Public Expenditure And Consumption Volatility

Prior to the launch of the euro, academics and policymakers were concerned that the loss of the monetary policy instrument would deprive participating countries of a vital tool to respond to country-specific economic shocks. This concern was rooted in the generally accepted proposition that market-based adjustment channels - i.e. labour mobility and capital flows - tended to be weaker among euro area countries than among regions of existing monetary unions such as the United States. Automatic stabilizers had long been regarded as playing a key role in macroeconomic stabilization. In particular, they were generally considered as having contributed significantly to the decrease of output volatility witnessed in Europe and in the United States after World War II, when the size of governments increased substantially on both sides of the Atlantic. Hence it was hoped that improved national fiscal policy could partly make up for the loss of monetary policy in stabilizing national macroeconomic conditions. The aim of the paper is to discuss this issue in the light of recent experience.

After more than a decade of strong growth, interrupted only by the 2008-2009 global financial crisis, Belarus’ economy has encountered major headwinds. Since 2012, growth has stalled, macroeconomic imbalances have intensified, and public finances have deteriorated. Unlike regional peers, the country was unable to take advantage of buoyant global demand, ample liquidity and strong risk appetite. This suggests that the causes for this disappointing outcome are domestic and rooted in the current economic model based on an outsized public sector and reliance on Russia for cheap energy and as main export market. The narrow export base has left the economy vulnerable to economic weakness in Russia and, indirectly, to volatility in global oil prices. These shocks have exposed major structural weaknesses, that have dragged down productivity and potential growth and increased Belarus’ vulnerability to major shocks such as the Coronavirus (COVID-19) pandemic. The policy response to the external headwinds has been pro-cyclical. It has focused on avoiding major financial disruptions and resorting to increased foreign borrowing to make it through the financing pressures rather than deeper structural adjustment needed to adjust to the new realities and anchor fiscal sustainability. It has focused on exchange rate adjustment accompanied by ad-hoc fiscal retrenchment. The latter, however, although significant, has been episodic and less than optimal as it has protected consumption at the expense of investment. The scope for fiscal adjustment has been constrained by the structural rigidities of Belarus’ public finances. Looking forward, Belarus now faces a perfect storm of a global economic shock caused by the Coronavirus (COVID-19) pandemic, an unprecedented drop in oil prices, and the phasing out of the energy import price discount by 2024 due to the Russian tax maneuver. All these adverse external developments come against the background of deeply rooted structural rigidities, a heavy debt redemptions schedule and a much-reduced policy space compared with previous episodes of external pressures such as in 2009 and 2015.

