Fiscal Frameworks for Resource-Rich Developing Countries

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I. MOTIVATION

- **Resource wealth: opportunity to boost development…**
- **But historical record unimpressive.**
- **Fund's previous approach:**
  - Excessive reliance on Permanent Income Hypothesis (PIH).
- **Key innovations:**
  - More attention to country-specific factors.
  - Focus on flexibility and trade-offs.
  - Toolkit to help design fiscal rules.

II. ANALYTICAL CONSIDERATIONS

- **Traits of natural resource revenues:**
  - Exhaustibility.
  - Volatility.
- **RRDCs' distinct characteristics:**
  - Low per capita income; limited access to international capital; domestic capital scarcity.
- **Capacity constraints have implications for:**
  - Speed of scaling up.
  - Design of fiscal rules/savings institutions.

III. FISCAL FRAMEWORK OBJECTIVES

- **Fiscal framework needs to address:**
  - **Demand management.**
  - **Inter-temporal solvency.**
- **Additional complications: price volatility and exhaustibility challenges.**
- **Fiscal institutions: should ensure efficient and transparent use of resource wealth.**

IV. FIVE KEY ISSUES

A. Resource Horizon

B. Volatility

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D. Effective Investment and Resources

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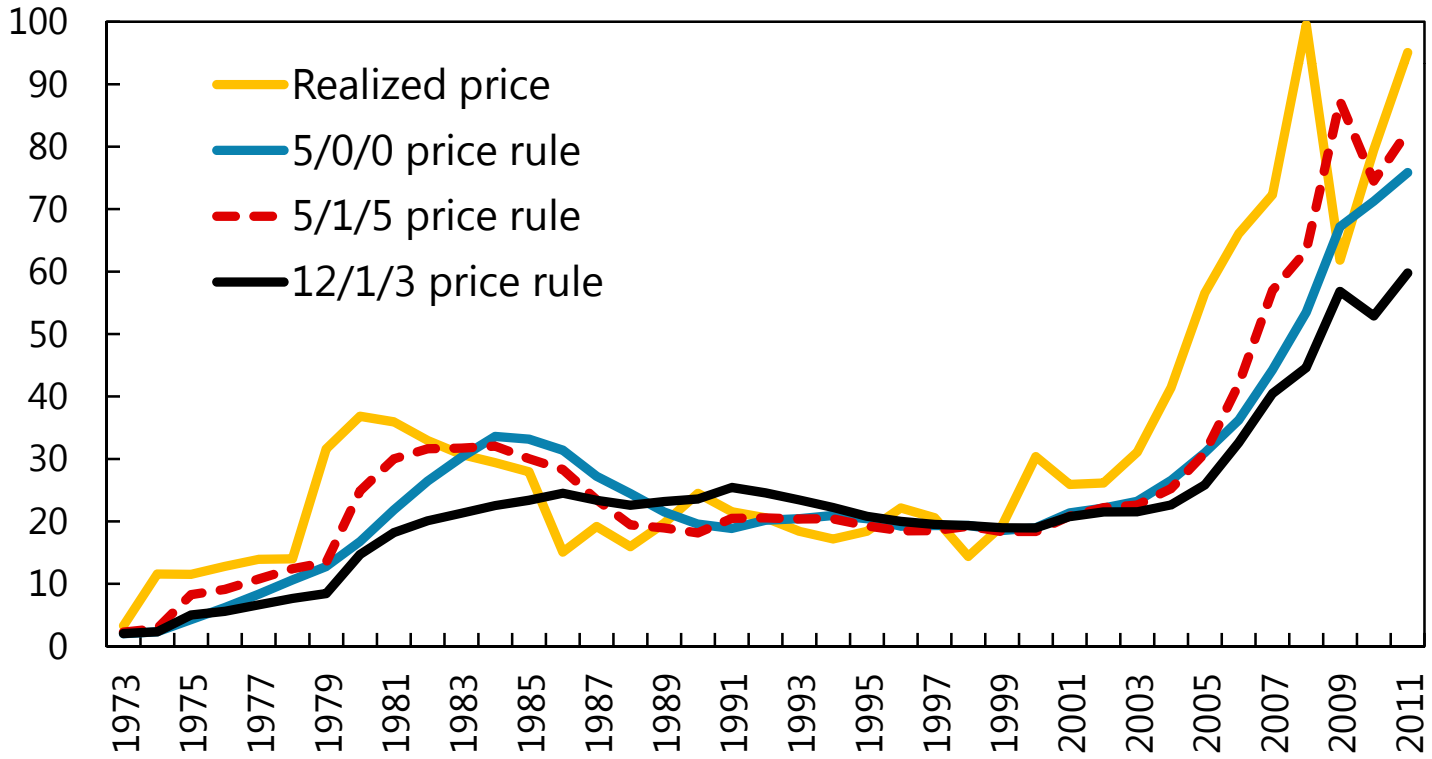
A. Resource Horizon (RH)

