



Stabilizing Role of Fiscal Policy

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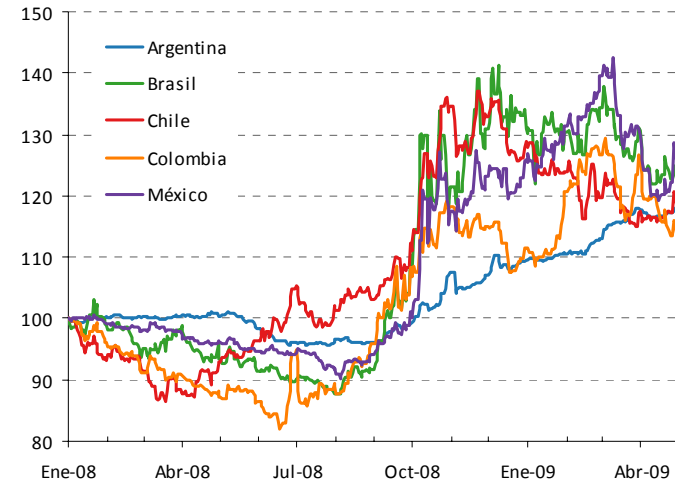


Comments: Alejandro Micco

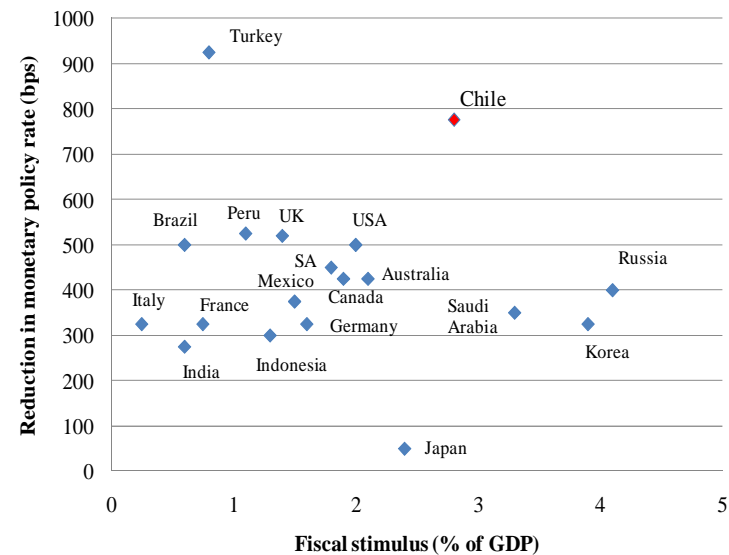
Stabilization Tools

- ▶ Exchange Rate Policy
 - ▶ NER rate movement
- ▶ Monetary Policy
- ▶ Fiscal Policy.
- ▶ **Credit Policy**

