Discussion of OECD Deputy Secretary-General Ludger Schuknecht: *The Consequences of Large Fiscal Consolidations: Why Fiscal Frameworks Must Be Robust to Risk*

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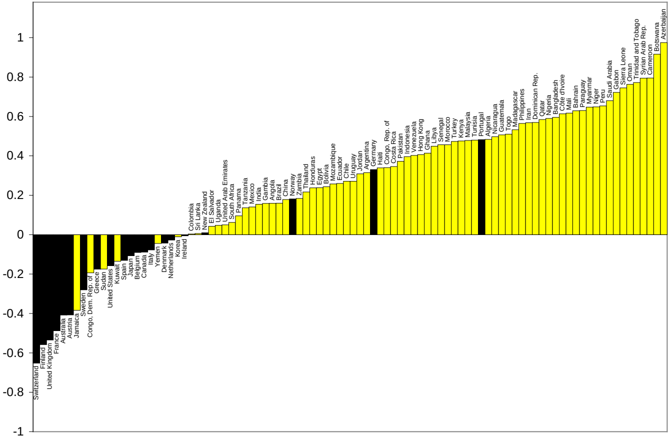
Risk, uncertainty and resource rich economies

- How can fiscal frameworks be robust to risk?
- **In resource rich economies?**
  - huge costs associated with the large and unpredictable swings in commodity prices
  - if not well managed, the volatility can destabilize the domestic economy and undermine long-term growth.
- Management of resources v/s rule based fiscal policy
- Recent volatile periods are opportune moments to review how fiscal policy can be strengthened to manage risk.

How does fiscal policy respond? ... Evidence of procyclical fiscal policy, 1960-1999...

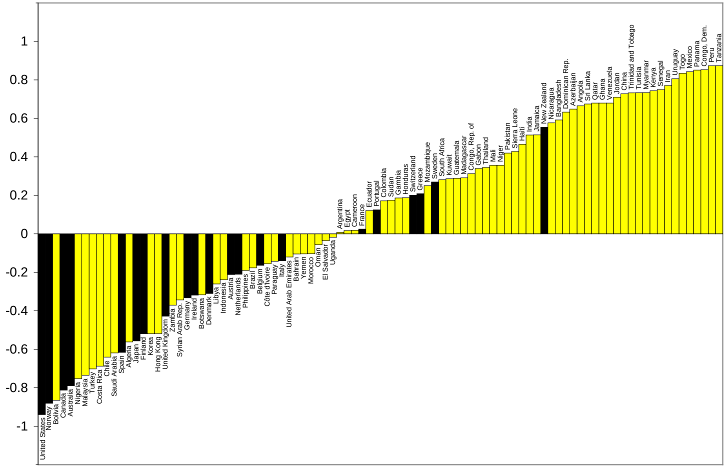
Figure I. Country correlations between the cyclical components of the real government expenditure and real GDP. 1960-1999



Notes: Dark bars are OECD countries and light ones are non-OECD countries. The cyclical components have been estimated using the Hodrick-Prescott Filter. A positive (negative) correlation indicates procyclical (countercyclical) fiscal policy. Real government expenditure is defined as central government expenditure and net lending deflated by the GDP deflator.
Source: World Economic Outlook and International Financial Statistics (IMF).

... to more countercyclical fiscal policy, 2000-2009

Figure II. Country correlations between the cyclical components of the real government expenditure and real GDP. 2000-2009



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Commodity producers - key questions to answer

- Still .... Countercyclical pattern could reflect the economic cycles - booming demand in the period 2000-2009.
- Does the fiscal framework adopted in resource rich economy shelter the economies from commodity price fluctuations?
- The adoption of a fiscal framework is no proof in itself that fiscal policy works to insulate the economy from commodity price fluctuations
- Rule can be too lax, or rule is not followed

Prime example - Norway

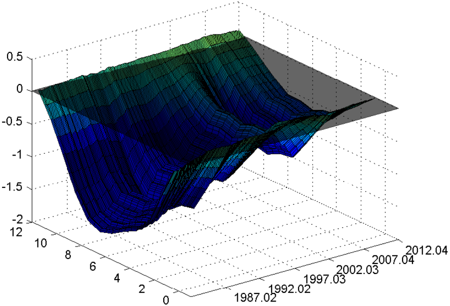
- Sovereign wealth fund established in the mid 1990s - all windfall gains saved in the fund
- Fiscal rule established 2001 - government can on average spend 4 % of the fund (the expected real return) every year (reduced to 3%):
  1. Smooth spending from the oil wealth. A gradual phase in should stabilise economic developments over time, thereby insulating the economy from Dutch disease
  2. Stabilises the fiscal impulse over and above longer term smoothing by allowing deviations from the 4 percent rule to counteract large cyclical variations in economic activity or sharp swings in the value of the fund.

Prime example - Norway - reconsidered

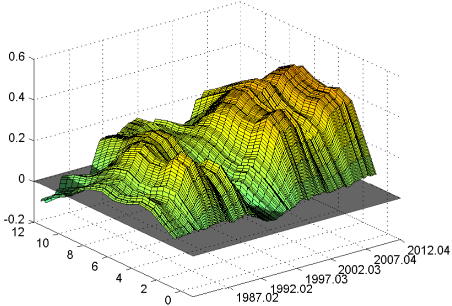
Bjørnland and Thorsrud (2018) find that for Norway:

- Following an oil price shock, fiscal policy has become more (not less), pro-cyclical after the implementation of the fiscal rule
- BUT Following a global activity shock, the picture is somewhat more nuanced, with some components of public spending being counter-cyclical the last decade.

Fiscal policy response (relative to GDP) to world demand shocks and oil price shocks



World activity shock



Oil price shock

Source: Bjørnland and Thorsrud (2018). The figure reports the response, across time and horizons, of value added in the public sector relative to the GDP in the mainland economy. A value above zero indicates that the public sector responds more positively to the given shock than GDP mainland economy.

Conclusions and policy recomodations

- Management of natural resource wealth should be seen as part of a strategy for sustainable, inclusive and broad based growth
- The goal of sheltering the economy from shocks, versus saving resource revenue for future usage.
- Trade off complex rules versus prudent spending
- Simple rules to avoid over-spending

References I

Bjørnland, H. C. and L. A. Thorsrud (2018). Commodity prices and fiscal policy design: Procyclical despite a rule. *Journal of Applied Econometrics (forthcoming)*.