COMMENTS ON SESSION 3
FISCAL POLICY AND MACROECONOMIC IMBALANCES
IN EMERGING ECONOMIES AND RESOURCE-RICH COUNTRIES

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We would like to thank Banca d'Italia for the opportunity to contribute to this excellent workshop by providing our comments on last two papers of Session 3, prepared by the representatives of Bank of Columbia and IMF. Both papers investigate empirically macroeconomic effects of fiscal policy in Emerging market economies (*EMs*). It was very interesting to read them since implications can be applied to Russia. We will take up these papers in turn, covering the motivation, the main results and our comments on the papers.

Comments on "Macroeconomic Effects of Structural Fiscal Policy Changes in Colombia" by Hernando Vargas, Andrés González and Ignacio Lozano

The paper prepared by Vargas, González and Lozano indicates uncertain state of public finances in Colombia by the end of 1990s both because of the high level of budget deficit, public debt, interest payments, etc., and due to the fact that the main fiscal indicators were on the wrong path. The fiscal adjustment in 2000s allowed to reduce structural budget deficit, decrease government currency mismatch, deepen local fixed-rate public bond market. The motivation of the paper is to assess macroeconomic effects of these improvements:

- on the sovereign risk premium;
- on the short run response of output to government expenditure shocks;
- on the transmission of monetary policy shocks to market interest rates.

By applying different econometric techniques authors test the relationships over 1999-2011 and come to the following conclusions. First, the reduction in the public debt-to-GDP ratio and government currency mismatch has contributed to a permanent drop in the sovereign risk premium and to a decline in its sensitivity to global risk aversion shocks. Moreover, the calculations show that the most of this dynamics is the result of the local factors' impact. Secondly, in Colombia throughout the 2000s there was an increase in the power of public spending to affect output which allows authors to conclude that there is a direct dependence between the soundness of public finances and the effectiveness of government spending shocks. Thirdly, the improvement in the state of public finances and increase in the credibility of Colombian monetary policy throughout the 2000s allowed to reinforce the transmission of monetary shocks both to public bonds and financial system interest rates, and 2004 is indicated as a transitional year.

Finally here are several comments on the paper. First, let us ascertain that the data used for estimations is seasonally adjusted. There are some doubts since we found no mention of this fact in the text while some series presented on the graphs definitely display seasonality (currency mismatch, difference between actual and debt-stabilizing primary balances, etc.).

Second, for the estimations authors use the data for the central government, while it is worthwhile to use those for the general government level. This should allow to capture the full effect of the fiscal policy, while otherwise inaccuracy and unrobustness of the results are possible. To illustrate this, in the paper authors draw a conclusion on the cyclicality of fiscal policy in