- **Affects choice of fiscal rule.**
- **Long RH: main focus is managing volatility.**
  - Price smoothing rule particularly useful.
- **Short RH: give prominence to exhaustibility.**

B. Managing Volatility: Smoothing Trade-offs

- **Structural primary balance rule ("normal revenues").**

Oil budget prices under price rules
(US$ per barrel)



Sources: IMF staff calculations.

Managing Volatility: Smoothing Trade-offs

- Structural primary balance rule (computes "normal resource revenues").

- Provides a simplified way of obtaining "structural" or "normal" resource revenues.

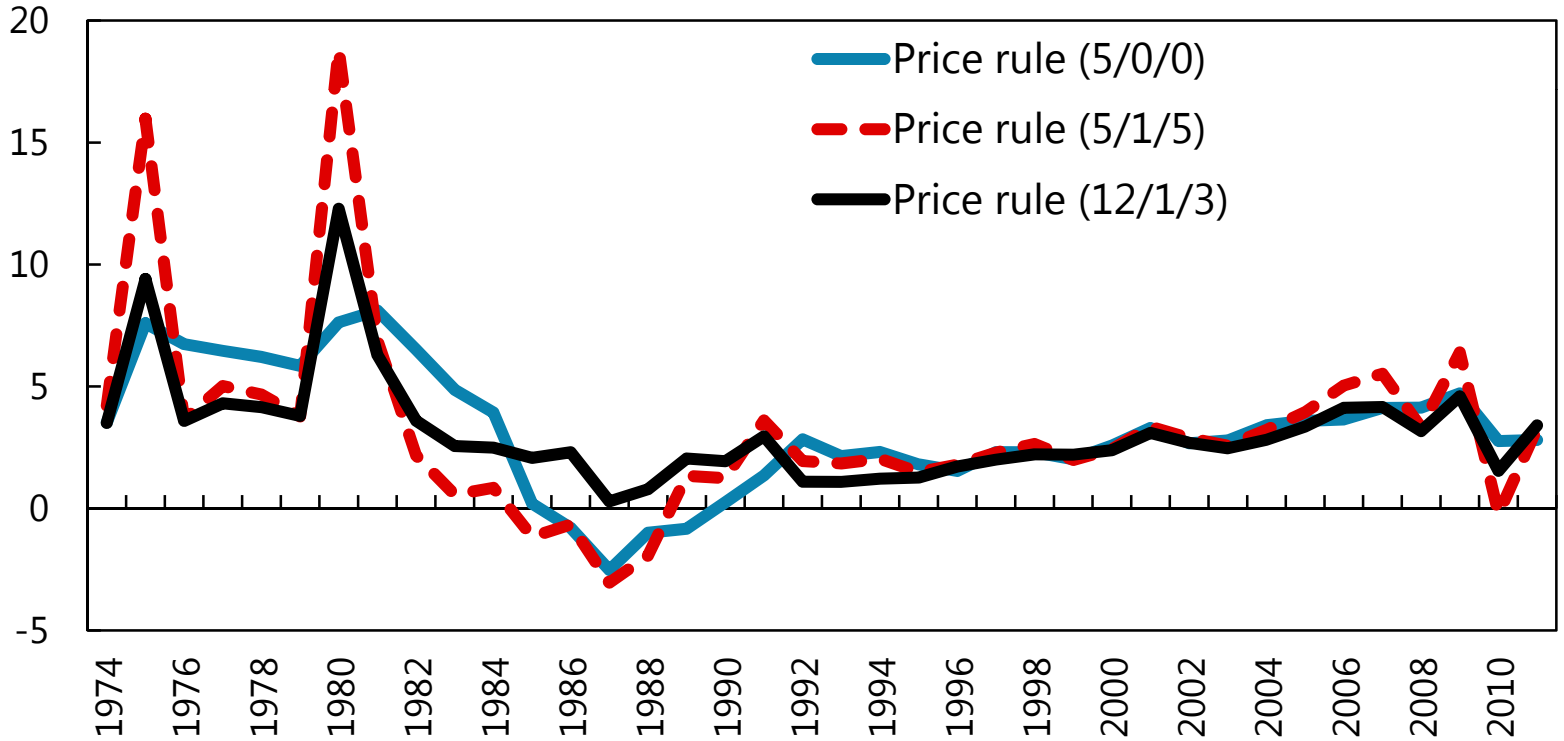
- Spending will be a function of the "structural" resource revenues and the PBs target.

