

Optimal Monetary Policy with Redistribution

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Abstract

We study optimal monetary policy in a dynamic, general equilibrium economy with a motive for redistribution. Unlike typical New Keynesian models, workers are heterogeneous and face shocks to their skill level. Unlike TANK or HANK models, all heterogeneity is ex-ante rather than ex-post—that is, we allow for complete insurance markets. Finally, unlike representative-agent Ramsey models, lump-sum taxation is not ruled out, but linear taxes are restricted to be non-state-contingent. We derive conditions under which implementing flexible-price allocations is optimal. We show that such allocations are not optimal when the motive for redistribution varies with the business cycle, and in such cases, optimal monetary policy implies a countercyclical mark-up conditional on shocks to the relative skill distribution.