Recent estimates of the welfare cost of consumption volatility find that it is significant in developing nations, where it may reach an equivalent of reducing consumption by 10 percent per year. Hence, examining the determinants of consumption volatility is of utmost relevance. Based on cross-country data for the period 1960-2005, the paper explains consumption volatility using three sets of variables: one refers to the volatility of income and the persistence of income shocks; the second set of variables refers to policy volatility, considering the volatility of public spending and the size of government; while the third set captures the ability of agents to smooth shocks, and includes the depth of the domestic financial markets as well as the degree of integration to international capital markets. To allow for potential endogenous regressors, in particular the volatility of fiscal policy and the size of government, the system is estimated using the instrumental variables method. The results indicate that, besides income volatility, the variables with the largest and most robust impact on consumption volatility are government size and the volatility of public spending. Results also show that deeper and more stable domestic financial markets reduce the volatility of consumption, and that more integrated financial markets to the international capital markets are associated with lower volatility of consumption. Following the onset of the global economic crisis in 2008, SACU member countries have witnessed a significant growth slowdown, and a deterioration of their fiscal balances. This paper (i) assesses options for the design of the needed fiscal consolidation, and (ii) discussed medium-term fiscal policy rules that would help maintain a sound fiscal stance once consolidation has taken place. The main messages are: (i) government consumption cuts appears to minimize the negative impact on growth, and would be appropriate given the relatively large size of the public sector in each country, (ii) fiscal rules could be of particular interest for SACU members notably, a new customs revenue-sharing formula, procedural rules to strengthen budget process, and numerical rules at the national level. Natural resource revenues provide a valuable source to finance public investment in developing countries, which frequently face borrowing constraints and tax revenue mobilization problems. This paper develops a dynamic stochastic small open economy model to analyze the macroeconomic effects of investing natural resource revenues, making explicit the role of pervasive features in these countries including public investment inefficiency, absorptive capacity constraints, Dutch disease, and financing needs to sustain capital. Revenue exhaustibility raises medium-term issues of how to sustain capital built during a windfall, while revenue volatility raises short-term concerns about macroeconomic instability. Using the model, country applications show how combining public investment with a resource fund—a sustainable investing approach—can help address the macroeconomic problems associated with both exhaustibility and volatility. The applications also demonstrate how the model can be used to determine the appropriate magnitude of the investment scaling-up (accounting for the financing needs to sustain capital) and the adequate size of a stabilization fund (buffer). The extractive industries (EI) sector occupies an outsize space in the economies of many developing countries. Policy makers, economists, and public finance professionals working in such countries are frequently confronted with issues that require an in-depth understanding of the sector, its economics, governance, and policy challenges, as well as the
implications of natural resource wealth for fiscal and public financial management. The objective of the two-volume Essentials for Economists, Public Finance Professionals, and Policy Makers, published in the World Bank Studies series, is to provide a concise overview of the EI-related topics these professionals are likely to encounter. This second volume, Fiscal Management in Resource-Rich Countries, addresses critical fiscal challenges typically associated with large revenue flows from the EI sector. The volume discusses fiscal policy across four related dimensions: short-run stabilization, the management of fiscal risks and vulnerabilities, the promotion of long-term sustainability, and the importance of good public financial management and public investment management systems. The volume subsequently examines several institutional mechanisms used to aid fiscal management, including medium-term expenditure frameworks, resource funds, fiscal rules, and fiscal councils. The volume also discusses the earmarking of revenue, resource revenue projections as applied to the government budget, and fiscal transparency, and outlines several fiscal indicators used to assess the fiscal stance of resource-rich countries. The authors hope that economists, public finance professionals, and policy makers working in resource-rich countries—including decision makers in ministries of finance, international organizations, and other relevant entities—will find the volume useful to their understanding and analysis of fiscal management in resource-rich countries.

Public Expenditure and Consumption Volatility

Chapters one and two of the dissertation investigate the effects of political disagreement on macroeconomic outcomes. I introduce a model of governments with heterogeneous preferences over the composition of consumption between private and public goods alternating in power. Unable to commit to future policies, the party in power has incentive not only to shape consumption according to their preferences but also to manipulate the future state faced by successive governments to influence the decisions of future policy makers. Alternating governments give rise to political business cycles; fluctuations in economy-wide variables due to the political system. Political business cycles help explain the divergence in outcomes of economic variables across countries with different levels of political disagreement and political stability. The first chapter adopts a real business cycle model to include political shocks in addition to the productivity shocks. This is motivated by a key puzzle in the business cycle literature: for emerging economies the volatility of consumption is higher than the volatility of output, a feature of the data that is not explained by standard theory. The goal of this chapter is not only to replicate the data but to understand how consumption responds to political shocks differently than shocks to productivity. This model is also able to recreate endogenously the high level of volatility in government expenditure observed in the data. The model can explain up to 29% of the variation in the relative volatility of consumption across countries. Chapter two focuses on a similar model in the presence of debt instead of capital to develop a positive theory for fiscal policy (debt, expenditure, and deficits) over the business cycle to compare to historical observation. I find that political shocks are important to understand observed U.S. data moments. Chapter three investigates the welfare effects of tax-deferred retirement accounts (similar to Traditional IRAs in the US). I find that such accounts increase aggregate welfare as well as increasing economy-wide inequality. I find from an aggregate welfare perspective the optimal contribution limit for IRAs is to not have a contribution limit.

