Fiscal Frameworks for Natural Resource Intensive Developing Countries

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Outline

1. A fiscal framework and its objectives
2. The current debate
3. Fiscal policy anchors for short-to-medium term
4. Considerations for scaling up
5. Benchmarks for long-term sustainability
6. Which framework to apply and when
7. Resource funds
8. Conclusions

1. A fiscal framework

- It should comprise:
  - ***Fiscal indicators*** for analysis and design of fiscal policy
  - ***Fiscal policy anchor(s)*** for the short- and medium-terms; and
  - ***Benchmarks*** for long-term fiscal sustainability assessments

1. Objectives of a fiscal framework

- Ideally, it should capture **country-specific characteristics** (no “one size fits all”):
  - Size and time profile of resource extraction, level of country’s development, credit constraints facing the country and its absorptive and institutional capacity
- Recognize that a **country’s objectives can change** over time

1. Objectives of a fiscal framework

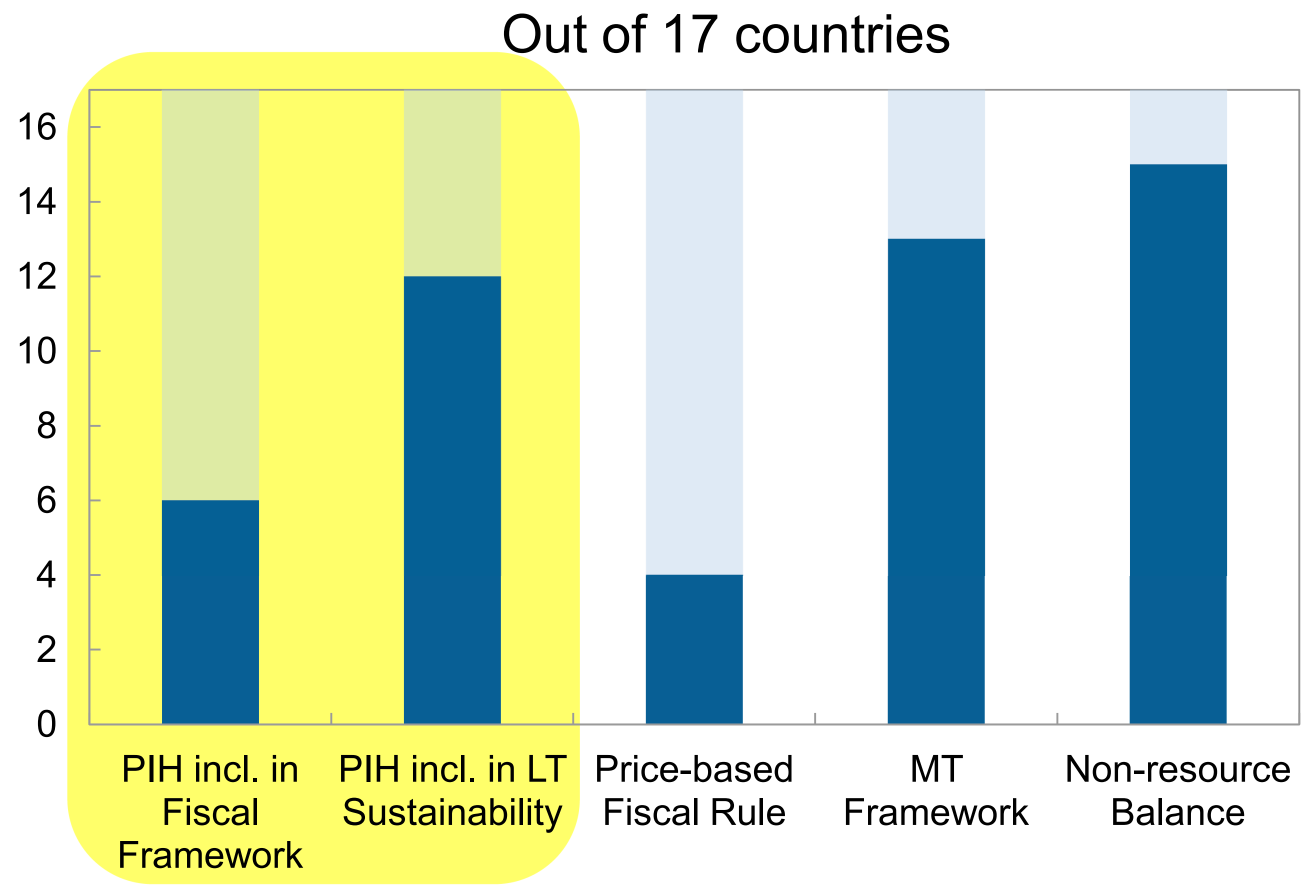
- It should ensure:
  - ***Macro-fiscal stability***, which is critical for all countries, including those with large, long-lasting resource revenues
  - ***Sustainability***, which is important for those facing temporary resource booms; and
  - ***Scaling up of growth-enhancing expenditure*** in countries with development needs as well as capital scarcity

