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Abstract

A budget surplus arises in a country when the total revenue earnings surpass expenditures in a particular financial year. Having a budget surplus is very important in the sense that it brings about a decrease in the net public debt, while the public debt is increased in the event of a budget deficit. Both budget deficits and budget surpluses also exert indirect influences on taxpayers. Normally, it is not essential on the part of the government to maintain a budget surplus, though it needs to be very careful when running a budget deficit to have the proper buffer.

1. Introduction

Resource-rich countries in general (like copper-rich Chile or oil-exporting Saudi Arabia) are at a critical juncture, facing the challenge of revamping their fiscal policy institutions and their conduct on the road towards financial stability, economic growth, and socio-economic development. Experience shows that fiscal and monetary pro-cyclicality is more likely in highly corrupted states with poor fiscal governance, low fiscal credibility, and weak integration into world financial markets. At the heart of good fiscal and political institutions are good governance, transparency and accountability, and the strongly-enforced incentives faced by politicians – which ultimately translates as democracy.

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Under normal circumstances, economists have a tendency to become concerned about the consequences of a situation whereby a government's debt undergoes a sharp increase as a proportionate share of the country's Gross Domestic Product (GDP). This is indeed a matter of serious concern, as government debt is the sole means to fund financial deficits arising in a country. Moreover, the amount paid as interest also increases in proportion to the GDP, which imposes an additional burden on the country's risk level until such time as there is a sufficient reduction in the average rate of interest paid on the debts at the governmental level. A rise in the interest load dictates that government revenues will be utilized for payment of financial costs, rather than being used for the country's production, and hence reduces its economic growth potential.

This analysis poses number of key questions to be addressed in this paper:

1. What are the main advantages of a policy of budget surplus?
2. Does the policy of budget surplus make any sense in a country with huge social needs?
3. Which countries have budget surplus rules (e.g. Norway, Saudi Arabia etc.)?
4. In times of globalization, is such a policy workable?

2. Different views on a budget surplus and the Chilean economy experience: what the literature says

According to a handful of economists the manipulation of a Budget Surplus at the governmental level serves as an effective medium for hastening or slackening the economic development of a country.

Another group of economists argues that manipulation of a Budget Surplus only affects the economy by bringing about a change in price levels. This is because real production is determined on the basis of such factors as changes in technology, the labor-force, and the productivity of the labor.

Policy-effectiveness oriented economists think that a targeted structural budget surplus is useful for reducing the risk of fiscal insolvency, improving credit worthiness, and reducing output volatility.

2.1. The nature of fiscal policy and the justification for fiscal policy rules

Fiscal Policy is a key and strong component of macroeconomic tools, even more so when it comes to supporting the recovery of economic growth or maintaining smooth business cycle fluctuations. Although taxable income drops when an economy is in a recession, this is a transitory situation. While deficits will arise if the pace of expenditures is maintained, such maintenance makes a recession smoother and the social costs and welfare losses lower. Tax revenues will adjust later to their previous level, closing the gap with expenditures. This is the basic textbook case for countercyclical macroeconomic policy (Gordon 1983).

Unfortunately, public revenues and expenditures do not react on the same pattern. While tax revenues follow the output trend (with tax revenues output elasticity around one), public expenditure elasticity is lower (less than one), which means that it takes more time to adjust expenditures downward after the recession is over. Consequently a deficit situation may last longer than necessary, with huge costs involved (the crowding out effect, efficiency losses because of resource misallocation, and losses in productivity and competitiveness). In the integrated world, these costs are not trivial, and it is better to be well aware of them and their consequences (capital outflow, inflation, increasing debt, higher country risk perception, and uncertainty). Thus, while fiscal policy might help to obtain economic recovery (assuming a healthy financial system), it might also become a constraint for maintaining a sustainable economic growth pattern (Pasten and Cover 2010).

Besides, there are lags in fiscal policy reactions, arising from both lack of information and legislative procedures, which makes the situation more complicated to handle. A reasonable alternative is to have the fiscal policy rule, which Gordon (1983) called the Natural Employment surplus, or as we call it in this paper, a structural budget surplus.

