

**COMMENT TO  
“SIGNALS FROM THE GOVERNMENT:  
POLICY UNCERTAINTY AND THE TRANSMISSION OF FISCAL SHOCKS”  
BY GIOVANNI RICCO, GIOVANNI CALLEGARI AND JACOPO CIMADOMO**

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The main conclusion of this paper is that the fiscal policy should be well communicated to the public in order to be more effective. It follows that policy effectiveness depends to a large extent on its expectedness, rather than on its unpredictability, in sharp contrast with the literature on the rational expectations.

As a consequence, this paper provides a number of lessons and recommendations for the policy makers. First of all, the government should send clear and unambiguous signals about its plans to firms, households and foreign investors, and policies, once decided, must be coherently implemented. Otherwise the uncertainty could weaken and delay the adjustment process of economic agents.

Nevertheless, the role of uncertainty is not symmetric. In fact, credible policies arguably make more effective a fiscal stimulus, since households and firms tend to spend more if they believe that their revenues are going to increase in the medium and short run as a consequence of stronger public expenditure. This fact may even increase the size of fiscal multipliers.

For the same reason, some policy ambiguity may contribute to reduce the cost of austerity, since private demand may decrease less if the fiscal restriction is underestimated.

In any case, exploiting the asymmetric role of signalling too much may be counterproductive, since policy instability brings large costs – as the Italian experience teaches – while the social and political cohesion grants a “peace dividend” – as the German experience shows. Excellent examples of worst practices in policy signalling are provided by the unnecessary perturbations related to the Fiscal Cliff in the US and by the hesitating stance of the ECB in adopting “unconventional measures” in the EU.

Ultimately, if the quality of signals coming from the government was better, the way out from the world crisis could be faster and less costly, as the economic agents were more confident on the commitment of governments and central banks to reduce the unbalances that caused the recession.

Measuring the degree of policy unpredictability is an hard task, and deciding the right dose of signal ambiguity is even harder. The authors of this paper elaborated on the variance of economic forecasts of public spending collected within the US Survey of Professional Forecasters (SPF). However the policy uncertainty is something different from the general macroeconomic uncertainty. The paper tried to disentangle the contribution of general macroeconomic uncertainty from that of pure ambiguity of policy signals taking the residuals of the regression of the dispersion of spending forecast against the dispersion of GDP future growth. Nevertheless, this measure of policy uncertainty may be subject to some criticisms.

First of all, the authors correctly acknowledge that the dispersion of forecasts measures the uncertainty only if professional forecasts are not influenced too much by private information, but arguably professional forecasters cannot survive on the market if they do not pretend to exploit private information! Secondly, the dispersion of professional forecasts may depend on strategic

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signalling, rather than on pure uncertainty. For instance, some analyst may voluntary overestimate GDP growth in order to boost the economic activity or to bias unduly upward the forecasts of his competitors as well. As long as this optimistic forecaster is very influential, his prediction could even be self-fulfilling.

Last but not least, the dispersion of forecasts could fall just when policy signals become more confusing because of the well-known “herd behaviour” of professional forecasters, that usually prefer being wrong all together instead of being right alone when the general scenario is less clear. The repeated overestimation of growth in most European countries is a good example of such behaviour. Thus the equivalence between forecasts variance and **true** policy uncertainty is ultimately questionable.

The effect of policy uncertainty is verified by comparing the IRFs of a simple Bayesian VAR model with a TVAR model where the regime is driven by the policy uncertainty proxy. Nevertheless, the effects of policy uncertainty plausibly vary according to a strong non-linear pattern. Considering only a single trigger threshold – the same over the full sample! – is probably less appropriate.

Maybe the paper may benefit from a non-parametric approach, although we realise that more flexible models would provide less robust results and fewer clear-cut conclusions as well. In any case, the threshold model simulations show that the economy reacts to the government signals faster and stronger in “normal” times, when policy (and general) uncertainty is moderate, than in “troubled waters” (even though the confidence bands of the IRFs are quite large). This is a valuable result, that should suggest the policy makers to be less cautious just during a crisis, when the economic agents are more confused and possibly would welcome some credible “anchor” for their plans.

We appreciated very much that the authors correctly make a distinction between the influence of “nowcast revisions” and “forecast revisions” on government spending. As expected, the latter have larger effects on GDP and private demand components, but not on Federal spending. It implies that credible long term public expenditure plans are more effective than short term (and probably transitory) measures. In contrast, larger Federal expenditure is “required” when policy is uncertain. Also, unexpected changes of current government expenditure in the short run have larger (negative) effects on the public balance.