2. The current debate

- Permanent income hypothesis (PIH) **too rigid** in underpinning fiscal framework as it
  - Calls for smoothing consumption over time and saving revenues for future generations even when current needs are large
  - Focuses unduly on financial investment of savings; and
  - Overlooks capital scarcity (and high return from capital) and credit constraints in many countries

2. The current debate

- Fund staff have followed an eclectic approach



2. The current debate

- Multiple indicators used to underpin fiscal policy analysis and implementation

- Non resource fiscal balance used widely as a fiscal policy indicator

- PIH mainly as an indicator of long term sustainability, along with other indicators (medium-term fiscal frameworks, non resource fiscal balance)

3. Fiscal policy anchors for short-to-medium term

- Several options are available, each with its pros and cons
  - Non-resource balance anchors
  - Price-based rules
  - Expenditure growth limits
  - Flexible PIH

3. Fiscal policy anchors for short-to-medium term

Non-resource balance anchors

- Defined as overall balance minus (net) resource revenue
- Allows effective short-term demand management and insulates fiscal policy from resource revenue volatility
- Specific non-resource targets can be determined through model-based scenarios taking absorptive capacity into account

3. Fiscal policy anchors for short-to-medium termrm

Price-based and structural balance rules

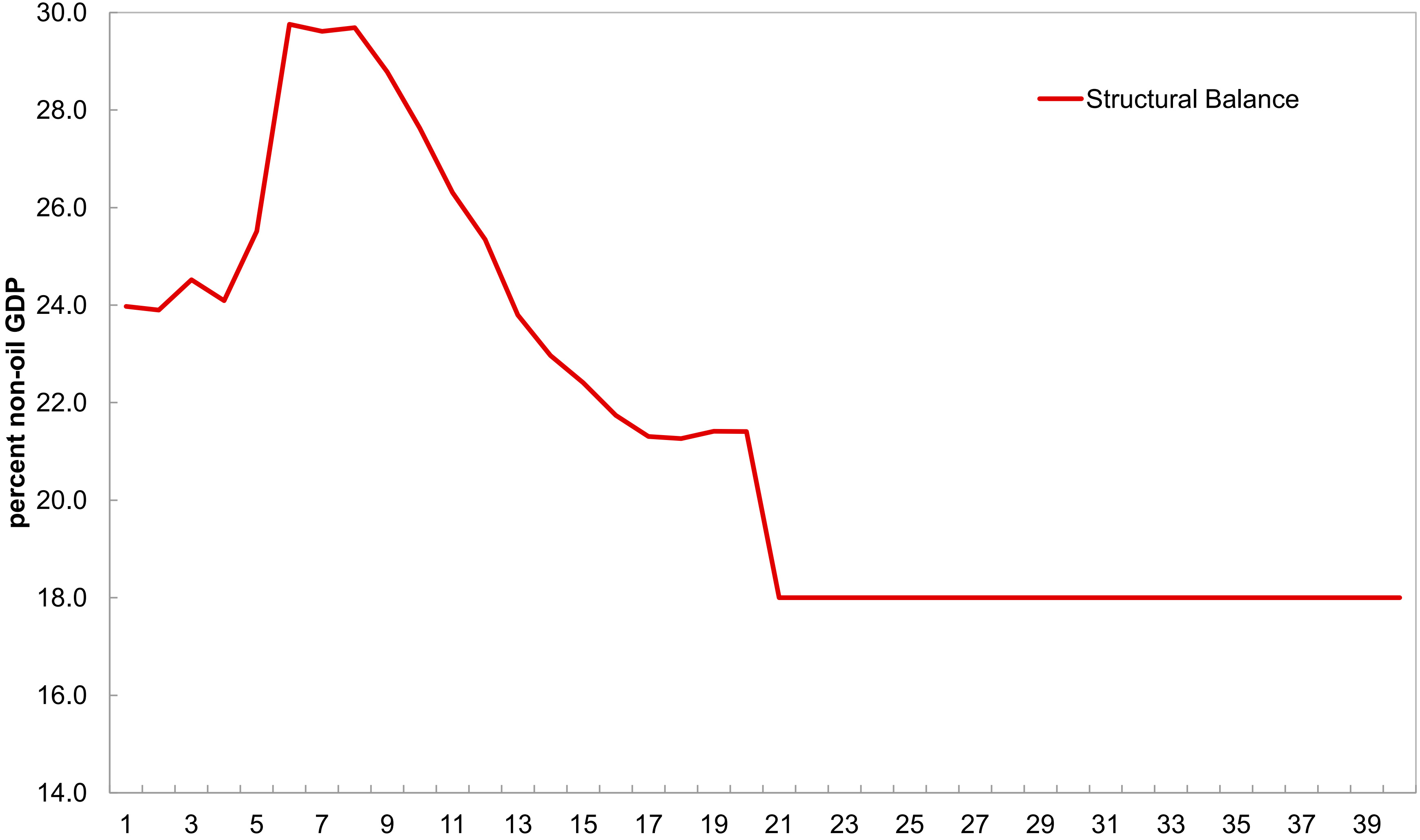
- Seek to “smooth” resource revenue
- Price can be based on a moving average of past and future (market) prices
- But ignores exhaustibility issues and changes in production volumes or fiscal regimes
- “Structural” balance goes beyond smoothing resource revenues and adjusts non-resource revenues to the economic cycle
  - In countries where the cycle is not well defined, adjustment for the cycle could be ignored (“structural” balance equivalent to price-based rule)

