy. To do this, we analyse the stylized facts of civilian and military expenditures for the U.S. economy focusing our estimates on private consumption. Our VAR estimations show, as expected, that non-military expenditure induces a positive and significant response of private consumption whereas military spending seems to have a negative and significant effect. The sensitivity analysis using total government expenditure suggests a positive and significant impact on private consumption although the magnitude is reduced by the effects of military spending.

We develop therefore a simple DSGE new-Keynesian model that might potentially account for that evidence. Our framework shares many ingredients with recent dynamic optimizing sticky price models, although we improve on the assumption of the fiscal sector by introducing non-military and military spending components including three main novelties. First, we analyze the effects of public spending on the economy accounting for "within" complementarity/substitutability of military and non-military spending. Second, we show that the financing mechanism of the different spending components is crucial for agent's decision about consumption. Finally, we argue that crowding in/out effects of government spending components on aggregate consumption are related to the existence of a precise portion of public expenditure that stimulates/depresses a fraction of consumers.

As a conclusion, the empirical and simulated impulse response functions are shown suggesting that the predictions of theoretical model may improve on the rigid approaches of Keynesian and Real Business Cycle models.

Keywords: Government Spending Multiplier, Public Spending Components, Structural Vector Autoregressive Analysis, Military Spending, Dynamic Stochastic General Equilibrium Model.

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