SOME COMMENTS TO "OIL-DEPENDENT REVENUES AND MACROECONOMIC STABILITY UNDER FISCAL AND MONETARY RULES: AN ANALYSIS FOR MEXICO"

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SUMMARY

The paper studies the impact on macro stability of alternative fiscal rules for an oil-producer country

- Framework:
  - A Small Open Economy that displays key features of an **oil-producing** country like Mexico
    - *High dependence of govt revenues on oil price fluctuations*
    - *Energy prices set by the govt*
  - A **monetary authority** that follows an **optimal** stabilization **rule**

- Key question: What is the impact of alternative **fiscal rules** on **macroeconomic stability?**
    - Balanced Budget vs Structural Balance

- Main findings:
  - The two fiscal rules perform **similarly** in response to domestic shocks (**cost-push** and **demand**)
  - But **Structural Balance** rule achieves **higher stability** in response to external **oil-price shocks**
  - Similar results if energy prices were liberalized

GENERAL OBSERVATIONS

1. Paper addresses a **relevant issue**…
   - Design of **policy rules** that foster **macro stability** is key for **commodity-producer countries**
     - *Their dependence on **highly volatile commodity prices** constitutes a **specific threat to macro stability***

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2. … an issue that is especially significant and **timely** for **Mexico**
   - o One of the **most vulnerable** commodity-exporters from the fiscal side
     - *Highest fiscal revenues from non-renewable resources as a share of GDP in LatAm*
   - o Its pro-cyclical **Balanced Budget fiscal rule** has been criticized for **not** contributing to **macro stabilization** and is currently being **replaced** in the context of the recently-approved **fiscal reform**

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3. **Methodologically sound** analysis
   - o Embeds features of oil-producing economies in McCallum and Nelson (1999) framework
   - o Carefully estimated to match features of the Mexican economy

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- Paper fits in the **literature** that studies optimal **policy for commodity-producer** countries
- Not the first one to study in simulations the impact of **fiscal rules** on **stability** for these countries
  - Kumhof and Laxton (2009)
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       - Allows to study how the **fiscal rule** in place can **constrain** the ability of an **optimizing Central Bank** to stabilize the oil-producing economy
       - First paper to look at appropriateness of fiscal rule in commodity-producer countries assuming an optimizing CB with a stabilization objective

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  2. Take into account the **energy pricing policy** and study how its **removal** can **complicate** the CB stabilization mandate
  3. Consider the effects of several shocks
  4. Application to the Mexican economy

COMMENT 2: ON THE CHANNELS OF SHOCKS TRANSMISSION

In the model, several **shocks** constitute potential threats to macro stability. Does the model take into account **all the channels** through which these shocks can impact the oil-producer economy?

- In the model, **fluctuations in oil prices** impact the economy only through the fiscal budget, by altering govt oil revenues
  - Literature has estimated that **increases in oil prices**, when driven by contractions in oil supply or by increases in oil-specific demand, have a negative impact on **global output**
  - Fall in **global demand** can decrease **exports**, with an indirect, lagged, second round effect on the oil-producer country
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- In int'l markets, oil is priced in USD. Therefore, after any shock, fluctuations in the **exchange rate** should have an additional impact on govt oil revenues
  - Does the model take this exchange rate channel of shocks propagation into account?

COMMENT 3: ON THE TRADEOFFS

- Paper shows that fiscal rule in place can constrain the ability of an optimizing Central Bank to stabilize the oil-producing economy

- No **tradeoff** between the two rules that are compared
  - **Balanced Budget** rule is pro-cyclical, increases govt spending in good times therefore amplifying cyclical fluctuations by construction
  - We expect it to have a **worse performance than the Structural Balance rule** in terms of macro stability

- Worth to introduce some tradeoff between fiscal rules in future research?
  - A suggestion in the next slide

COMMENT 4: ON THE UNCERTAINTY IN THE ESTIMATION OF STRUCTURAL COMPONENTS

- A-cyclical fiscal rules like **Structural Balance** require **identifying** the **structural** and **temporary components** of output and oil price fluctuations

- Recent research has shown that in practice this identification is subject to considerable **uncertainty**
  - **Structural estimates** of potential output vary with the method, are subject to large margins of errors
  - Use of **filtering techniques** complicated for EMEs by the fact that shocks to trend GDP growth are often the main source of fluctuations, which tends to blur the distinction between trend and cycle
  - Temporary fluctuations difficult to identify in periods in which the **LR component changes** – which might actually be the case for **commodity prices** whose increasing super-cycle is projected to end

- Can uncertainty in the estimation of cyclical components introduce a relevant tradeoff btw alternative fiscal rules?
- Can a Structural Balance rule with wrong estimates end up accumulating too much debt and destabilizing the economy?

Thanks for your attention

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