Fiscal policy rules, like the structural budget surplus, focus on the political commitment to control the fiscal situation as soon as the need for a fiscal boost disappears. However, this does not mean that the structural budget surplus becomes a fixed target. The Chilean experience worked out the structural budget surplus in two phases: the first one (2000-2008) with 1% budget surplus and the second one (2009-2010) with 0,5-0% structural fiscal surplus, which signals the importance of flexibility because of economic growth scenarios, since the proposed objectives might be wider than at the beginning, or it may become convenient to improve the institutional framework which surrounds its implementation (Vergara 2002, Rodriguez 2007, Frankel 2011, Larrain 2011, Schmidt-Hebbel 2012).

On the other hand, the implementation of a structural budget surplus is based on some premises which are hard to find in less developed economies, where fiscal policy is usually seen more as a political instrument than an economic tool for stability purposes. It follows that some countries are more suitable than others for responsible fiscal management (Vial 2001, Arellano 2005, Pasten and Cover 2010).

2.2. What are the premises for the Chilean economy and what are their implications?

- a) The importance of policy coordination.
- b) The effectiveness of economic policies as the key criterion for policy makers.
- c) The lags arising in the process of working out the proper policy mix.

The importance of policy coordination.

Characteristics of the global economy, including the high mobility of all kind of resources and risk aversion, force us to make sure that each policy instrument is properly in place in order to get better control over the impact of shocks to the economic growth path. Therefore, a policy focused on output and unemployment (fiscal) and a policy focused on inflation and the financial sector (monetary) work better on the basis of coordination than on their own, even when exchange rate fluctuations are included (Marcel 2001).

The effectiveness of economic policy as the key criterion for policy makers.

A recent IMF report (2013 Forecast, September 27th) says that the resilience of emerging economies to the current global economic crisis is explained 60% by good economic policies, as long as they have allowed more space for maneuvering when it comes to facing external shocks. Therefore, effective economic policy plays an important role in the global economy.

There are lags in finding the proper policy mix.

Once the economy falls into recession, there is not much time to get the proper policy mix. It is better to have the job done in advance. If this is not the case, a mismatch arises when there is an asymmetrical pattern in policy implementation. Given an external shock, (either from the demand or supply side), an ex-ante over expansionary fiscal policy implies a more restrictive monetary policy to deal with the shock, making the adjustment more costly.

3. Different cases and experiences concerning the Structural Budget Surplus rule. Is it possible for all countries to have policy rules?

Few countries can fully meet the requirements of policy rules. Even so, since the 1990s a growing number of countries have implemented different fiscal policy rules, starting with 10 countries in 1990 and rising to 51 in 2011. However, only 10 countries have rules aimed at stabilizing cyclically adjusted balances, providing for the implementation of counter cyclical fiscal policy, or at least avoiding a pro-cyclical policy bias (IMF 2009). The fiscal rules implemented by the EU have a key weakness: according to current evidence, when the economy goes into recession, there is no way to keep the rule in place.

Monetary or fiscal policy rules are subject to some constraints and institutional conditions, which go beyond short term evaluations. For instance, the 11 Arab countries which account for 55% of oil and 29% of world gas reserves obtain 80% of government revenue from these sectors, but many of them do not have fiscal policy rules. Instead, they have pro-cycle fiscal policy, RER misalignment, and macroeconomic volatility (Schmidt-Hebbel 2012).

The budget process is difficult whether you are talking about a household, a company, or a government.

3.1. Positive externalities of a budget surplus

Running a budget surplus carries a number of advantages and positive externalities such as: increased flexibility, lower interest costs, the ability to invest in future growth, lower output volatility, and more flexible monetary policy, described below as follows:

Greater Flexibility. When the economy falters, governments often use stimulus spending projects as a way to jump-start the country and put people back to work. Countries that run budget surpluses in good times have a lot more flexibility when it comes to stimulating spending in a recession. If the country has a budget surplus in place, it can spend part of that surplus to stimulate the economy and hopefully shorten the duration of the recession. But when the country that enters a recession is already in debt, it has fewer options to stimulate the economy. Any stimulus spending must be borrowed from future generations, and that makes a bad financial situation even worse.