3. Fiscal policy anchors for short-to-medium term

- Long-term sustainability considerations can be introduced into the framework through more ambitious targets (structural surplus) to allow savings to accrue over time

- Scaling up objectives can be accommodated by setting less ambitious targets or paths based on absorption capacity

Primary expenditure under rules

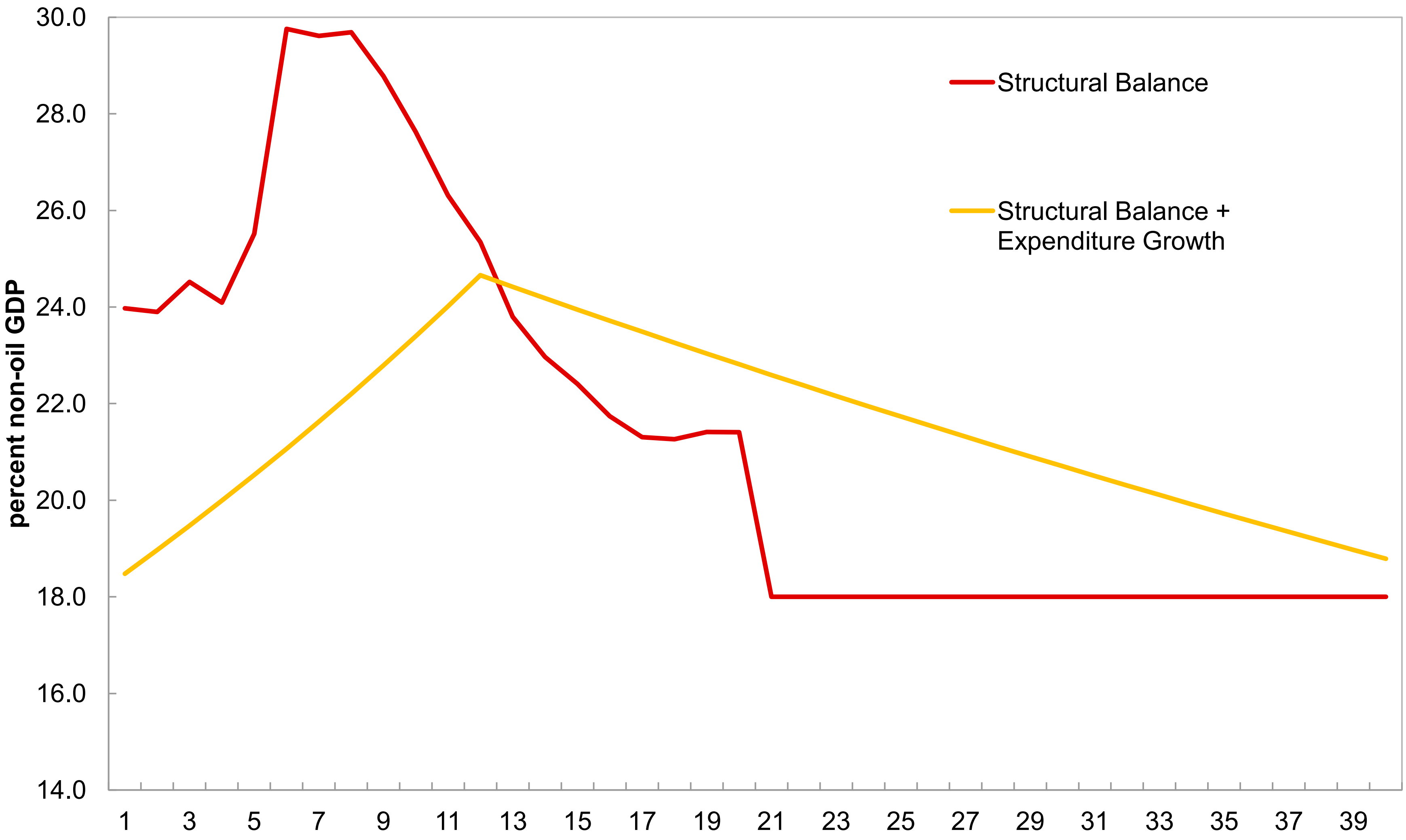


3. Fiscal policy anchors for short- to medium-term

Expenditure growth rules

- Can limit the growth of government spending in nominal or real terms or in percent of non-resource GDP
- Useful in combination with structural balance rules if faced with potential changes in production volumes
- Advantages include visibility and that it can be linked to absorption capacity
- As a downside, could create disincentives to not mobilize non-resource revenues

