Redistribution and Fiscal Uncertainty Shocks

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Abstract

This paper revisits the macroeconomic impact of an uncertainty shock about fiscal policy in a New Keynesian framework. Motivated by the observation that many fiscal policies are redistributive and that many U.S. households do not own capital, I introduce household heterogeneity in the form of limited capital market participation. I show that household heterogeneity significantly magnifies the aggregate effect and restores co-movement of macroeconomic variables
in a contraction that is generated by a fiscal uncertainty shock. This is because the heterogeneous household model captures individual uncertainty about redistribution that cancels out in representative agent models. Importantly, the impact of fiscal uncertainty shocks becomes larger as wealth becomes more concentrated.