PORTFOLIO STRUCTURE DYNAMICS, UNSTABLE FISCAL POLICY AND WELFARE IN EMERGING OPEN ECONOMIES

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Abstract:

In this paper, we study the dynamic effects of the fiscal policy in the emerging economies' context through the elaboration of a two sectors endogenous stochastic growth model. Number of works devoted to this issue, out of emerging economies framework, consider as stochastic only taxation and/or productivity shocks. Following available macrodynamic representations (Turnovsky (1997-2000), Joshi (1998), Mendoza (1997)..), the dualistic growth model we constructed has made it possible, through Ito's lemma, to analyse the stationary state growth rate, where the majority of the macroeconomic variables interactions are taken into account.We show that the fiscal policy instability trade-off effect between growth and volatility stops occurring once *a threshold* of *risk aversion and fluctuations'* frequencies is reached. This result has not been reported in works which establish a monotonous relationship between volatility and growth. Also, we proof trough a corollary that for a given differential of rates of returns, (in the domestic and foreign assets), a tax reduction in the sector of exchangeable *indexed on foreign inflation* allows to avoid the reduction on *domestic capital share in portfolio.* Our statistical investigations suggest that a stabilization policy and/or a transfer policy would make it possible to offset the cost in welfare incurred by the representative agent. The constructed model also allows the study of the fluctuation effects in the small open economies imitating several foreign technologies.

Classification JEL : E25, O17, O41

Key words : Two sectors Stochastic Endogenous growth; Ito's Lemma; Welfare Offsetting variation; unstable fiscal policy; fluctuations sources; portfolio structure.

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