This paper constructs a general equilibrium model with monopolistically competitive firms and endogenous markups where government spending consists of both consumption and investment goods. It is shown that when markups are counter-cyclical, increases in the share of investment goods in aggregate government expenditure entail a trade-off between greater long-run efficiency and higher short-run volatility. Estimates based on the model, calibrated to the postwar U.S. economy, show that the effects on output, employment, and welfare can be significant.

This paper examines the effect of stabilization funds on the volatility of government expenditure in resource-rich countries. Using a panel data set of 68 resource-rich countries over 1988–2012, the results find that the existence of stabilization funds contributes to smoothing government expenditure. The spending volatility in countries that have established such funds is found to be 13 percent lower in the main estimation, and similar impacts are found in robustness tests. The analysis also shows that political institutions and fiscal rules are significant factors in reducing the expenditure volatility, while highlighting the roles of the size of economy, diversified exports, real sector management, and financial markets.

Advances in Food Security and Sustainability, Volume Five, takes a scientific look at the challenges, constraints and solutions necessary to maintain a healthy and accessible food supply in different communities. This ongoing series addresses a wide range of issues on food sustainability and security, exploring challenges related to protecting environmental resources while also meeting human nutritional requirements. Contains expertise from leading contributors on the topics Covers a vast array of subjects relating to food security and sustainability Explores challenges related to protecting environmental resources while also meeting human nutritional requirements Over the past decade, Lesotho and Swaziland have faced significant volatility in their fiscal revenues, owing to highly unstable Southern African Customs Union (SACU) receipts. Based on model analysis, this paper explores the advantages of implementing fiscal rules to deal with such volatility. It finds that the use of a structural balance target could smooth the growth impact from revenue shocks while helping preserve sufficient international reserves during bad times. From a long-term perspective, it suggests possible welfare gains from introducing fiscal rules. Last, it concludes that, based on experiences in other countries, developing strong institutions and improving public financial management are necessary steps to ease the transitions to a rules-based fiscal policy framework.

This exercise and solutions manual accompanies the main edition of Introduction to Computational Economics Using Fortran. It enables students of all levels to practice the skills and knowledge needed to conduct economic research using Fortran. Introduction to Computational Economics Using Fortran is the essential guide to conducting economic research on a computer. Aimed at students of all levels of education as well as advanced economic researchers, it facilitates the first steps into writing programming language. This exercise and solutions manual is accompanied by a program database that readers are able to download.

This paper analyzes the tradeoffs between savings, debt and public investment in the Republic of Congo, a developing country with looming oil exhaustibility concerns. Our results highlight the risks to fiscal and capital sustainability of oil exporting countries from large scaling-up in public investment and oil price volatility in view of a projected decline in the oil revenue to GDP ratio. However, structural reforms that improve the efficiency of public investment can allow for a relatively faster buildup of sustainable public capital and sustain higher non-oil growth without adversely affecting the debt ratio or savings. Moreover, we show that even if a government pursues prudent fiscal policy that preserves resource wealth and debt sustainability in the face of exhaustible and volatile resource revenues, low public investment quality in the form of a misallocation of resources can hinder attainment of sustainable public capital and positive non-oil growth.

This paper estimates the causal effect of fiscal rules on political budget cycles in a sample of 67 developing countries over the period 1985–2007. We exploit the geographical pattern in the adoption of fiscal rules to isolate an exogenous source of variation in the adoption of national fiscal rules. Based on a diffusion argument, we use the number of other countries in a given subregion that have fiscal rules in place to predict the probability of having them at the country level. We find that in election years with fiscal rules in place, public consumption is reduced by 1.6 percentage point of GDP as compared to election years without these rules. This impact is equivalent to a reduction by a third of the volatility of public consumption in our sample. Furthermore, the effectiveness of these rules depends on their type, their institutional
design, whether they have been in place for a long time and finally on the degree of competitiveness of elections.