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Fiscal Policy Cyclicality on the Different Levels of the Russia's Budget System, 2001-15
*(change in structural non-oil-and-gas primary balances: percent of GDP
(positive value indicates balance decrease), change in output gap: percent of potential GDP)*
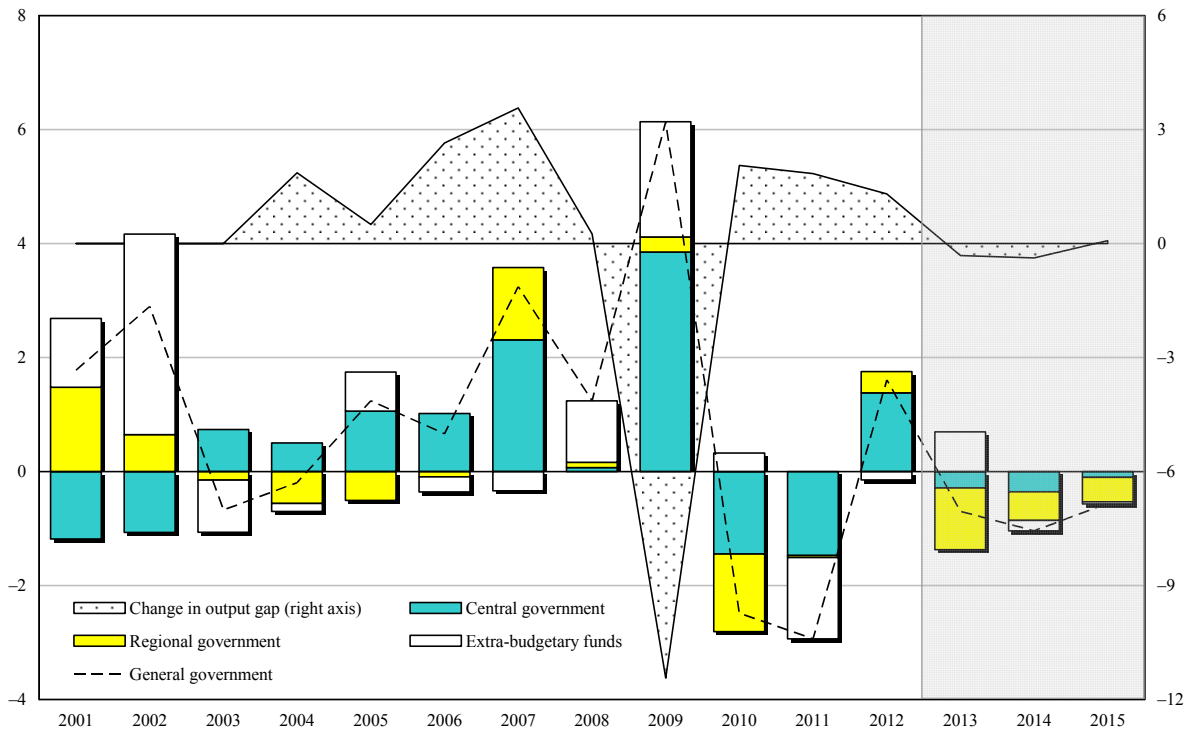
Colombia. Our calculations made for Russia show that the estimates of the fiscal policy cyclicality can differ significantly for the central and general government, particularly they were opposite in 2001-2004 (see Figure 1 for the estimates of fiscal policy cyclicality on the different levels of the Russian budget system over 2001-15 and Vlasov (2012) for the employed methodology).

Third, concerning modeling of the second and third effects the following sentence from the text is highly arguable: "An unexpected increase in public expenditure may prompt an expectation of higher taxes in the short run in a dire financial situation of the Government, thereby offsetting its possibly expansionary effect on output." (Vargas *et al.*, 2013). It seems important to note that identification of structural shocks basing on deviations between projected and actual values of fiscal indicators may be hindered by market inefficiency in EMs, at least this should be fair in the Russian case.

Also while reading the text we got the impression that authors treat currency depreciation as one of the main threats to be prevented. In this respect the following paper stands up for a rather opposite view.

Comments on "Real Exchange Rate Appreciation in Emerging Markets: Can Fiscal Policy Help?" by Marialuz Moreno Badia and Alex Segura Ubiergo

The motivation of the paper prepared by Badia and Ubiergo is the sizeable currencies appreciation in recent years in a number of EMs that resulted from the terms of trade gains, large

Figure 2

Developments of the Russian Ruble's Real Effective Exchange Rate
(monthly, percent, January 1999=100 per cent)
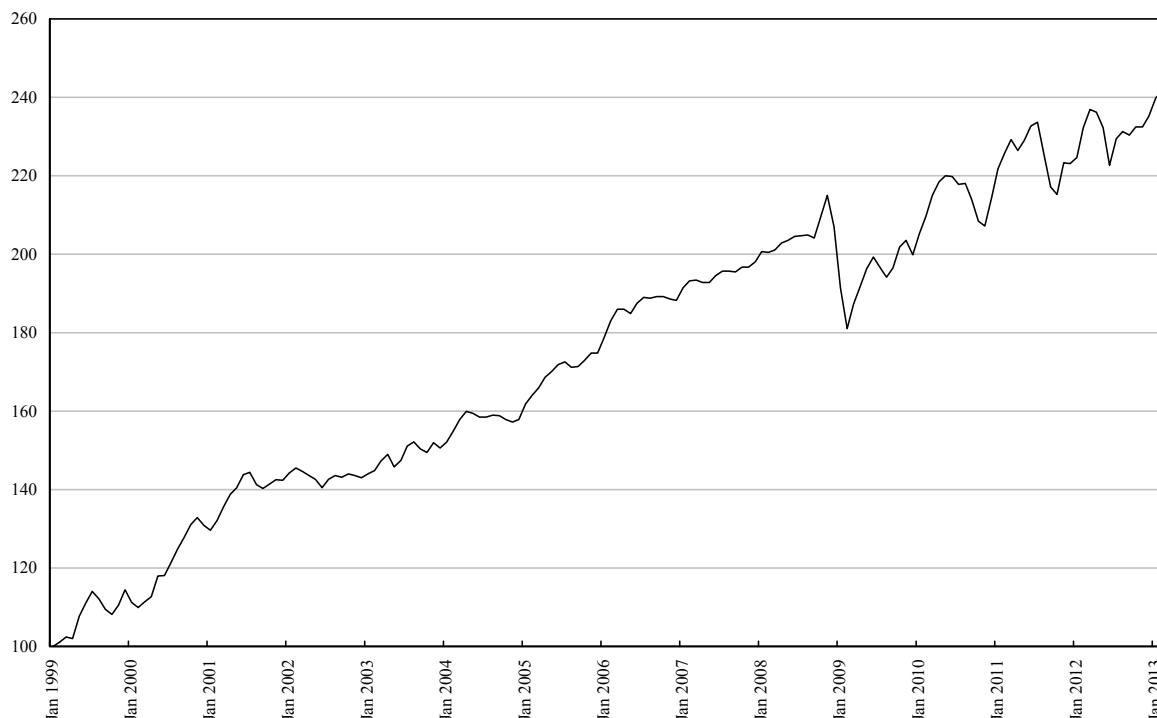
capital inflows, etc., and led to a loss of competitiveness of export-oriented companies. The paper discusses to what extent can fiscal policy actions help contain exchange rate appreciation pressures in EMs with the special focus on Brazil.

