

Discussion of “Fiscal Rule and Public Investment in Chile”

by R. Fuentes, K. Schmidt-Hebbel & R. Soto

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Implementation of the fiscal rule in Chile

Fuentes, Schmidt-Hebbel & Soto (2021) evaluate the Chilean fiscal rule using 3 approaches:

1. narrative approach
2. counterfactual (synthetic control method)
3. quantitative DSGE model

My take: great discussion of future challenges of the fiscal rule

Some upcoming challenges

- Intergenerational inequity
- Debt Sustainability
- Forecasting of macro variables
- Rule enforcement
- Optimal fiscal policy

Reform proposals:

- Multi-year planning horizon
- Debt anchor
- Escape clause and swift return protocol

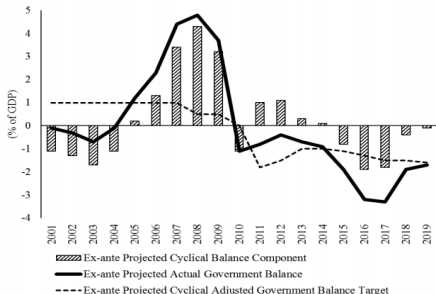
Debt sustainability and intergenerational concerns

First order given:

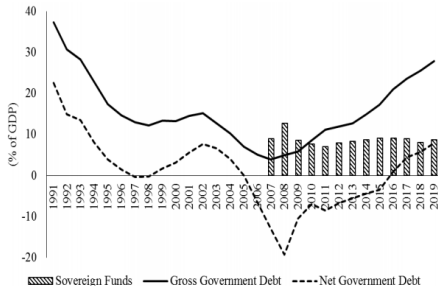
- increasing trend in public debt
- pension withdrawals.

Current fiscal rule: bygones are bygones

Govt Balance

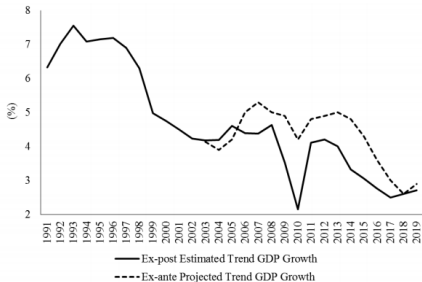


Govt. Debt

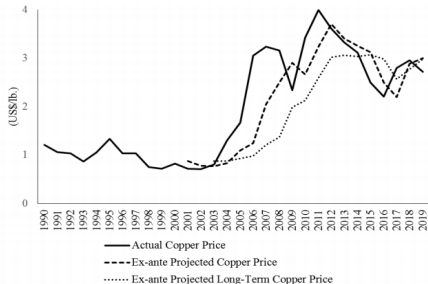


Forecasting macro variables

GDP growth

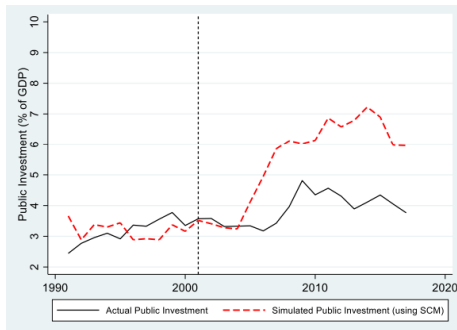


Copper price



- **Systematic forecast error**
- Important for government spending and public investment

Public Investment: Counterfactual analysis



- Estimated counterfactual suggest negative effect of fiscal rule in public investment.
- Not consistent with results from DSGE model
- Trade off for counter-cyclical fiscal policy: public investment vs transfers

DSGE Model: Right methodology for counterfactual

Would be nice to exploit further

1. Counterfactual economy lacks a CAB rule, "*...but still ruled by a responsible authority*".
 - Still a (countercyclical?) rule. Conservative benchmark
 - Easy to examine procyclical expenditure
2. IRF are important to show mechanism.
 - Would be nice to see how the model interprets 2009 (historical shock-decomposition)
 - Then, using the same shock estimation simulate path for the no-CAB economy and see how this relates to the SCM exercise.
3. The model could inform about unobservables (Kalman): the (-2%?) productivity shock, shocks to no-compliance with fiscal rule, etc.
4. Q: how important is eq. (14) for the dynamics of public investment, which is a key variable in this model

Overall

- Very well written, always appreciated
- Important question, timely analysis
- Easy to point flaws, harder to make actual proposals, and this paper does! important for policy debate
- Paper could benefit from digging (even) deeper on the composition of government expenditure and how it is affected by different rules. Would also be nice to include some elements from proposals, like debt rule.