Paraguay: Addressing the Stagnation and Instability Trap provides an overview of the analytical insights and policy challenges that a country faces while on the path to sustained growth with stability. It covers a wide range of themes, including improving macroeconomic assessments and policy implementation, eliminating turbulence and deepening financial reforms, and, most important of all, enhancing growth performance and reducing poverty. This book provides useful guidance for policymakers by examining the improvements in policy implementation in Paraguay since the regional crisis of 2002. The chapters discuss how to correct economic imbalances and institutional shortcomings in the context of an economic reform program. The results have been impressive with the Paraguayan economy experiencing the highest growth in a quarter of a century and the strongest financial system in decades.

Despite improved macroeconomic fundamentals, this 2009 edition of OECD's periodic survey of the Mexican economy finds that Mexico is being hit hard by the financial crisis and world economic downturn. In addition to a chapter examining how to ...

The Kyrgyz Republic suffered severe shocks during the early years of independence, loosing its traditional markets in the Former Soviet Union republics, as well as substantial transfers and subsidies from the Soviet Union, that included a falling GDP during the first five years of transition. These circumstances prompted the Kyrgyz Republic to adopt a wide range of reforms to accelerate the transition to a market economy, emphasizing price and wage liberalization, and the shift of ownership of state assets to the private sector, including land, and most state-owned enterprises (SOEs). Since the mid-1990s, the economy has shown steady signs of recovery. Despite these favorable developments, the Kyrgyz Republic remains the second poorest of the FSU republics, and one of the poorest countries in the world. Absolute poverty affected about half of the population in spite of progress made in 2001, and, although poverty is highest in rural areas, there are large regional disparities, where transient poverty is high as a result of high consumption volatility. Access to public services such as water and sewerage, electricity, district heating, and telecommunication services, is very low. This Public Expenditure Review (PER) has sought to provide a strategic framework for fiscal adjustment and public expenditure reform, consistent with the government's objectives for accelerated growth and poverty reduction. The broad contours of the strategy are: To stabilize the government's finances through stronger revenue, and expenditure management instruments and institutions, as well as through debt relief; to re-align sector policies with the most essential country priorities, with a general thrust toward improving targeted, and efficient use of resources in both social and public infrastructure sectors; to revamp the public administration to improve policy implementation and service delivery; and, to secure external financial support. Given the fragile external debt situation and the extent of poverty, priority has to be given to fiscal adjustment and the expenditure reform agenda. Government performance needs to be monitored, particularly at the grass roots levels, through systematic diagnoses of institutional problems, and through quantitative performance indicators, to monitor progress and competition in public service delivery.

Since the 1990s, several emerging market and developing economies (EMDEs) have, to varying degrees, embraced the process of financial globalisation, broadly defined as a set of policies that involve allowing for greater openness to cross-border capital flows as well as greater market access to foreign financial institutions. This book provides a systematic empirical analysis on the complex interactions between fiscal policy, financial development, macroeconomic stability, and foreign direct investment flows and their real impacts in EMDEs. Each of the chapters analyse important economic policy issues of contemporary relevance and is informed by data and rigorous empirical analysis. The book will be appealing to anyone interested in exploring the implications of a key set of issues emanating from financial globalisation on EMDEs in a rigorous but readable manner.

This paper examines fiscal cyclicality in the CEMAC region during 1980-2008. The issue has attracted very little empirical interest but is important if fiscal policies are to play a role in mitigating external shocks that exacerbate economic cycles across the region. We assess whether fiscal policies across these six countries have been procyclical using panel data to elaborate our analysis. Like in other sub-Saharan countries, total public expenditure in the CEMAC is found to be strongly procyclical. This is most pronounced for public investment, which overreacts to output growth with elasticity above 1. We further find that institutional weaknesses and poor governance partly explain this behavior. In contrast, the existence of an IMF-supported program can be a countervailing influence in attenuating this bias.

