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How Changing Government Spending Affects Inequality

By Juan Carlos Suárez Serrato[1]

Introduction

In recent years, an important national conversation has begun on the extent and causes of inequality in the United States. A large part of this debate has focused on inequality at the top of the earnings distribution and on related policies including the taxation of top earners. However, there has been less focus on how long-term changes to government spending may affect inequality even when such policies may be much more important. Understanding how changing government spending affects inequality can help us make more informed policy decisions.

It is not hard to see that government spending may have unequal effects across the income distribution. For example, community development block grants are given to localities for a variety of purposes, such as improving local infrastructure including parks and health facilities, providing access to affordable housing, and providing social services to children, the elderly, and the mentally ill. In 2012, these federal grants totaled $3.9 billion. While relatively well-off individuals may enjoy many of these services, it is likely that individuals with lower incomes derive a larger benefit from this spending. Thus, a decrease in this type of spending might increase inequality, as those with lower incomes may not be able to resort to private alternatives, including private counseling services or higher rent for access to better parks and amenities.

Similarly, targeting services to areas with lower proportions of lower income individuals is likely to increase inequality because of a disproportionate decrease in the well-being of

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About The Author

Juan Carlos Suárez Serrato is a Postdoctoral Fellow at SIEPR. He is also a Research Scholar at Duke University, where he will be an Assistant Professor in the Economics Department starting in the fall of 2014. Prior to joining SIEPR, he attended the University of California, Berkeley, where he received a Ph.D. in Economics. Juan Carlos's research focuses on local effects of fiscal policies, including the incidence of government spending and state corporate taxation.