  - PE = RRs + NRR - PBs

Managing Volatility: Smoothing Trade-offs

- **Price smoothing rule.**

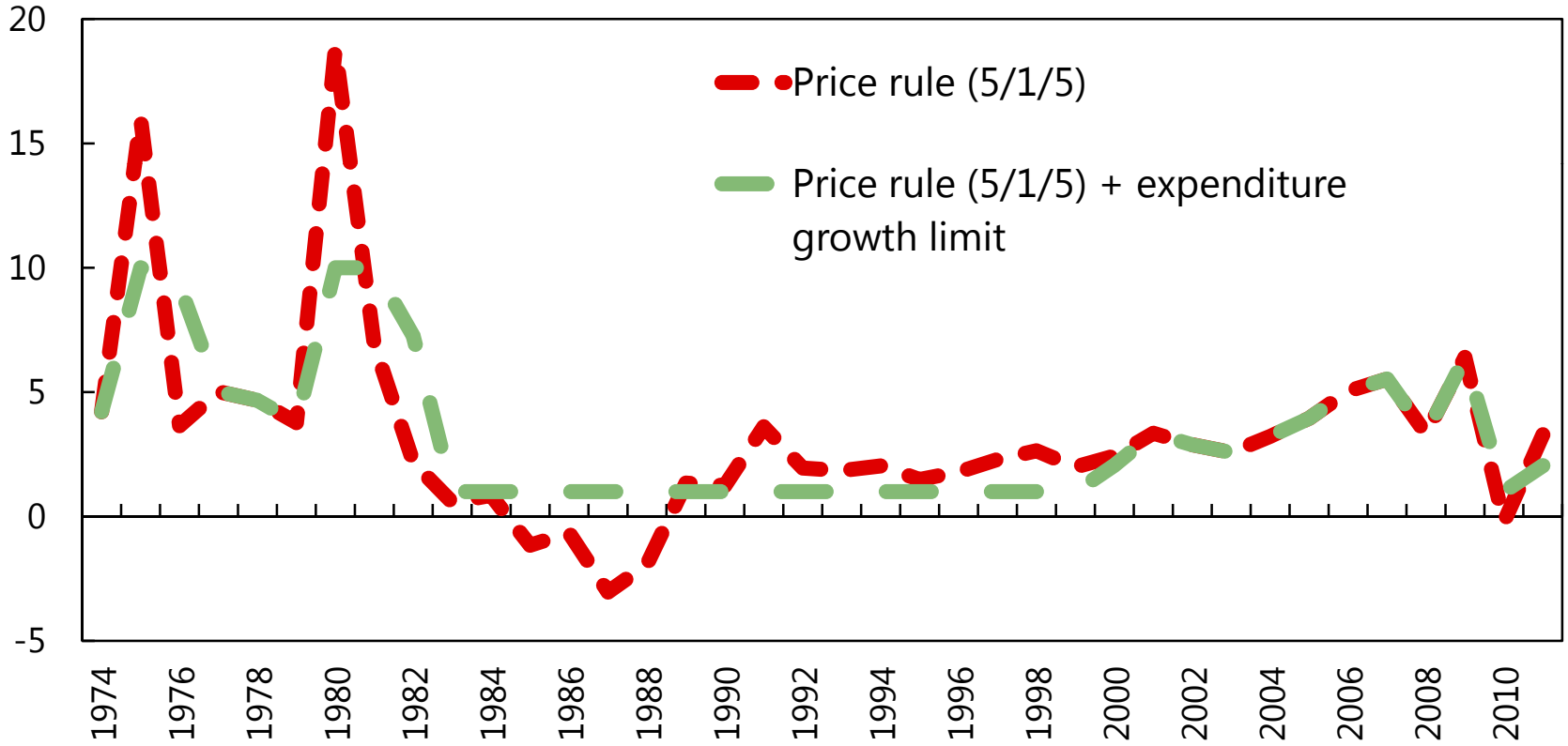
Real primary expenditure growth
(Percent change, year-on-year)



