Fiscal Rules in Resource Rich Countries

David Mihalyi
Senior Economist, NRGI & Visiting Fellow, CEU
GIMPA-BSG Public Finance Workshop
Oct 2018
Our research

• Review of fiscal rules in resource rich countries (Resource Governance Index)
• 34 countries reviewed incl. 14 in Sub-Saharan Africa.
  – Characteristics of rule
  – Compliance with rule
  – Oversight of rule
Challenge 1: Growth

MINERAL EXPORTS AND GROWTH, 1970-2008

Source: World Development Indicators, World Bank
Challenge 2: Volatility

Data: IMF WEO. % change in expenditure & revenue measured in domestic currency
Challenge 3: Debt sustainability

Risk of debt distress in LDCs according to IMF / WB Debt Sustainability Analysis
Definition: A permanent quantitative constraint on government finances

How do they work?

• Constrain spending in good years so the government can spend more in bad years
• Stronger monitoring of government budgeting since there is a benchmark to measure against
Fiscal rule illustration

Budget revenue and expenditure

5 years

Surplus

Deficit

“Smoothed” expenditures

Revenues
Fiscal rule - Types

Overall 26% supra-national but 65% in SSA. CEMAC, WAEMU treaties and now EAC. Domestic only Botswana, Liberia, Uganda, Tanzania.

Mostly combination of budget balance rules, and debt rules. But details matter, many adopted more complex metrics. (e.g. non-oil balance)
Example - Tanzania’s fiscal rules

• Balanced budget rule: Non-gas deficit cannot exceed 3% of GDP

• Debt ceiling: Public debt cannot exceed 50% of GDP

• Expenditure rule 1: Recurrent expenditure growth limited to GDP growth rate

• Expenditure rule 2: Total expenditure has to remain below 40% GDP.

• Fund deposit and withdrawal rules: Excess gas revenues are saved in fund, which can be withdrawn during shortfall.
Fiscal rule compliance

Compliance during the commodity price shock in 2015-16

Out of 34 countries studied
Only 6 complied with their Fiscal Rules in both years 2015-16:
Botswana, Colombia, Indonesia, Liberia, Malaysia and Norway.

Rule not yet put to test in Ug, Tz
9 countries have supranational oversight, but shows limited effectiveness. (See WAEMU report)

13 countries have domestic oversight body. These vary in effectiveness. In Africa, only Nigeria has one (FRC), but last report from 2013.
What mechanisms promote fiscal compliance?

Robust organizational structure
- Economic development ministry or agency
- Compliance or audit within the bureaucracy
- Clear operational guidance

External oversight
- Independent gov. bodies
- Cooperation with government agencies
- Yearly reports on compliance
- Reports by CSOs, think tanks

Consensus building
- Political commitment

Punishment?
Thank You!

Contact: dmihalyi@resourcegovernance.org;
Operationalizing fiscal rules

- Constitution
- Legislation
- Regulation / Executive decree
- Policy
The good – flexible and counter-cyclical

Chile’s structural balance rule
The bad – Ineffective and procyclical

Liberia’s debt rule
The ugly – modified all the time

Mongolia’s debt rule

Gov. debt as % of GDP

- 2010
- 2011
- 2012
- 2013
- 2014
- 2015
- 2016
- 2017
Short-term growth impact of giant oil and gas discoveries

Cust & Mihalyi (2017): Evidence of a presource curse?
Optimistic projections - Mongolia
What you should avoid: Premature Funds

8% vs 14% (MNT)  1% vs 9% (USD)
Fiscal rules – Balanced (non-resource) budget rule

Primary or recurrent balance rule: Maximum x% (primary or recurrent) deficit allowed
Examples: CEMAC (non-grant), EU, Indonesia, Peru, Nigeria, New Zealand, Pakistan, WAEMU

Non-resource balance rule: Maximum x% deficit allowed after subtracting resource revenues
Examples: CEMAC

Budget balance rule (primary non-resource balance)

- Non resource revenue
- Public expenditure

e.g. 5% primary non-resource deficit
**Fiscal rules – Structural (non-resource) budget balance rules**

**Structural budget balance rule:** Maximum x% deficit “over the cycle”

*Examples: CEMAC, Chile, Colombia, EU, Germany, Mongolia*

**Non-resource structural balance rule:** Maximum x% deficit allowed “over the cycle” after subtracting resource revenues

*Example: Norway, Russia*

---

**Budget balance rule (Structural balance)**

- **Non resource revenue**
- **Public expenditure (structural balance)**

- e.g. 3% structural non-resource deficit
**Fiscal rules – Expenditure rules**

**Expenditure growth rule:** Limit on total or recurrent expenditure in absolute terms, in terms of expenditure growth, or as a percent of GDP

*Examples: Australia, Botswana, Brazil, Mongolia, Namibia, Peru, Poland*
Debt rule: Limit on public debt as a percent of GDP.

Examples: CEMAC, EU, WAEMU, Mongolia
Revenue rule: Constraint on the amount of (natural resource) revenue entering the budget

Examples: Ghana, Kazakhstan, North Dakota (USA), Timor-Leste, Wyoming (USA)