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 Band
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

### Chile: Fiscal Revenues

<table>
<thead>
<tr>
<th>Ingresos Presupuesto 2010</th>
<th>MM$</th>
<th>MM$</th>
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<tbody>
<tr>
<td>Ingresos tributarios netos</td>
<td>17,524,887</td>
<td>75%</td>
</tr>
<tr>
<td>Minería Privada</td>
<td>1,608,556</td>
<td>9%</td>
</tr>
<tr>
<td>Otros</td>
<td>15,916,332</td>
<td>91%</td>
</tr>
<tr>
<td>Cobre Bruto</td>
<td>2,961,943</td>
<td>13%</td>
</tr>
<tr>
<td>Previsionales</td>
<td>1,452,835</td>
<td>6%</td>
</tr>
<tr>
<td>Rentas Propiedad</td>
<td>425,679</td>
<td>2%</td>
</tr>
<tr>
<td>Otros</td>
<td>1,117,033</td>
<td>5%</td>
</tr>
<tr>
<td>Transacciones Financiera:</td>
<td>28,527</td>
<td>0.1%</td>
</tr>
<tr>
<td>Total Ingresos</td>
<td>23,510,904</td>
<td>100%</td>
</tr>
<tr>
<td>Total Mining</td>
<td>4,570,499</td>
<td>19%</td>
</tr>
</tbody>
</table>

![Graph showing Ingresos Cobre (US c por libra) and Precios de Cobre over years 1994 to 2009](image)
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
Bachelet alaba a Velasco en EE.UU.: Pasó de ser catalogado como "mano de guagua" a un "héroe nacional"
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- **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 198.7  Current Investment Policy vs. Financial Committee Recommendation
But you cannot construct institution in one day.