Natural-Resource Booms, Fiscal Rules and Welfare in a Small Open Economy

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This document analyzes the macroeconomic effects of a boom in a small-open economy’s natural-resource sector. We study the effects of this shock on the most important macroeconomic variables, the resource reallocation across sectors and on welfare under alternative fiscal rules. We employ a DSGE featuring three productive sectors (non-tradable, manufacturing and commodity goods), government and two types of consumers (Ricardian and non-Ricardian).

Our results show that the natural-resource boom leads to an initial reduction of the manufacturing sector’s employment and production. The opposite temporal effect is obtained in the remaining two productive sectors. However, the effect on welfare is positive for all consumers since the boom increases consumption in all households. Finally, we find that a countercyclical fiscal rule leads to a slight increase in welfare compared with a balanced-budget rule.

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