Sources: IMF staff calculations.

Managing Volatility: Smoothing Trade-offs

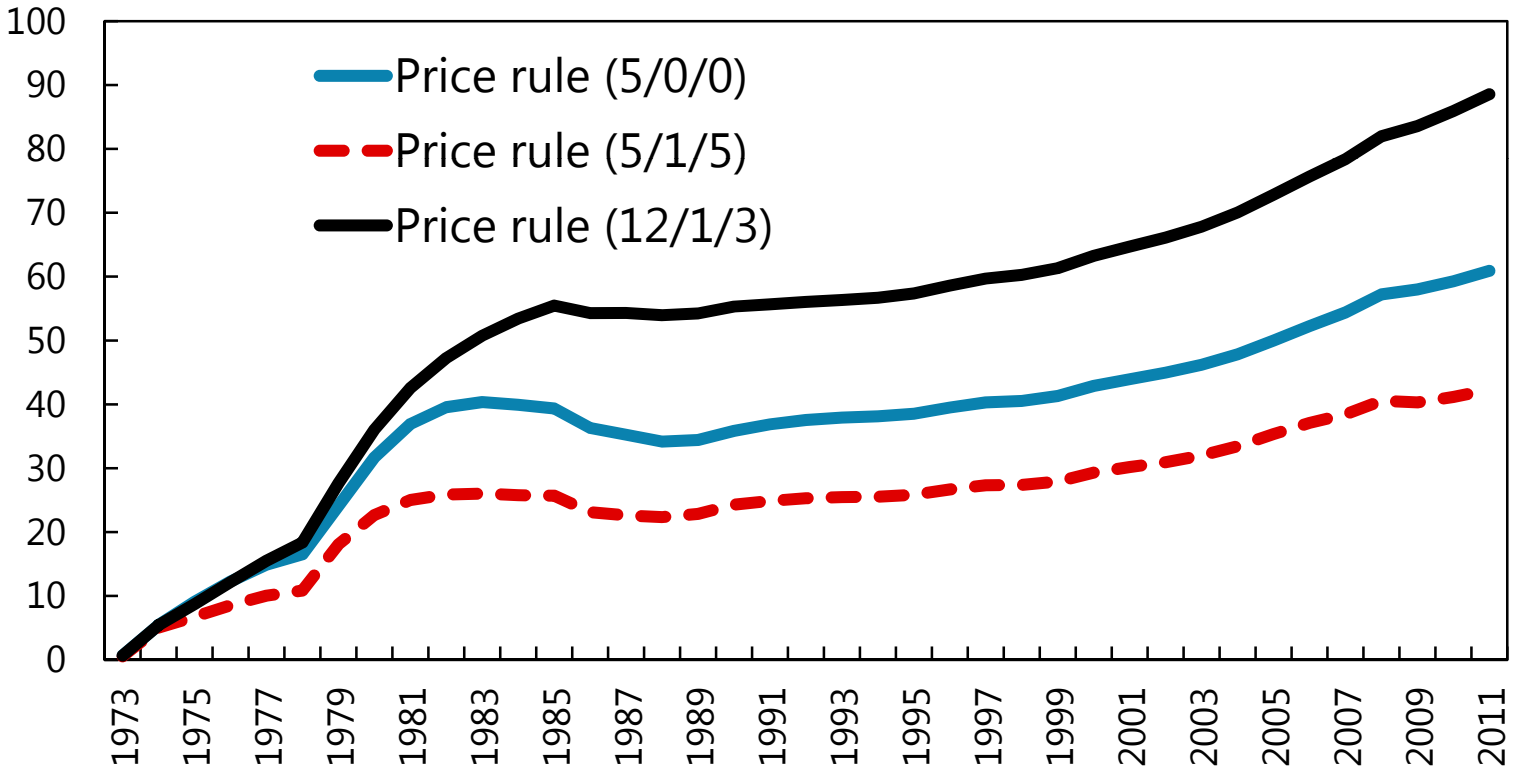
Real primary expenditure growth
(Percent change, year-on-year)



