Home Production and Fiscal Policy*

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Abstract

This paper studies the impact of home production on the effectiveness of fiscal policy. We augment a New Keynesian sticky price model popular in monetary and fiscal policy research with a home production sector that employs an identical labor input to that of market labor. We find that the home production channel introduces significant substitution effects that increase the effectiveness of tax stimulus and have modest gains for stimulus spending. In response to tax innovations, the model is found to produce comparable multipliers, as well as similar dynamic responses, to those generated by several models popular in the fiscal policy literature. We find that factors which impact the substitution decision – such as the relative efficiency of market and home production and changes in the desired steady state home production hours – can have significant impacts on the effectiveness of fiscal policy.

JEL Codes: E30, E60, E62

Keywords: home production, fiscal policy, output multiplier

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