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Fiscal Policy in a Small Open Economy with Oil Sector and Non-Ricardian Agents

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In this paper we develop a dynamic stochastic general equilibrium fiscal model for the Colombian economy. The model has three main components: the existence of non-Ricardian households, price and wage rigidities, and a fiscal authority that finances government spending partly with public debt. The model is calibrated to capture the empirical evidence on the macroeconomic effects of government spending and it is used to study the effect of an oil price shock under different fiscal policy rules. Our results show that fiscal multipliers in Colombia are positive in a way consistent with the evidence. Our analysis also shows that a structural fiscal rule delivers a better outcome in terms of macroeconomic volatility relative to a balanced budget rule or a countercyclical fiscal rule.

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