Sources: IMF staff calculations.

Managing Volatility: Saving Trade-offs

Cumulative financial savings
(Percent non-resource GDP)

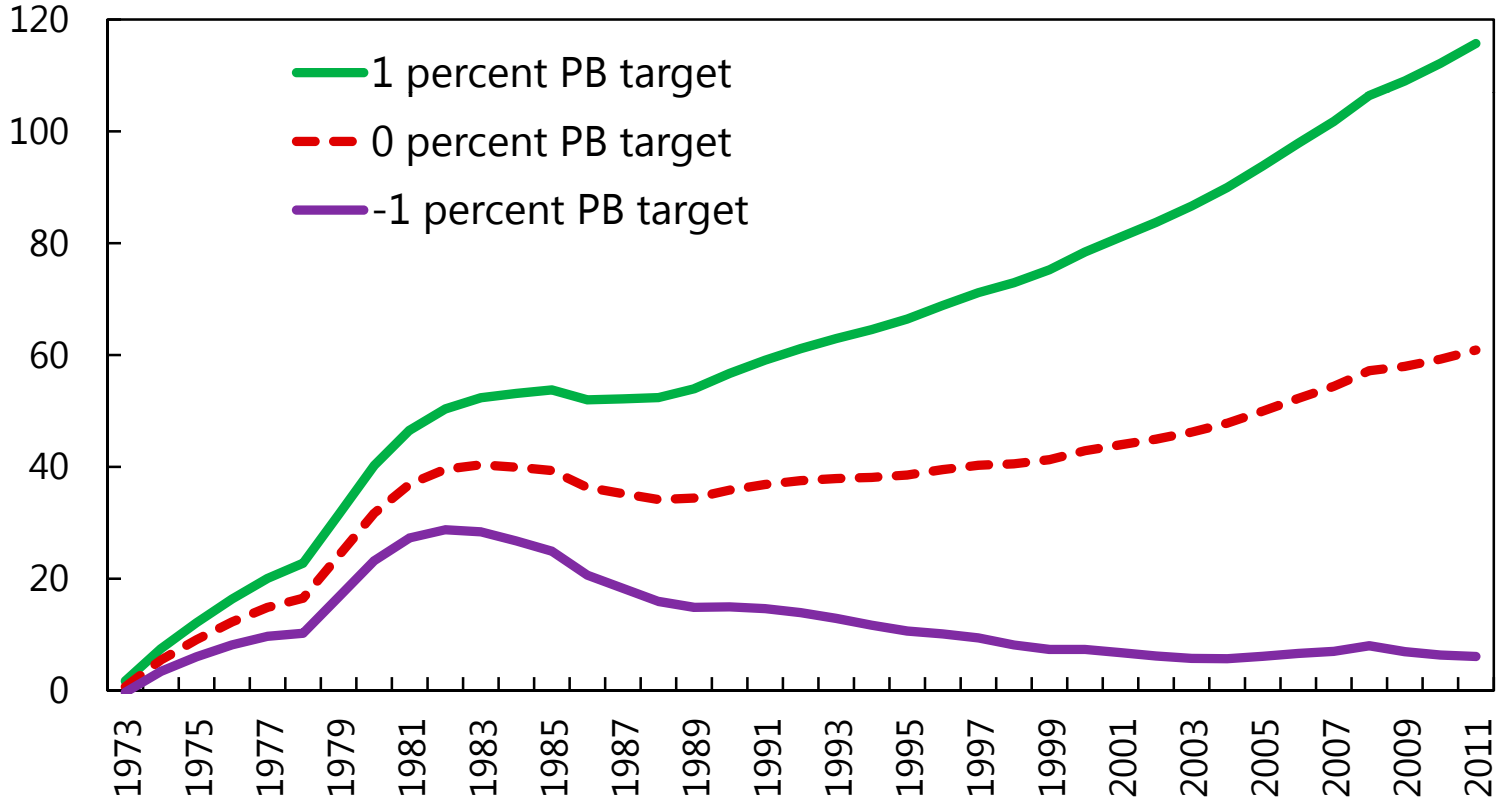


Sources: IMF staff calculations.

Managing Volatility: Incorporating Prudence

- **Smoothing rule can address sustainability concerns (e.g. Chile).**

Savings under 5/0/0 rule and alternative primary balance targets
