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# Optimal Fiscal and Monetary Policy With Occasionally Binding Zero Bound Constraints

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**Abstract**

This paper studies optimal fiscal and monetary policy when the nominal interest rate is subject to the zero lower bound (ZLB) constraint in a stochastic New Keynesian economy. In the baseline model calibrated to match key features of the U.S. economy, it is optimal for the government to increase its spending when at the ZLB in the stochastic environment by about 60 percent more than it would in the deterministic environment. The presence of uncertainty creates a unique time-consistency problem if the steady state is inefficient. Although access to government spending policy increases welfare in the face of a large deflationary shock, it decreases welfare during normal times as the government reduces the nominal interest rate less aggressively before reaching the ZLB.

JEL: E32, E52, E61, E62, E63

Keywords: Fiscal Policy, Government Spending, Markov-Perfect Policy, Occasionally Binding Constraints, Time-Inconsistency, Zero Lower Bound

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