

Fiscal Forward Guidance*

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Abstract

Should the fiscal authority use forward guidance to reduce future policy uncertainty perceived by private agents? Using dynamic stochastic general equilibrium models, we examine the welfare effects of announcing future fiscal policy shocks. Analytical as well as numerical experiments show that *selective transparency* is desirable — announcing future fiscal policy shocks that are distortionary can be detrimental to ex ante social welfare, whereas announcing non-distortionary shocks generally improves welfare. Sizable welfare gains are found with constructive ambiguity regarding the timing of a consumption tax increase in the fiscal consolidation scenario in Japan recommended by Hansen and Imrohoroglu (2016). However, being secretive about distortionary tax shocks is time inconsistent, and welfare loss from communication may be unavoidable without commitment.

JEL Classification: D82; E62; H20; E30

Keywords: news shock; fiscal policy; private information; communication; forward guidance

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