Abstract

I study a dynamic model of strategic reform decisions that may affect the stochastic evolution of a publicly observed economic variable. Policy makers try to maximize their public evaluation, which follows a boundedly rational rule for attributing observed outcomes to observed actions. Specifically, the public attributes recent changes to the most recent intervention. I analyze subgame perfect equilibrium in this model for a variety of stochastic processes. In particular, when the economic variable follows a (history-dependent) linear growth trend with noise, equilibrium is essentially unique and stationary, bearing a subtle formal relation to optimal search models. In equilibrium, policy makers tend to act during temporary crises, display risk aversion conditional on acting, and prefer that the random shocks associated with reforms be permanent rather than transient.