Nominal Exchange rate reaction

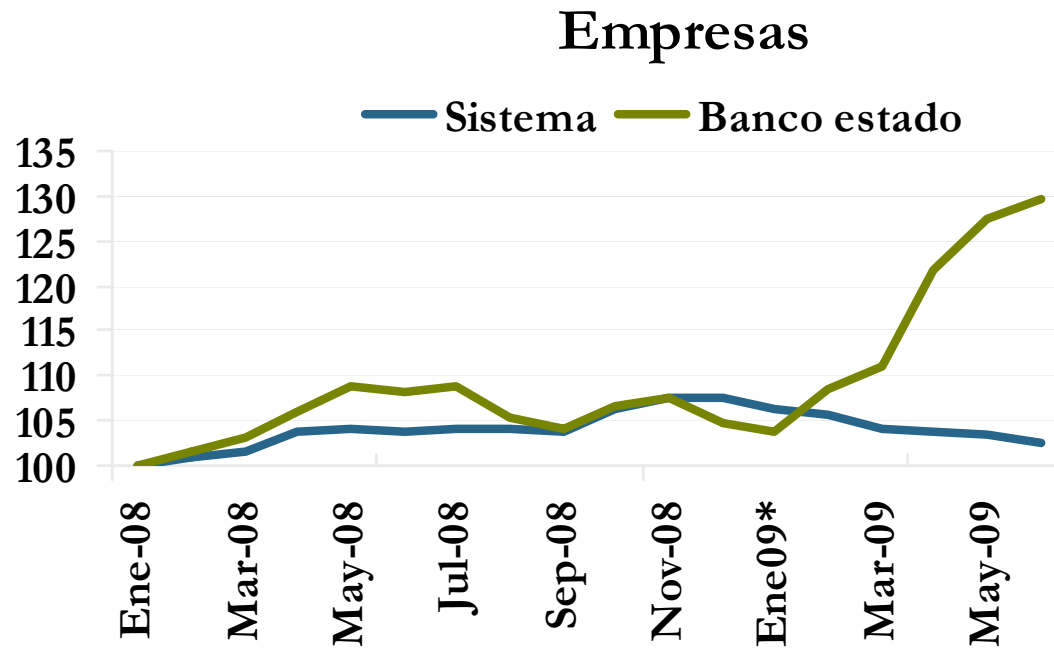


Fiscal and Monetary Policy Stimuli



Liquidity (MP) did not arrive to Firms and households.

- ▶ Lending to the private sector.
 - ▶ Private Bank
 - ▶ State-owned Bank



Capital Inflows Stabilization Tools

- ▶ **Fiscal Policy**
 - ▶ Fiscal rule reduce capital inflows.
 - ▶ but does it have the size and the elasticity required to offset capital inflows?
 - ▶ Elasticity in Chile is low.
- ▶ **Capital Control.**
 - ▶ Distortions / loophole
 - ▶ In mainly in the medium run?
- ▶ **Exchange rate uncertainty?**



Fiscal Policy and business Cycle

- ▶ In the last crisis, not before, FPs were countercyclical.
 - ▶ Structural Change? Luck because we were in a commodity boom?
- ▶ It is difficult to implement



Fiscal revenues are volatile

- ▶ Commodity dependence.

- ▶ Chile: Fiscal Revenues.

- ▶ Impact on FP

- ▶ CC FP and REER vol

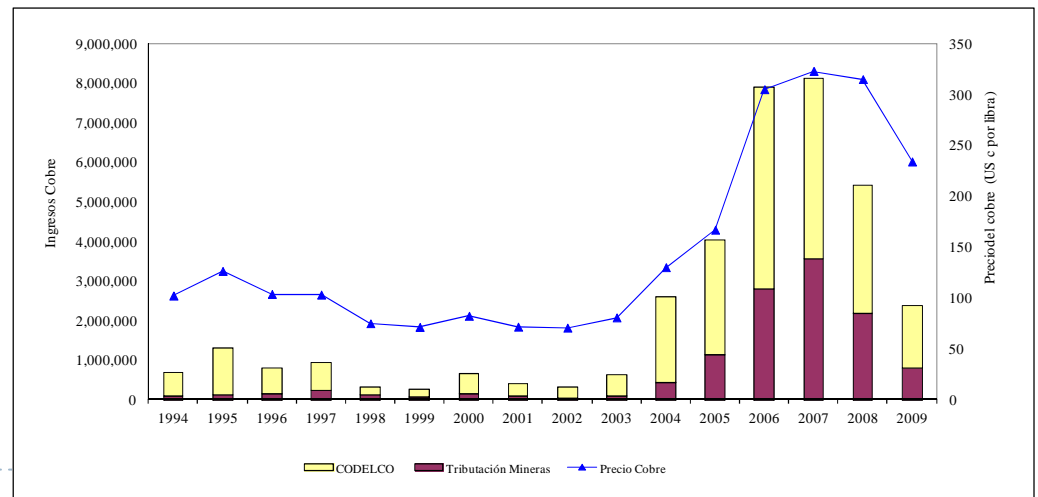
- ▶ Financial system

- ▶ High i

- ▶ Inefficient specialization

Ingresos Presupuesto 2010

	MM\$	MM\$	
Ingresos tributarios netos	17,524,887		75%
Minería Privada		1,608,556	9%
Otros		15,916,332	91%
Cobre Bruto	2,961,943		13%
Previsionales	1,452,835		6%
Rentas Propiedad	425,679		2%
Otros	1,117,033		5%
<hr/>			
Transacciones Financiera:	28,527		0.1%
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Total Ingresos	23,510,904		100%
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Total Mining	4,570,499		19%