Lower interest rate costs. When a company or a country continually operates in the red, that organization is spending a great deal of money simply to pay the interest on what it owes. This can be a serious problem even when

interest rates are low, but a large budget shortfall can quickly become unsustainable when interest rate payments rise. By paying down its debt and running a budget surplus instead, a company (or country) can reduce, and even eliminate, these costly interest payments. This puts the company or the government on a sounder financial footing and improves its risk perception status, thereby reducing future borrowing costs. In the Chilean case, the gross debt/GDP ratio ranged from 23% (1990-2000) to 9% (2001-2011). Before the fiscal policy rule, Chile was a net debtor by 9% of GDP. After the fiscal policy rule it became a net creditor by 4% of GDP. As a consequence borrowing costs went down from 7% in 1999 to 3.35% in 2011 (Larrain 2011).

Implementation of a responsible fiscal policy demonstrates fiscal discipline. A reputation for fiscal discipline and sound financial planning can translate into the ability to borrow money at favorable (i.e. lower) rates, since lenders look at the overall health of a company and its ability to manage its resources wisely. A company in excellent financial shape is also more attractive to investors, which can increase the price of its stock and the value of the company.

Investment opportunities. A company or government that is flush with cash has the opportunity to jump on a promising investment opportunity when it comes along. But if the company does not have extra cash, investment decisions are a lot harder. In that case every investment decision means adding to an (already heavy) debt burden, and that can reduce the company's options significantly. At the governmental level, a budget surplus, which allows for an increase of investment into social areas, also provides it with more sustainable financing than just increasing taxes.

Less output volatility. As it has been demonstrated with other policy rules, a fiscal policy rule also brings about lower output volatility. The Chilean economy is an interesting case in point, because in the period 1999-2005, after the budget surplus was implemented, output volatility decreased by 32-33%. In addition, when coupled with other policy decisions (such as changing the exchange rate regime from a crawling peg to a flexible exchange) the impact was even stronger, pushing down volatility by a further 25-27% (Larrain and Parro 2006; Kumhof and Laxton 2010). Thus, budget surplus rules also contribute to the efficiency and effectiveness of macro-economic policy as a whole.

Trilemma implications. It has been argued that the trilemma is an impossible situation: free capital flows, exchange rate regime (fixed or flexible) and autonomous monetary policy cannot work freely alongside the economic cycle. Sooner or later one of them has to be modified in relation to the effectiveness of the monetary policy and its space for maneuvering. The

argument goes as follows: capital flows have an undoubted effect on exchange rates, especially in smaller economies, pushing rates up or down depending on whether there is capital inflow (appreciation) or outflow (depreciation). These exchange rate variations are not neutral. Leaving aside their distributive effects, they affect both banks with heavy foreign currency-denominated debt and the competitiveness of the export sector. With exchange rate fluctuations monetary policy should change the interest rate, but as long as it operates on its own it has to deal with key constraints which affect its independence and effectiveness. Whether the options are increasing (depreciation) or reducing (appreciation) interest rates, these options cannot be fully applied without risking a severe aggregate demand contraction in the former case (increasing interest rates), or an overexpansion of aggregate demand in the latter case (reducing interest rates). Thus, monetary policy is limited in its ability to correct the distortions arising from exchange rate fluctuations. However, a fiscal policy rule (budget surplus rule) can make the difference, because in the case of a recession due to a contractive monetary policy (higher interest rate), it allows self-stabilizing factors to take place. In this scenario, previous savings are available for counter cyclical spending. In the other case scenario (i.e. lower interest rates), the fiscal rule compensates for expansionary pressures in aggregate demand. Thus the fiscal policy rule provides a back up to monetary policy, giving it increased flexibility and independence. The Chilean experience in this area shows that fiscal policy became less correlated with the economic cycle after the structural budget surplus was applied, decreasing from 0.77 (1990-2000) to 0.57 (2001-2011). Therefore, a fiscal policy with a smaller pro-cyclical profile complements monetary policy in such a way that output volatility decreases (Larraín 2011).

