

*MBS 98-22*

Credibility May Require Discretion, Not Rules

Tyler Cowen, Amihai Glazer, Katarina Zajc

---

We reexamine the common argument that rules produce greater credibility than discretion. Rules limit the actions of agents, restricting observations of the agents' preferences or types. In a second-best world, where rules cannot be everlasting, a regime of discretion in some periods may produce superior credibility and dominate a regime of rules.