Solutions

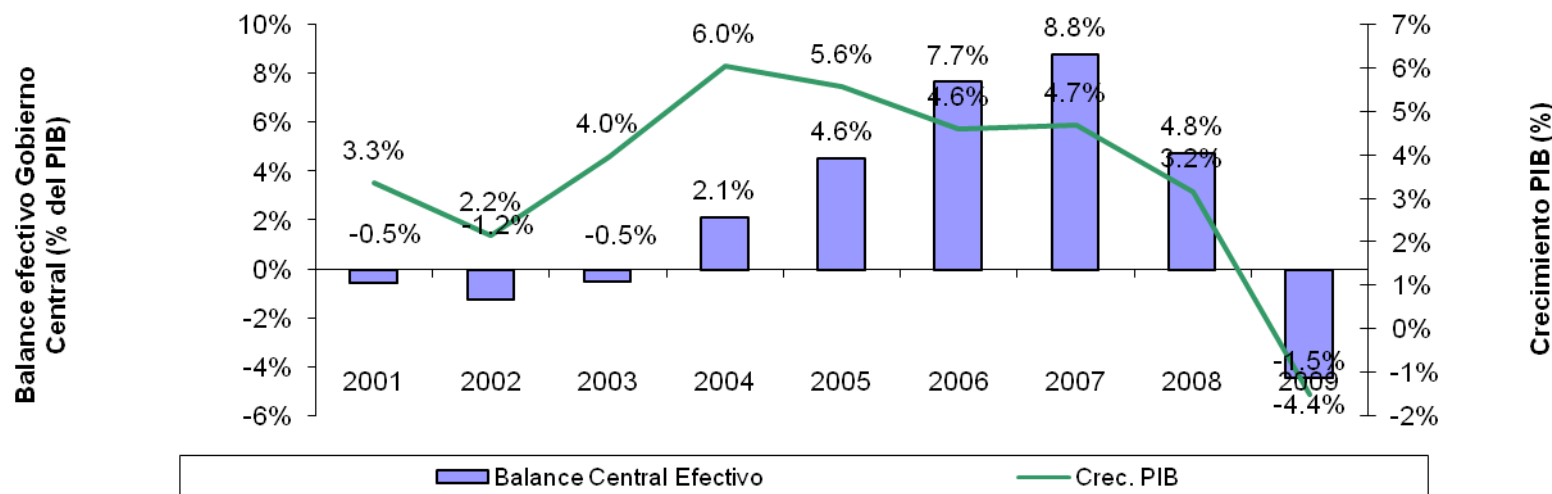
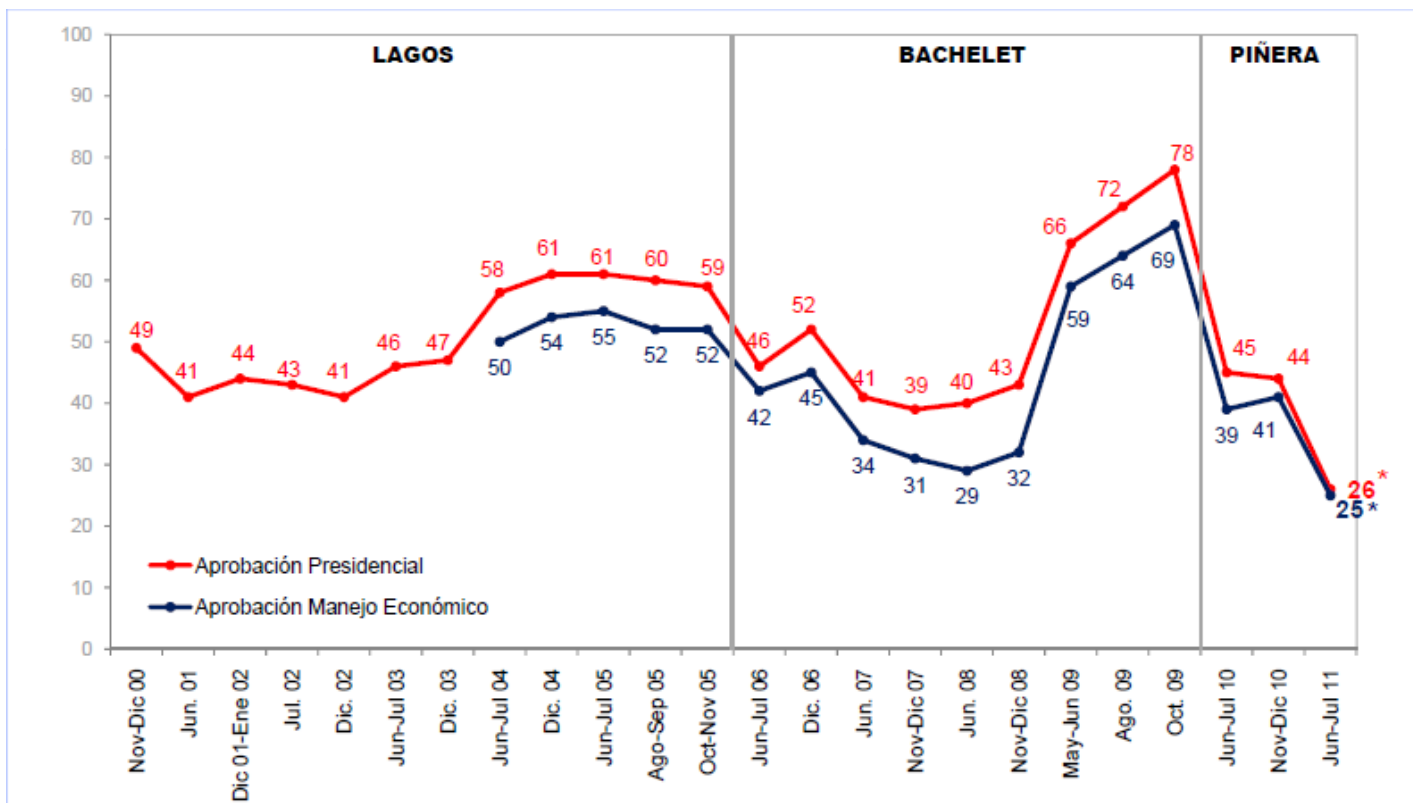
- ▶ Insure the risk
 - ▶ Transfer the risk to foreigners.
 - ▶ Privatization. Very popular!!!
 - ▶ Royalty.
 - Political pressure to increase revenues during good times: Increasing Royalty.
 - ▶ Derivative
 - ▶ Extremely expensive.
 - ▶ High political Risk: Oil and Copper in Chile
 - ▶ Contingent debt
 - ▶ Stabilization Fund / Fiscal Rule



