

## Non-technical summary

# Monetary Policy in Resource-Rich Developing Economies

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The paper evaluates the role of monetary policy in a natural resource abundant, developing economy where fiscal indiscipline in the form of immediate responses to foreign natural resource revenue changes is inevitable. This assumption is based on the fact that in these countries governments tend to ineffectively spend a considerable part of windfall revenues in the short run.

The research builds a theoretical general equilibrium model of a small, open, natural resource-rich economy reflecting the situation described above. The main finding is that under this setup, monetary policy can help improve the allocation problem.

In particular, the simulation results indicate that targeting the exchange rate or price level through foreign exchange interventions by the central bank can soften the negative effects of Dutch Disease and stabilize the economy in the face of volatile natural resource revenues in the short run. The research also uncovers that a fixed exchange rate regime outperforms price level targeting by delivering higher isolation and hence less vulnerability to shocks in natural resource revenues. In contrast, if the central bank chooses to pursue a *laissez faire* policy, i.e., not to intervene, then the economy becomes vulnerable to shocks in foreign resource revenues and the resource curse becomes more severe.

The findings of this research provide support for the central bank targeting exchange rate stability when the government pursues natural-resource backed fiscal expansion. The paper depicts the situation observed in Azerbaijan, an oil and gas rich developing post-Soviet economy during the last decade. However, the results of the study can be applied to other natural resource rich developing economies and also to aid receiving countries due to similarities between aid and natural resource revenue inflows.