



**PREPARED BY THE FISCAL AFFAIRS DEPARTMENT, THE RESEARCH DEPARTMENT, AND
THE STRATEGY, POLICY, AND REVIEW DEPARTMENT, IN COLLABORATION WITH THE
AFRICAN DEPARTMENT AND THE MIDDLE EAST AND CENTRAL ASIA DEPARTMENT**

**BOARD PAPER ON MACROECONOMIC POLICY FRAMEWORKS
FOR RESOURCE-RICH LOW- AND LOWER-MIDDLE INCOME COUNTRIES**

ISSUES FOR CONSULTATION

Background and Motivation

Natural resources account for an important share of export and government revenues in a growing number of low- and lower-middle income countries (LICs/LMICs), offering vast opportunities for economic development. Resource-rich countries face macroeconomic challenges from exhaustible and volatile revenues. Revenue exhaustibility raises questions regarding intergenerational equity and long-term fiscal and external sustainability, while revenue volatility and uncertainty complicates macroeconomic management and medium-term budget planning.

Traditional frameworks to analyze consumption and savings decisions and assess long-term *fiscal* sustainability positions have often used some form of the permanent income hypothesis (PIH). The PIH implies that resource revenues are mostly saved during production years, while a smooth spending profile is maintained over time from the interest income. The savings could be managed in some form of wealth fund that invests in financial assets abroad, and the interest on those financial assets would help sustain spending in post-production years. (Additional funds could be set aside to provide a stabilization buffer to cope with volatility of commodity prices.) However, such approaches would have some drawbacks for resource-rich LICs/LMICs—which typically face capital scarcity and credit constraints. The large gaps in infrastructure and human capital, in the presence of difficult access to international capital markets, could call for scaling up investment in domestic capital. Similarly, consumption smoothing in traditional intertemporal models of exhaustible natural resources implies that the current accounts should register large surpluses to finance the accumulation of net foreign assets needed for future consumption. Therefore, the traditional methodologies need to be amended to incorporate the scaling up of public investment needed to close the above-noted gaps.

Scope

The objective of the paper is to reassess the IMF's policy advice to LICs/LMICs in light of past experience in these economies, the growing importance of natural resources in many countries, and new insights from recent research.

To achieve this objective, the paper will present stylized facts, discuss recent advances in analytical thinking on natural resource management, consider the implications for policy design, and make suggestions for IMF advice. Specifically, the paper will:

1. Analyze macroeconomic performance in resource-rich LICs/LMICs, including: savings, investment and current account dynamics in the face of resource booms, fiscal policy stance, and transmission channels to growth;
2. Utilize (and extend) savings and investment analytic frameworks from recent research to derive implications for fiscal policy, the sustainability of the external current account and exchange rate alignment;
3. Examine practical policy issues such as fiscal policy anchors, the role of fiscal institutions (rules, funds, and public financial management), and develop usable current account benchmarks; and
4. Draw lessons for Fund policy advice and program design.

Questions

Savings-investment decisions in resource-rich LICs/LMICs. Countries endowed with large resource wealth but facing large immediate development gaps face the difficult decision how much of that wealth to consume and save. They also need to weigh the pros and cons of investing their savings in the domestic economy versus in foreign assets. *We welcome your ideas on factors that would help inform such decisions.*

Anchor for fiscal policy. *We seek your views on considerations for choosing a suitable fiscal anchor and determining the stance of fiscal policy in resource-rich LICs/LMICs, recognizing that what may work in some countries may not be feasible in others. Also, what practical considerations do you believe should be taken into account when designing and implementing fiscal policy frameworks that respond to challenges facing those countries?*

Fiscal policy and the pace of scaling up. The recent commodity price boom created fiscal room for scaling up expenditure for development. In order to maximize the potential from the additional resource envelope, scaling-up decisions ought to take into account issues such as absorptive capacity, sustainability of higher spending, and maintaining macroeconomic stability. *What factors do you believe should guide decisions about the pace of scaling up of government investment? (We are especially interested in receiving ideas for practical fiscal*

policy guidelines for the desirable speed—and possibly “speed limits”—of increases in public investment in response to resource revenue booms.)

Resource funds. Resource-dependent could choose among a range of alternative mechanisms to manage resource flows, ranging from an account at the central bank to independently managed sovereign wealth funds. *How do you see the role of resource funds in resource revenue management? What type(s) of funds make sense and what are the principles for fund inflow-outflow rules and asset composition?*

External sector assessments. A proper assessment of the implications of natural resource flows also requires keeping a close eye on balance-of-payments developments. In this context, it would be desirable to derive usable benchmarks (“norms”) for assessing the sustainability of current accounts and exchange rates from simple models that incorporate optimal savings and investment dynamics as well as economic frictions (such as absorptive capacity constraints and public spending inefficiency). *We welcome your views on how such benchmarks could be derived.*

Your views on any other relevant aspect of the topic not included in this preliminary outline of the paper are also welcome too. We greatly appreciate your input to our deliberations on this important topic.

The deadline for comments will be April 27, 2012, but comments received in advance of that date will be more than welcome.