4. The Chilean case (2000-2008) and other experiences

Chile's fiscal policy since 2000 was conducted in accordance with a structural surplus rule of 1% (Marcel 2001). The introduction of this rule (see the sequence in Schmidt-Hebbel, 2012) confirmed and intensified Chile's commitment to fiscal responsibility since the mid-1980s by introducing a more explicit medium-term orientation (Vial 2001, Arellano 2005).

The rule was initially not regulated by law. However, this changed with the 2006 Fiscal Responsibility Law, which also introduced new rules on the investment of accumulating assets. The structural surplus rule only covers the central government and deals only with income, keeping expenditure on its mid-term trend.

It also assumes that the tax structure is neutral in relation to distributive effects, assuming an output tax elasticity of 1.0. An alternative case would be to have a progressive tax rate, in which case this elasticity would be higher (1.5 - 1.6), or at least greater than 1. In the Chilean case, the elasticity ranges from 1.0 - 2.4, depending on the tax source, although for the structural budget proposal it was considered to be close to 1 (1.05). The implications of this progressiveness are that it has a higher impact on government revenues when output grows (Gordon 1983). This makes the structural budget surplus more cautious in the growth path, and more countercyclical in recessions, which seems to suggest that the impact of the structural budget surplus policy is not neutral in relation to the tax structure. The main elements of the public sector left outside the rule are: the central bank, public non-financial enterprises, the military sector, and municipalities.

4.1. Institutional and economic conditions for implementing the target

The existence of additional conditions – both institutional and economic – were relevant to the implementation of this target (Marcel 2001, Vial 2001; Arellano 2005).

These conditions pertained to:

- a) An independent Central Bank, which set an inflation targeted monetary policy at an annual level of 3%.
- b) Macro policy consistency. Without a fiscal policy rule monetary policy is aimed at exchange rate objectives, breaking down the Tinbergen rule. Besides this, it adversely affects policy coordination.
- c) A crossover political commitment to steadily improve the macroeconomic institutional framework.
- d) A level of openness in the Chilean economy. Global economy fluctuations require economic policy tools to be fully available to deal with the impact of shocks. In fact, the Asian economic crisis made it evident that inconsistencies in macroeconomic policy matter (Elbadawi 2011; Schmidt-Hebbel 2012).

The structural surplus rule implies a counter-cyclical behavior of ex-ante expected government surpluses. In Chile, this was the case for the expected higher copper prices. It could also be the case for higher oil prices or the prices of agricultural goods. It states that the central government's overall structural balance should in every year equal a surplus of 1% (0.5% effective since 2008) of actual GDP. The structural balance equals structural revenues plus interest on

net government assets (which are positive in Chile), minus actual expenditures on goods and services. Structural revenue is determined by two independent panels of experts and reflects what tax revenue would have been if the economy had operated at its potential rather than actual output, and what copper revenue and other derivatives would have been at a long-term reference of world copper price, rather than the actual price. The rule therefore specifies permissible annual expenditures on goods and services as a residual, given the values of the target structural revenues, the level of government assets, interest rates, and GDP. The resulting counter-cyclicality of government deficits isolates government expenditures on goods and services from the cycle and keeps them growing with the output trend. No distinction is made between government consumption and investment expenditures, because this is difficult to do in practice.

This positive fiscal rule was supported by certain features that are not intrinsic to it, but optional in its implementation. A key feature was the level at which the structural balance is targeted. During the first years a structural surplus target equivalent to 1% of GDP was set, with the aim of ensuring the accumulation of assets with which to reduce the liabilities inherited from the debt crisis in the 1980s and to meet future public sector commitments including, in particular, the contingent liabilities generated by the guaranteed minimum pension and old-age beneficiaries, arising from the pension reforms implemented in 1980. In addition, another argument for maintaining a structural surplus was the structural operating deficit of the Central Bank of Chile, as a result of losses arising from the bailout of the private banking system during the 1980s.

