



Distributional Effects of Public Spending and Tax Shocks in Middle-Income Countries: A Panel VAR Approach

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Non-Technical Summary

- This paper is the first to employ the GMM Panel VAR approach in examining the distributional effects of public spending and tax shocks over different horizons in middle-income countries.
- The study also investigates the response of income distribution variables to shocks imposed on three key components of social expenditures: social protection, health expenditures and education spending.
- We find that:
 - (i) shocks to government and education spending tend to exhibit the most pronounced distributional consequences;
 - (ii) shocks to both these expenditures positively impact the low- and middle-income groups, with high-income groups benefiting from education spending shocks as well
 - (iii) social protection shocks often exhibit brief equalizing effects,
 - while (iv) health spending and tax shocks generally have no apparent effects on the economic divide;
 - (v) social protection and health spending shocks largely elevate the income share of the wealthy, whereas tax shocks generally do not benefit the income groups under study.
- Further inference from variance decompositions confirms that fiscal policy variables are crucial drivers of the income distribution.
- Our results are robust to alternative measures of inequality, different orderings of variables, the inclusion of inflation, the exclusion of countries with relatively lower level of inequality, as well as those with high level of inequality.
- As a final contribution, our study examines how the results for middle-income countries compare with high-income ones.
- We find that while the same fiscal policies could have different distributional effects across the middle- and high-income groups, we also reveal that the results for both groups often agree on some general trends.
- Interestingly, the equalizing impacts of health spending and tax shocks are witnessed only in high-income countries.

You can read the full paper [here](#).