The paper revisits the link between fiscal policy and macroeconomic stability. Two salient features of our analysis are (1) a systematic test for the government's ambivalent role as a shock absorber and a shock inducer—removing a downward bias present in existing estimates of the impact of automatic stabilizers—and (2) a broad sample of advanced and emerging market economies. Results provide strong support for the view that fiscal stabilization operates mainly through automatic stabilizers in EMDEs in general and those in the Asian region in particular. The book consists of three sections pertaining to monetary and exchange rate policies under financial globalisation; financial inclusion and macroeconomic policies in the context of financial liberalisation; and finally, the dynamics of foreign direct investment flows and their real impacts in EMDEs. Each of the chapters analyse important economic policy issues of contemporary relevance and is informed by data and rigorous empirical analysis. The book will be appealing to anyone interested in exploring the implications of a key set of issues emanating from financial globalisation on EMDEs in a rigorous but readable manner.

The global economy grew strongly in the first half of 2007, although turbulence in financial markets has clouded prospects. While the 2007 forecast has been little affected, the baseline projection for 2008 global growth has been reduced by almost 12 percentage point relative to the July 2007 World Economic Outlook Update. This would still leave global growth at a solid 4.374 percent, supported by generally sound fundamentals and strong momentum in emerging market economies. Risks to the outlook, however, are firmly on the downside, centered around the concern that financial market strains could deepen and trigger a more pronounced global slowdown. Thus, the immediate focus of policymakers is to restore more normal financial market conditions and safeguard the expansion. Additional risks to the outlook include potential inflation pressures, volatile oil markets, and the impact on emerging markets of strong foreign exchange inflows. At the same time, longer-term issues such as population aging, increasing resistance to globalization, and global warming are a source of concern.

This paper explores the role of foreign aid and remittance inflows in the mitigation of the effects of food price shocks. Using a large sample of developing countries and mobilising dynamic panel data specifications, the econometric results yield two important findings. First, remittance and aid inflows significantly dampen the effect of food price shocks in the most vulnerable countries. Second, a lower remittance-to-GDP ratio is required in order to fully absorb the effects of food price shocks compared to the corresponding aid-to-GDP ratio.

The World Bank considers financial inclusion to be an enabler for at least 7 of the 17 United Nation's sustainable development goals (SDGs). Financial inclusion, with its associated policy implications, is an important issue for ASEAN. This book examines the economic effects of financial inclusion. It explores issues surrounding measurement and impact of financial inclusion. The book
looks at various, salient topics including measurement of financial inclusion, the impact of (various indicators of) financial inclusion on development outcomes and macroeconomic volatility using aggregate data, as well as the effects of financial inclusion on poverty and development outcomes using micro data.

In the years following the global financial crisis, many low-income countries experienced rapid recovery and strong economic growth. However, many are now facing enormous difficulties because of rapidly rising food and fuel prices, with the threat of millions of people being pushed into poverty around the globe. The risk of continued food price volatility is a systemic challenge, and a failure in one country has been shown to have a profound impact on entire regions. This volume addresses the challenges of commodity price volatility for low-income countries and explores some macroeconomic policy options for responding to commodity price shocks. The book then looks at inclusive growth policies to address inequality in commodity-exporting countries, particularly natural resource rich countries. Perspectives from the Middle East and North Africa, sub-Saharan Africa, emerging Asia, and Mexico are presented and, finally, the role of the international donor community is examined. This volume is a must read for policymakers everywhere, from those in advanced, donor countries to those in countries with the poorest and most vulnerable populations.