A positive surplus target implies significant asset accumulation by the government. However, when it was adopted it pretended to provide for future social commitments and to address contingent liabilities. The 2006 Fiscal Responsibility Law formalized this by establishing rules for the investment of surpluses. These rules envision investment in a government pension fund, gradual central bank recapitalization, and a Fund for Economic and Social Stabilization (FESS). In May 2007, following the recommendation of an expert panel, a reduction in the surplus target from 1% to 0.5% of GDP was announced, effective in 2008. The additional resources that thereby become available for current spending were to be devoted primarily to education.

There were important reasons for this change in the target from 1% to 0.5%:

- a) The initial target of 1% implied that government asset accumulation over time (2007-2016) would be 10% of GDP on average, which is hard to justify when it comes to meeting social demand arising from growth (Engel, Marcel and Meller 2007). Besides, the welfare gains from following this rule are lower (by 18%) than those obtainable by

implementing fiscal policy rules with a flexible clause to break the transitory rule down (Engel, Neilson and Valdes 2011).

- b) Most of the initial justifications for such a target were fulfilled at that time. In 2005, Central Bank operational deficit was equivalent to 0.005% of Chilean economy's GDP, down from 1% at the end of the nineties. Further government efforts to reduce its liabilities with the Central Bank improved its capitalization, and its independence.
- c) The 2006 Fiscal Responsibility Law formalized the financial resources to support contingency liabilities arising from the pension reforms, creating a government pension fund with resources equivalent to a minimum of 0.2% and up to a maximum of 0.5% of GDP, which will be ready for spending only after 10 years of interest rate gain accumulation.
- d) Other contingency liabilities arising from private sector investment in public infrastructure, based on state-guaranteed income, were estimated at US\$ 5 billion (2006), but with new institutional developments aimed at improving the quality of contracts and better arbitration procedures, these were expected to decrease substantially.
- e) After some years of strong fiscal savings owing to the constant boom in commodity prices, the Treasury became a net creditor to the rest of the world, with growing stabilization funds. By late 2008, the Economic and Social Stabilization Fund (successor to the Copper Buffer Fund) and the Pension Reserve Fund had accumulated the equivalent of 18% of GDP, while fiscal liabilities were negligible after significant amortizations made with previous surpluses in the fiscal balance. The socially beneficial allocation for that 1% of GDP was to finance social investments and productive development, such as better quality of education, training of workers and small entrepreneurs, support for innovation, regional infrastructure, and incentives for long-term financing of SMEs and new entrepreneurs.

Consistently, the structural surplus target for 2008 was reduced to 0.5% of GDP (Engel, Marcel and Meller 2007). The contagion of the global crisis led to further reduction of the balance to 0% in 2009, and the earthquake of 2010 moved the target into negative territory, at -1%. At the same time, Chile moved sharply from a rather cyclically neutral approach to a strong counter-cyclical one. In 2009 Chile is expected to reach a 0.4% structural fiscal deficit and 4% measured deficit, with a 15% rise in fiscal public investment. An expert panel was appointed in 2010 to propose recommendations to improve the quality of the rule (for a detailed analysis, see Schmidt-Hebbel 2012).

4.2. Evaluations of the targeted fiscal policy rule and implications for RRE: Arab countries and Norway

Chilean fiscal policy has evolved in the last two decades, combining discipline, transparency and macroeconomic management within an institutional framework designed to improve the quality of signals for investment and growth, thus reducing the sources of instability and uncertainty. Since 2001, in spite of several shortcomings (such as the insufficient intensity of countercyclical effects) the rule has served to avoid a pro-cyclical bias and has given stability to public expenditures. As the concept of the structural budget has gained credibility, it has been easier to introduce improvements and discretionary windows, for example allowing for an unprecedented expansive reaction to the 2009 crisis within the context of fiscal sustainability.