(Percent non-resource GDP)



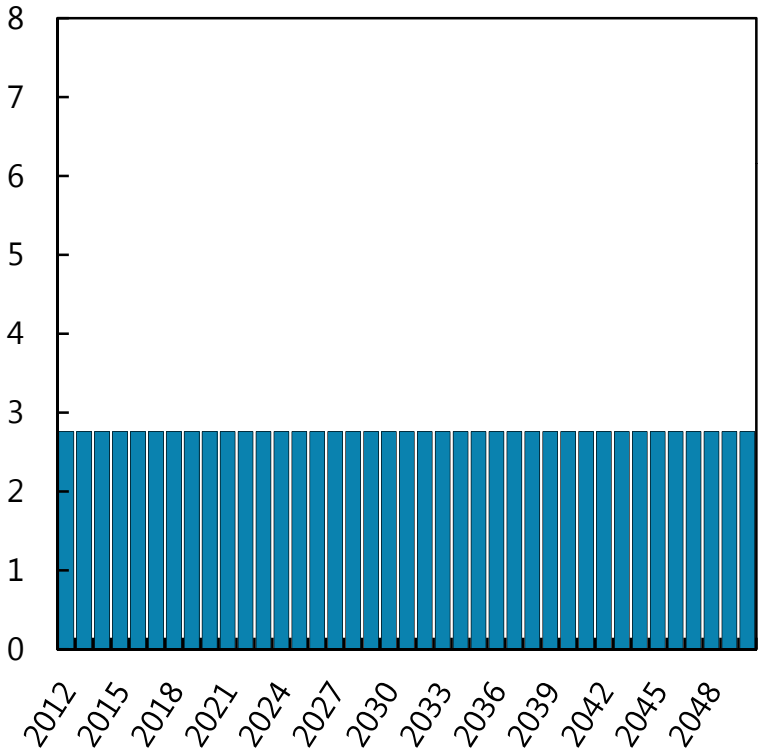
Sources: IMF calculations.

C. Assessing Sustainability

- **Compute PIH benchmark.**
- **Should you deviate from PIH?**
- **Answer: depends on impact of public investment on growth.**
  - Deviations could be justified if “resource wealth” is used well (good projects, human capital, etc.).

