Nominal Rigidities and Policy Trade-Off in the Long Run

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Abstract

We introduce a simple government that consumes the income taxes collected from households into a model with sticky prices and nominal wages proposed by Tsuzuki and Inoue (2010), which introduces a constant rate of technological change and money growth. The government consumption provides households with utility. Tsuzuki and Inoue (2010) examined whether a monetary policy trade-off exists between stabilizing employment and curbing inflation in the steady state when the rate of technological change decreases. In their model, if only prices are sticky, there is no monetary policy trade-off. However, if both prices and nominal wages are sticky, a monetary policy trade-off exists. Our model, on the other hand, shows that if the government changes the tax rate appropriately, the policy trade-off disappears even when both prices and nominal wages are sticky.

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