Overall, the Chilean experience demonstrates the importance of both the introduction of structural budgeting as a principle, and the value of learning in policy making and paying attention to local structural specificities. Better coordinated and consistent macroeconomic policies mean less output volatility (Larraín and Parro 2006), less efficiency and welfare losses (Kumhof and Laxton 2009), less interest rate volatility (Rodríguez 2006), and less exchange rate volatility (Velasco 2010), thereby increasing the effectiveness of the institutional framework for economic policy design. A small economy, highly integrated to the global economy, obtains major benefits from these positive externalities, as long as it reduces the financing cost of new investment projects, whether they are social or private. In fact Chile has become a low risk country, which allows it to secure better financial conditions than many of its Latin American counterparts.

Key challenges for the future are a greater understanding of and further guiding principles for the macroeconomic effect of fiscal policy on economic activity, prices and exchange rate determination, and the stabilizing and complementary support role of monetary policy. In particular it is important to achieve a degree of management of public savings that efficiently serves both short-term macroeconomic policy and long-term economic development (Larraín 2011).

Progress in fiscal policy has contributed to improvement in the counter-cyclical capacity for management of aggregate demand and exchange rate fluctuations, which in recent years have become quite unstable in response to both pro-cyclical capital flows and high copper prices. In the 1990s Chile had an outstanding and successful experience with counter-cyclical regulation of financial inflows and the achievement of comprehensive real macroeconomic balances which, although well fitted to confront the capital inflow pressures,

were not effective enough to solve the real side shocks arising from the Asian economic crisis of 1997-1998. Chile's strong recovery lost some momentum at the beginning of the 2000s as the world economy slowed, weakening copper prices (2000-2003), capital inflows, and consumer confidence. Given the current considerable uncertainties regarding the health of the world economy, more supportive macroeconomic policies may be needed in the short run. In the longer run, reducing poverty and inequality is a key challenge. Both remain high by OECD standards, notwithstanding impressive progress. Redistributive transfers and progressive taxes are very limited. Better education and job opportunities for the poor would enable more Chileans to contribute to a more dynamic and productive economy and thus to greater welfare.

The following measures would help Chile overcome the challenging situation of the world economy in the short run, and attain stronger growth and a more inclusive society in the longer run:

Supportive macro policies in the short run. Given the uncertain global environment, monetary policy should remain on hold for now. A slow pace for consolidation is appropriate at the moment, but once the external environment improves the government should return to a structural fiscal balance to rebuild buffers against shocks and to improve the quality of fiscal policy as a stabilizing factor.

A strengthened fiscal rule and higher tax revenues to finance long-term spending increases. Chile's structural fiscal balance target has led to low debt and large assets in the sovereign wealth funds. The government plans to create an independent fiscal council, which could validate the correct application of the rule and assess the targets chosen by the government as well as changes in the methodology. This shift should strengthen Chile's fiscal framework. There is also a strong demand for higher quality education and social services in Chile, which is likely to mount as the country develops. The government already plans significant spending increases on such programs, which will need to be financed on a sustainable basis. Higher environmental taxes would be a particularly efficient source of revenue. A reduction of regressive tax loopholes and of still-pervasive income tax evasion would also make the tax system more progressive.

The current tax reform, which is expected to be applied next year, is aimed only at increasing spending on education, and it might not be enough to cope with other social demands arising from a variety of factors such as an ageing population, (the elderly are expected to constitute 30% of population by 2020), insufficient urban infrastructure, and public-private partnership for higher innovation and reduction of social inequalities.

Greater cash transfers for the poor, combined with support for recipients to find employment, as envisaged by the government through the

new Ethical Income Program. The government currently plans to target the bulk of the transfers to families living in extreme poverty. Over time, it should consider opening all new transfers to a wider range of participants, for example through a more gradual benefit withdrawal. This would also enhance work incentives for beneficiaries and limit fraud. To assess whether transfers should increase over time the government should evaluate the impact of higher cash transfers on recipients' work incentives, employment opportunities, and capacity to invest in human capital.