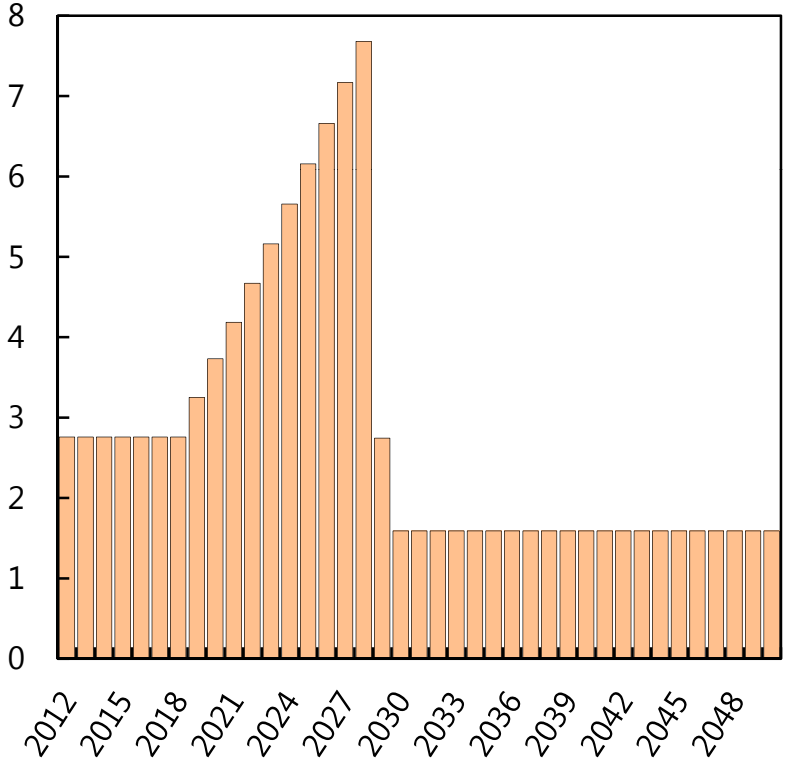
Assessing Sustainability

Hypothetical fiscal space: PIH
(Percent of non-resource GDP)



Sources: IMF Staff calculations.

Hypothetical fiscal space: FSF
(Percent of non-resource GDP)



Sources: IMF Staff calculations.

D. Critical Factor: Effective Investment

- **"Invest" in "public investment process".**
  - Capacity to select, implement and evaluate projects.

- **Why? It affects "fiscal returns".**
  - Key to ensure sustainability.

- **What else? Track use of resource wealth:**
  - Monitor share of public investment in total spending.

E. Resource Funds

- **What purpose?**
  - Save in “good times” and spend in “bad times”.
  - Save for future generations.
- **Source of funding? Fiscal surpluses.**
- **What to avoid? Independent spending authority.**
- **How many? One fund is easier to handle.**
  - Especially when capacity is limited.
  - Separate portfolios for stabilization and saving can be useful.

CONCLUSION

- **Conservative approach (e.g. PIH) not optimal.**
- **Investing part of the resource wealth can be better.**
- **But need to consider carefully:**
  - Absorptive capacity constraints (macro and micro).
  - Political economy: governance and transparency.
- **Misuse of resource wealth can be catastrophic:**
  - New approach increases the cost of inefficiencies.
  - Scaling up of spending should be gradual, in line with capacity.

Annex: Fiscal Framework Objectives

Decision Matrix		Natural Resource Revenues			
		Long-lasting		Short-term	
		Objectives	Examples	Objectives	Examples
Capital Scarcity	High	Macroeconomic Stability Managing Volatility Development	Iraq Nigeria	Macroeconomic Stability Sustainability/Exhaustibility Development	Ghana Bolivia
	Low	Macroeconomic Stability Managing Volatility	Saudi Arabia Canada Kuwait	Macroeconomic Stability Sustainability/Exhaustibility	Scotland Holland Norway