Research Seminar "Quantitative Economics"

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Abstract

Redistribution and the wage-price dynamics: Optimal fiscal and monetary policy
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Abstract
When both prices and wages are subject to nominal frictions, an increase in input prices such as energy can initiate a wage-price dynamics, as both nominal wages and prices adjust slowly. High inflation in prices and wages reduces welfare as it generates distributional effects and affects aggregate demand. To analyze optimal policy in this environment, we consider a heterogeneous-agent model, with both wage and price stickiness. We derive joint optimal fiscal-monetary policy, using a rich set of fiscal tools. We first identify the set of fiscal tools, which implements nominal price and wage stability as an optimal outcome. Starting from this equivalence result, we identify the key instrument for implementing price and wage stability, which appears to be a time-varying wage subsidy. We call this policy a non-Keynesian stabilization policy, as it does not directly channel through aggregate demand. We finally compare our results to those obtained in a representative-agent environment.