Better access to quality housing, along with measures to reduce residential segregation and enhance mobility. This could improve access for the poor to higher-quality education, social services, and jobs. Better targeting of housing subsidies will be essential to free resources for those truly in need. At the same time the government should rethink subsidies, which are currently directed exclusively at home ownership. Means-tested rental cash allowances, coupled with more balanced tenant-landlord regulations, would strengthen the rental market, thus enhancing residential mobility and potentially reducing segregation. Other measures that would contribute to lowering segregation and inequality include better enforcement of social housing quotas, more investment in infrastructure and social services in poorer neighborhoods, and development of unused land in urban areas.

Over the past two decades Chile generally has taken actions that address the long-term fiscal pressures expected to arise from an ageing population. Surpluses have helped the nation enhance future fiscal and economic capacity by reducing debt burdens. By reducing its debt burden, the country has taken a step toward improving its long-term fiscal and economic health and enhancing future budget flexibility. Budget surpluses increase national saving, which can lead to increased investment and productivity, thereby increasing potential future economic output and living standards. Budget surpluses also reduce the government's interest costs, freeing resources to be spent on other priorities. Furthermore, lower levels of debt can improve the nation's capacity to borrow and meet future budgetary needs.

Everything indicates that the world economy is at risk of going into a global recession in 2013. The best examples are the recession in Europe, which started in the second half of 2011, and the US economy, which will undergo a fiscal adjustment in excess of 3 per cent of output at the end of this year. China – along with much of the developing world – is in a deceleration phase.

The fear of another crisis is still here and the question is whether anyone can help alleviate its impact. In this context, emerging markets could have a new and important role to play. Their relative importance in the world economy has increased dramatically. Currently, they represent 50 per cent of global gross

domestic product (in purchasing power parity terms), up from only 30 per cent 20 years ago.

These countries now have more room for maneuver in the face of a deterioration in economic conditions. Most have adopted sound macroeconomic policies, controlling inflationary pressures and consolidating improved fiscal positions – in contrast to their more developed peers. Chile, for example, runs its fiscal policy according to a structural rule whereby spending is determined by anticipated revenue, which depends on an independent committee's estimates of the long-term copper price and potential output growth. Fiscal policy is countercyclical, resulting in a surplus in the good times and

a deficit in the bad times. The rule has allowed Chile to accumulate more than 20 billion USD (about 10% of GDP) in sovereign wealth funds, most of which can be used in the event of significant shocks.

The challenge now for emerging economies is to draw up well-structured contingency plans to counteract the pressures coming from the developed world. Most have room for a more expansionary fiscal policy during 2012 and beyond. They are acting accordingly, as the examples of China, India, Mexico and Chile demonstrate. Yet, if things worsen in the global economy countries should be ready to react quickly. Public investment is a case in point. There are opportunities to expedite investments and to bring forward new projects that have passed the appraisal stage. It is also possible to have in their toolboxes a set of incentives for private investments that may bring more private projects forward.

However, a well-designed contingency plan should go beyond fiscal policy. At its heart, it should include measures promoting flexibility and work incentives in labor markets in order to combat unemployment's pernicious social effects. Emergency public programs to employ people directly may be needed, but these programs also create a long-term dependency of workers on low-paying, low-productivity jobs. Temporary incentive schemes for private-sector employment are generally a better option.

Careful monitoring of domestic financial markets is also key to limiting the fallout of a crisis stemming from the developed world. It should be a priority to identify systemic risks and make ready a battery of prudential instruments to provide liquidity to the banking system quickly. These include the timely use of repurchase agreements ("repos") by the central bank and the auctioning of foreign exchange deposits by the treasury.

It is also essential for the countries to establish a financial stability council that brings together the main economic decision-makers (including at least the

finance minister, central bank president and the heads of banking and security regulation) to monitor financial risks and co-ordinate policy responses.