Primary expenditure under rules

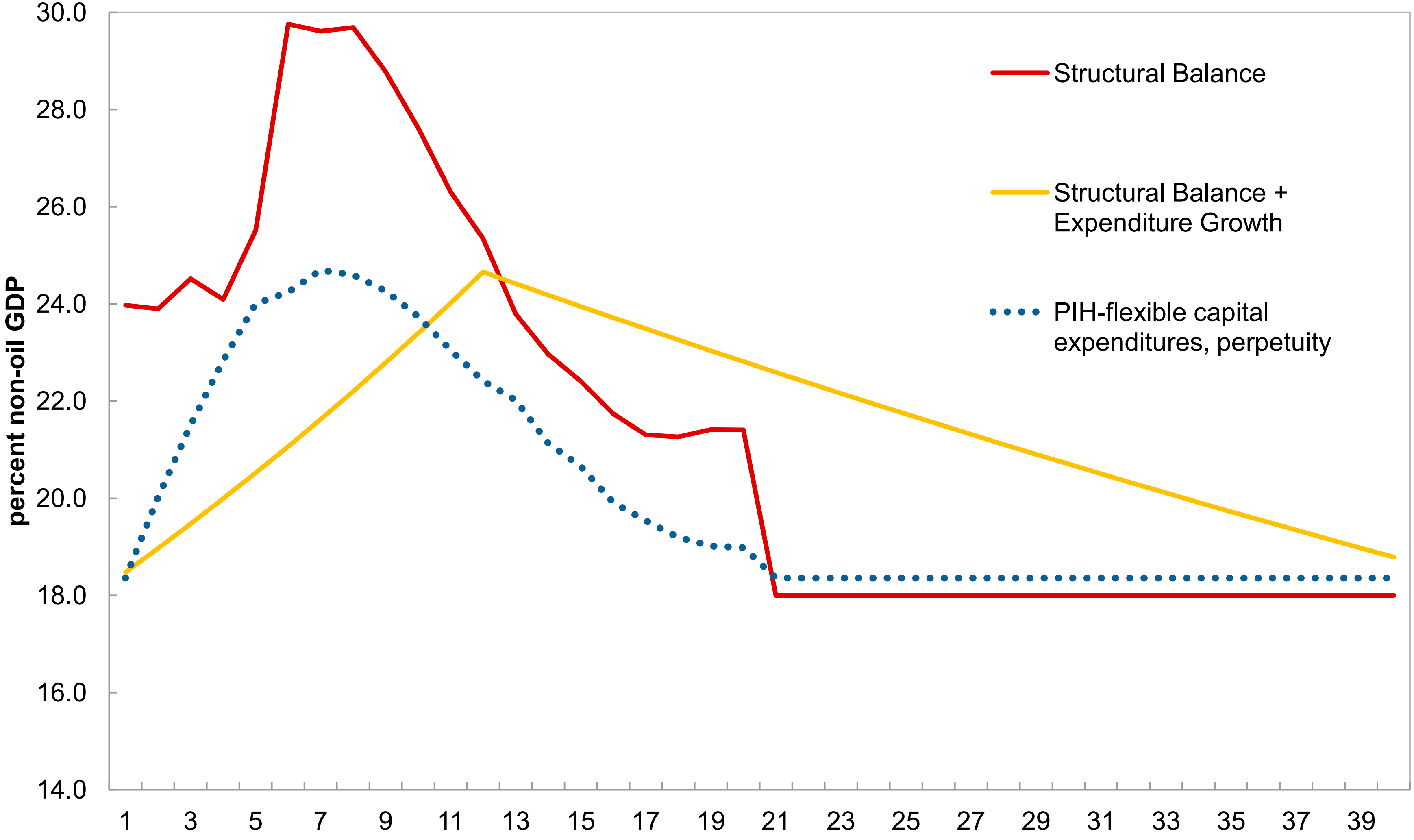


3. Fiscal policy anchors for short- to medium-term

PIH with flexible spending

- The PIH can be modified to allow for scaling up of spending
- Spending is no longer smoothed, but fiscal policy remains anchored within an estimate of the long-term sustainable use of resource revenue
- Front-loaded spending would be financed by an additional drawdown from resource revenues, reducing spending in future years

Primary expenditure under rules



4. Considerations for scaling up spending

- The pace of scaled up expenditure needs to consider macro and micro absorption constraints
  - Macro level:
    - avoid REER appreciation (Dutch disease)
    - build buffers to deal with volatility and uncertainty
  - Micro level: ensure quality of spending
- There should be no special treatment of capital expenditure; risk of fragmentation of the budget

4. Considerations for scaling up spending

- Large and lumpy investment projects are better accommodated by widening the fiscal deficit target for a given period.   Excluding such projects from the framework weakens the ability of the framework to anchor fiscal policy

- Debt accumulation can be accommodated best if there are explicit limits

5. Benchmarks for long-term sustainability

- Should focus on government net wealth defined to equal financial assets + natural resource assets – liabilities (debt)
- One option could be to target non-resource primary balance that stabilizes net wealth
- An alternative option could be to target non-resource primary balance that results in a gradual drawdown of net wealth and stabilizes it at a lower level (which is country-specific)
- A final option would be to rely on the PIH approach, where income from natural resource wealth is compared to the non resource fiscal balance

6. Which framework to apply and when?

	Capital scarce	No scarcity of capital