Fiscal rule and Stabilization Fund

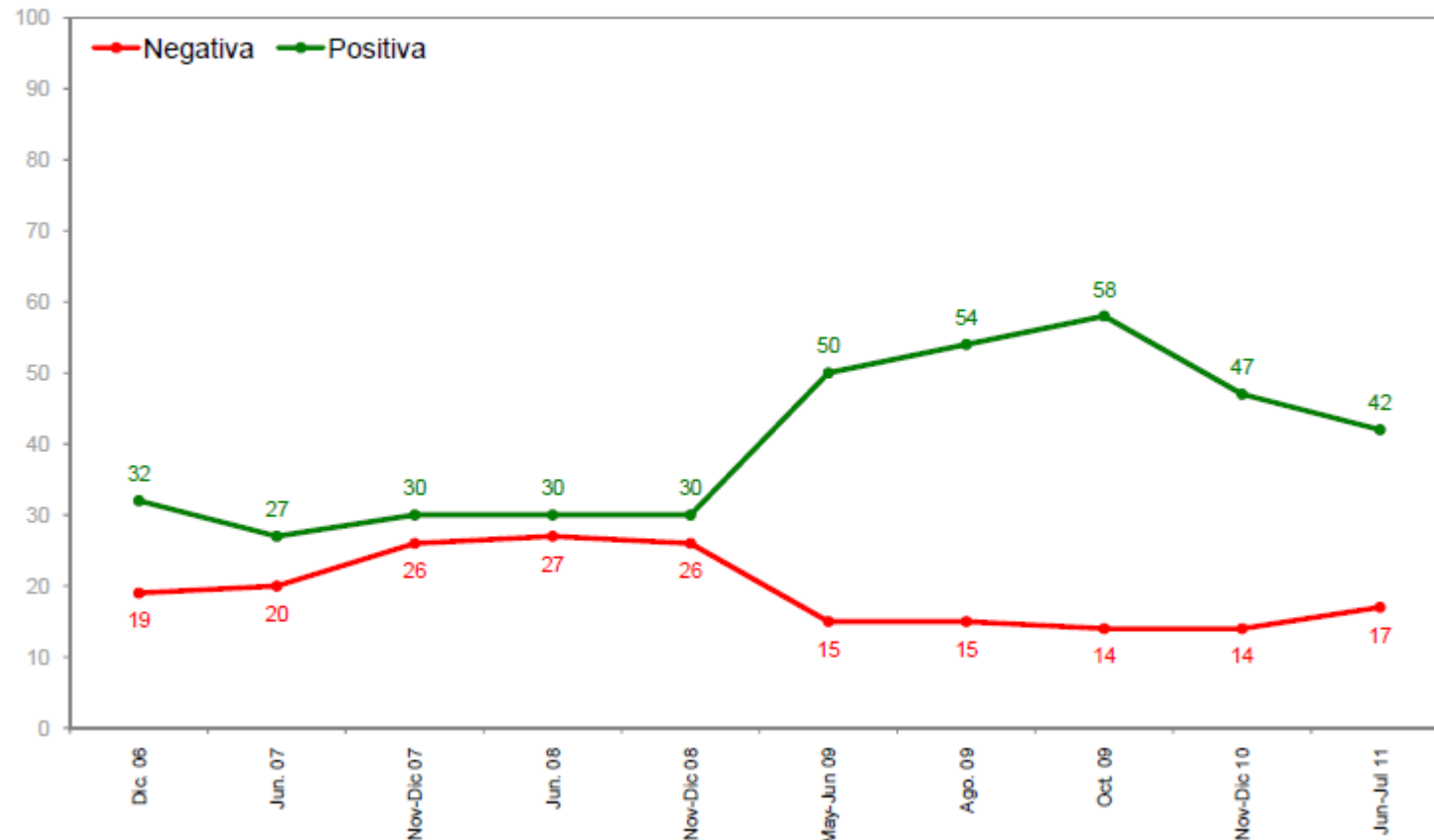
- ▶ Stabilization Fund is different from a Fiscal Rule.
 - ▶ Include different source of risk
 - ▶ Wealth funds should be the result of a Fiscal Rule.
- ▶ Fiscal rule:
 - ▶ Ensure fiscal funds for bad time
 - ▶ Define a long term fiscal policy. Credibility.
 - ▶ Structural balance and/or deficit.
 - Permanent income
 - Discretion.
- ▶ Both have similar political problems





Ministry of Finance (Andrés Velasco): Public Evaluation

- ▶ **Bachelet alaba a Velasco en EE.UU.: Pasó de ser catalogado como "mano de guagua" a un "héroe nacional"**



Fiscal rule and Stabilization Fund

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 - Discretion.
- ▶ Both have similar political problems
- ▶ Although Fiscal Rule help the political process
 - ▶ Define how much you can spend in a given year: Budget discussion.
 - ▶ The public opinion need to understand.
 - ▶ Discussion becomes how you divide the cake.