Just to add up to the motivation Figure 2 presents the developments of the Russian ruble's real effective exchange rate (*REER*) and real exchange rate against US dollar. With the exception of the crisis period there is a continuous ruble's REER appreciation since the beginning of 2000s. The background is large-scale oil-and-gas budget revenues against relatively low standard of living that followed crazy 1990s in Russia. Insufficient savings of resource revenues in the sovereign funds and limited efficiency of the Central Bank's instruments contributed to asymmetrical development of oil-and-gas and non-oil-and-gas sectors of the Russian economy.

Using a sample of 28 EMs for the period 1983-2011, authors estimate a panel dynamic OLS model of the real exchange rate. Baseline model includes five explanatory variables: 1) Relative GDP per capita (*GDPPC*); 2) Balance of goods and services (*TB*); 3) Structural balance (*SB*); 4) Relative public consumption (*PC*); 5) Relative public investment (*PI*).

The estimations allow Badia and Ubiergo to come to the following conclusions applied for the long run. First, they show that appreciation pressures can be reduced by permanent fiscal adjustment: a 1 per cent of GDP increase in the structural balance would imply a depreciation of the real exchange rate of 1.7 per cent. The second finding is that the composition of public spending matters: the increase in relative government investment leads to REER depreciation and government consumption does not have a significant effect. An illustration for Brazil means that a 1 percentage point increase in relative public investment would mean increasing public investment

by 7.5 percentage points of GDP and would be associated with 12.6 per cent depreciation of the real exchange rate. While the former finding is in line with the existing literature the latter is in contrast with the findings for the advanced economies where public consumption appreciates the real exchange rate and public investment does not have an effect. An explanation for this difference given by the authors is that public investment is more likely to increase productivity in the nontradable sector among EMs given likely lower levels of infrastructure development. An additional argument is that EMs have relatively higher public investment and lower public consumption compared to advanced economies.

Finally, we would like to produce some comments on the paper. First, let us inquire about the results of multicollinearity testing since there are some doubts about the correlation between PC, PI and SB indicators.

Second, since both fiscal and monetary policy simultaneously affect fluctuations in macroeconomic variables it seems worthwhile to try to introduce as an explanatory variable any monetary indicator, for example, interest rate. This will allow to control for monetary policy effect (for example, see Mountford and Uhlig, 2009, and Rossi and Zubairy, 2011). Another suggestion that can improve the model is to employ public debt, possibly instead of structural balance indicator.

Third, as for the representative of the oil-producing country, it's of particular interest whether the public investment effect on REER is fair for oil-producing countries on a par with the others presented in the sample, since such countries are characterized by a special structure of export, capital flows, etc., and economic development at all.

Moreover, we believe some description is required of the results for GDPPC and TB indicators since nothing is presented in the text. The special interest is for the second specification, that is characterized by the largest number of observations and the wrong sign of coefficient associated with the relationship between GDPPC and REER.

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