Long-lasting resources	Fiscal indicators: ▪ Non-resource and overall balances Short-and medium-term anchor: ▪ Flexible non-resource balance rule + expenditure cap ▪ Price-based rule plus expenditure growth cap Long-term fiscal sustainability benchmark ▪PIH perpetuity/annuity ▪Net wealth convergence	Fiscal indicators: ▪ Non-resource and overall balances Short-and medium-term anchor: ▪Non-resource balance rule ▪ Price-based rule plus expenditure growth cap ▪ PIH-based framework Long-term fiscal sustainability benchmark ▪PIH perpetuity/annuity ▪Net wealth convergence
Short-lasting resources	Fiscal indicators: ▪ Non-resource and overall balances Short-and medium-term anchor: ▪ Flexible non-resource balance rule + expenditure growth cap ▪ Modified PIH-based framework Long-term fiscal sustainability benchmark ▪PIH perpetuity/annuity ▪Net wealth convergence	Fiscal indicators: ▪ Non-resource and overall balances Short-and medium-term anchor: ▪PIH-based framework Long-term fiscal sustainability benchmark ▪PIH perpetuity/annuity ▪Net wealth convergence

7. Resource funds

- Resource funds should be viewed as complementary policy tools, not the main instrument of fiscal policy:
  - They should support the implementation of sound fiscal policies
  - Enhance transparency and credibility of fiscal policy, making resource revenues and associated savings more visible

7. Resource funds

- They should be fully integrated into the budget

- One should avoid “development funds” with power to spend or make domestic investments (“islands of excellence”)

8. Conclusions

- There is no “one size fits all” for the design of fiscal frameworks
- Various options are available for short-to-long term: choice driven by country-specific conditions
- Frameworks and targets are not static. They should be revisited as country and resource conditions evolve; and
- Resource funds should be fully integrated and support fiscal policy implementation

Thank you