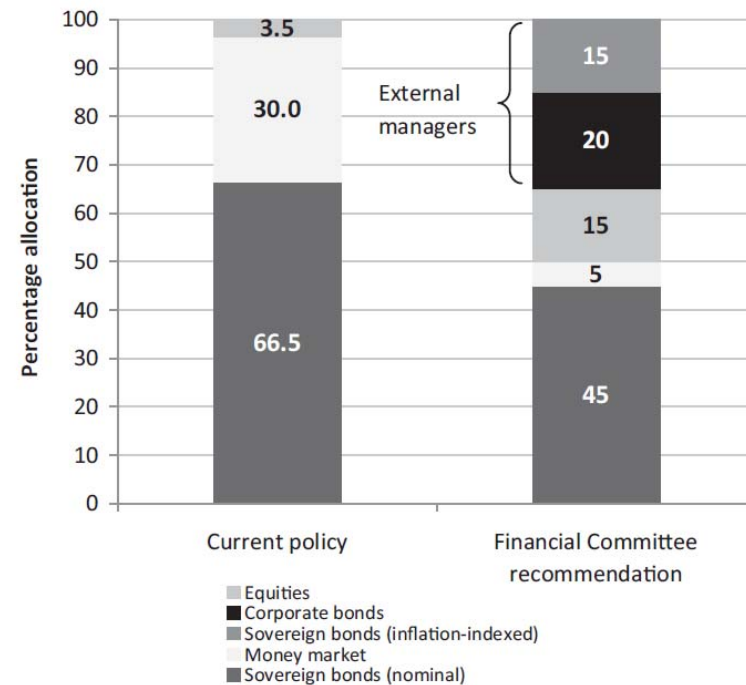
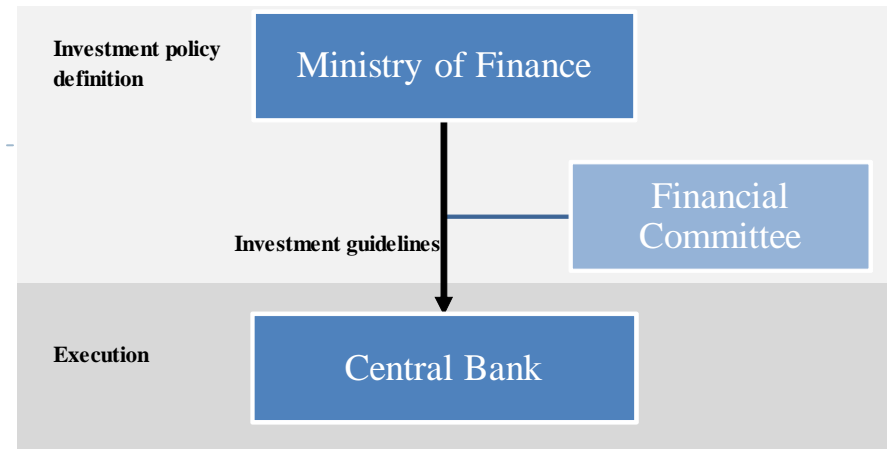


Institution

▶ Institutional Arrangement

- ▶ Reduce the probability to change the FR.
- ▶ Reduce the political problem to define expectation about future income.
- ▶ Reduce the political cost to have a risky strategy.
- ▶ Externalize the political cost to have a negative returns.

▶ Investment Policy



Source: Ministry of Finance.

Figure 19B.7 Current Investment Policy vs. Financial Committee Recommendation

But you cannot construct institution in one day.

