Redistribution and the Monetary–Fiscal Policy Mix*

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Abstract

We show that the effectiveness of redistribution policy is tied to how much inflation it generates, and thereby, to monetary-fiscal adjustments that ultimately finance the transfers. In the monetary regime, taxes increase to finance transfers while in the fiscal regime, inflation rises, imposing inflation taxes on public debt holders. We show analytically that the fiscal regime generates larger and more persistent inflation than the monetary regime. In a two-sector model, we quantify the effects of the CARES Act in a COVID recession. We find that transfer multipliers are larger, and that moreover, redistribution is Pareto improving, under the fiscal regime.

JEL classification: E53; E62; E63

Keywords: Household heterogeneity, Redistribution, Monetary-fiscal policy mix, Transfer multiplier, Welfare evaluation, COVID-19, CARES Act

*We thank David Andolfatto, Guido Ascari, Oli Coibion, Marco Del Negro, Refet Gürkaynak, Yoonsoo Lee, Eric Mengus, Gernot Muller, Taisuke Nakata, Woong Yong Park, Christiaan van der Kwaak, seminar participants at University of Tokyo, New York University–Abu Dhabi, and Sogang University, and conference participants at the CEPR/Bank of Italy 8th Conference on Money, Banking and Finance, CEPR/Keio University 6th International Macroeconomics and Finance Conference, 27th International Conference on Computing in Economics and Finance, 3rd Warsaw Money-Macro-Finance Conference, 2021 KIF-KAEA-KAFA Conference, and 2021 North American Summer Meeting of the Econometric Society for helpful comments. The views expressed here are those of the authors and do not necessarily reflect those of the Federal Reserve Board or the Federal Reserve System. First version: December 2020. This version: June 2021.

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