Authorities must be keenly aware that there is no reasonable response from fiscal policy that can fully counteract a credit crunch, as the recent experience of 2009 shows.

These elements are at the core of the contingency plan the Chilean authorities have been designing for some time. There seems to be a serious need for emerging market countries to prepare contingency programs that will enable them to respond effectively should the international outlook deteriorate further. In this way, emerging markets can not only help themselves but also help cushion the rest of the global economy. In other words, Chile now has a clear opportunity to be part of the solution instead of being part of the problem.

5. Concluding remarks

An important question is whether Chile's experience is useful for an analysis of the situation of Poland and other emerging economies. The answer is not straightforward and largely depends on national resources (Chile – copper, Saudi Arabia and Norway – crude oil, etc.) and the social expenditure policies of given countries. If a country has an expensive social program it will be quite difficult to follow the Chilean example.

Because of its countercyclical nature, budget surplus policy gives more space for the power of monetary policy adjustment (either upward through a higher interest rate, or downward through a lower interest rate). In both cases, fiscal policy acts like a buffer, helping to reduce volatility.

For the EU, as well as for Poland, it is clear that a policy of budget surplus, instead of a policy of budget deficit (3%), would have eased the consequences of the financial crisis of 2008-2013.

Given the political nature of fiscal policy, it helps to have fiscal policy rules to improve the effectiveness of macroeconomic policies as a whole, and the stability of growth in particular. The positive externalities linked to fiscal policy rules reinforce a virtuous circle of growth, as long as volatility and welfare levels are improved.

Considerations concerning social needs should go beyond the short-term objectives. These overlap generations, which means they influence the long run sustainability of economic policy. Thus, in light of these needs, the issue is not necessarily to have or not to have policy rules, but how to make those rules more effective over time. Therefore, it is very important to have fiscal policy rules

with flexibility clauses. Otherwise, welfare gains are lower and social needs harder to satisfy.

Although there has been an increasing number of countries following fiscal rules, only a few apply a structural budget surplus rule (like Chile, Norway, Saudi Arabia etc.). In the case of the Chilean economy, on the one hand a combination of political, economic and institutional settings helped quite a lot, but on the other hand it also helped to have specific financial demands arising from past governmental compromises, hard to resolve without important increases in public savings. At the ideological level, based on the past experience of the Chilean economy, the notion that the state drives economic growth was deeply internalized, i.e. that it is responsible through public expenditures and that its role is to complement the private sector in order to obtain efficient allocation of resources and sustainable welfare gains. The slogan at the beginning of the nineties, “Growth with fairness”, was no longer possible when the state did not match the new framework for macroeconomic policies.

Other countries might implement such policy rules, but it is a matter of political will, governmental action, accountability, and having modern institutions. As long as the global economy is risk averse, policy rules help to implement a more consistent and efficient policy framework, suitable for the flow of productive resources (as opposed to speculative ones), which help a country take the lead for global growth.

Owners of productive resources need to know the rules they are submitted to. The ‘no rules’ alternative means speculative forces flourish and economic agents make their bets on what comes next, with the accompanying uncertainty.

Thus, the global economy needs not only better policy, but also better rules for policy implementation and global resource flows, making the real side of the economy more relevant than its financial side, thus reducing volatility and welfare loss.

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Streszczenie

POLITYKA NADWYŻKI BUDŻETOWEJ W CHILE

Od kilkunastu lat polityka fiskalna Chile jest oparta na koncepcji równowagi budżetowej. W przeciwieństwie do równowagi efektywnej, która pokazuje aktualną sytuację fiskalną, ta pierwsza odzwierciedla średnioterminową perspektywę budżetu. Nadrzędną zasadą systemu jest szacowanie wpływu netto z podatków w określonym średnim okresie. Wydatki muszą być przy tym równe wpływom. W praktyce oznacza to oszczędzanie podczas wzrostu gospodarczego oraz wydawanie uzyskanej nadwyżki w okresie, kiedy wpływy z podatków są mniejsze.