Given that public spending will have a positive impact on GDP if the benefits exceed the marginal cost of public funds, the present paper deals with measuring costs and benefits of public spending. The paper discusses one cost seldom considered in the literature and in policy debates, namely, the volatility derived from additional public spending. The paper identifies a relationship between public spending volatility and consumption volatility, which implies a direct welfare loss to society. This loss is substantial in developing countries, estimated at 8 percent of consumption. If welfare losses due to volatility are this sizeable, then measuring the benefits of public spending is critical. Gauging benefits based on macro aggregate data requires three caveats: a) considering of the impact of the funding (taxation) required for the additional public spending; b) differentiating between investment and capital formation; c) allowing for heterogeneous response of output to different types of capital and differences in network development. It is essential to go beyond country-specificity to project-level evaluation of the benefits and costs of public projects. From the micro viewpoint, the rate of return of a project must exceed the marginal cost of public funds, determined by tax levels and structure. Credible evaluations require microeconomic evidence and careful specification of counterfactuals. On this, the impact evaluation literature and methods play a critical role. From individual project evaluation, the analyst must contemplate the general equilibrium impacts. In general, the paper advocates for project evaluation as a central piece of any development platform. By increasing the efficiency of public spending, the government can permanently increase the rate of productivity growth and, hence, affect the growth rate of GDP.

Setting the issue "Most economists consider the marked increase in automatic stabilizers a highly favorable development with respect to maintenance of economic stability". Besides the rare privilege of having being signed by both Milton Friedman and Paul Samuelson (Depres,Friedman, Hart, Samuelson, and Wallace [1950]), among others, this sentence expressed as soon as 1950 the consensus view on the stabilizing effect of fiscal rules governing tax revenue and public expenditure and transfers. This positive ex ante assessment will have been confirmed ex post as part of the explanation for post war stabilization (Burns [1960], de Long and Summers [1986], Moore and Zarnowitz [1986]). However, it becomes disputed in both its positive and normative aspects. Many institutional changes since the eighties point at curbing back the transfer mechanisms underlying automatic stabilizers, and legal restraints on deficits such as the US balanced budget amendment or the European Maastricht criteria would involve serious risks for the future of stabilizers. Under such rules "the government would become, almost inevitably, a destabilizer rather than a stabilizer" said Joseph Stiglitz, quoted by the New York Times (April 1995). "Built-in stabilizers are automatic fiscal adjustments that reduce the national income multiplier and thus cushion the effects of changes in autonomous spending on the level of income" (Pechman [1987]). Early analyses of the automatic fiscal stabilizers include the contributions of A. G. Hart [1945], R. Musgrave and M. Miller (1948) and E. C. Brown (1955).

The deregulation of domestic financial markets and the capital account in developing countries has frequently been associated with financial turmoil and macro volatility. The book analyzes the experiences of several countries, drawing implications for building development-friendly domestic and international financial architectures.

In this paper, we analyze how lack of credibility and transparency of monetary and fiscal policies undermines the effectiveness of macroeconomic policies to isolate the economy from commodity price fluctuations. We develop a general equilibrium model for a commodity-exporting economy where macro policies are conducted through rules. We show that the responses of output, aggregate demand, and inflation to an increase in commodity price are magnified when these rules are imperfectly credible and lack transparency. If policies are imperfectly credible, then transparency helps private agents to learn the systematic behavior of the authorities, reducing the effects of commodity price shocks. Coherent with the model, we show cross-country evidence that monetary policy transparency and fiscal credibility reduce the incidence of export price volatility on output volatility. Also, our results indicate that having an explicit fiscal rule and an inflation targeting regime contribute to isolate the economy from terms of trade fluctuations.

Expenditure in Iceland, especially related to the government wage bill, has tended to move in a procyclical manner, related to the fragmentation of political decision making. Iceland's elevated macroeconomic volatility reinforces these tendencies, as large booms unleash greater fiscal pressures as well as procyclical revenue elasticities that magnify these underlying strains. To improve its fiscal framework, Iceland could look to the experience of countries like Belgium and the Netherlands. In particular, it could adopt binding nominal expenditure rules, independent forecasts, and use representative committees to lay out medium-term targets across different levels of government.

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