

How Did Fiscal Rules Hold Up in the Commodity Price Crash?

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Introduction

One proven strategy for avoiding the resource curse and taking full advantage of natural resource wealth for governments in low- and middle-income countries is to prioritize investing proceeds from natural resource, rather than consuming them. Another priority is to build up precautionary savings to mitigate the risk of boom and bust cycles associated with the commodity sector. Still, politicians and their voters are often tempted to favor short-term consumption over savings or investment. Fiscal rules are multi-year numerical constraints on budget balances, spending or public debt that can help policymakers commit to more sustainable policies.¹

Partly inspired by successes in managing resource revenues in countries such as Chile, Peru and Norway, countries that have established fiscal rules and have abided by these budgetary constraints for over a decade, a growing numbers of countries have been adopting such rules. Governments in countries and regions as diverse as Canada (Alberta), Colombia, Mexico, Mongolia, Uganda and Tanzania have enacted new rules over the last few years to help manage their resource wealth.

We reviewed the experience of using fiscal rules across resource rich countries. We carried out our research by building on the compilation of the Resource Governance Index 2017.² In-country researchers collected the answers and supporting evidence to a questionnaire regarding fiscal rule alongside other questions on resource governance.³ We complemented this research with additional desk research reviewing government reports, academic and policy studies.

Across the 79 countries assessed in the Resource Governance Index, we found that 34 of them have a fiscal rule in place. For each of these, we reviewed the evidence on its characteristics, the compliance with the rule and its oversight.⁴

This research looks at the evidence and experience of these countries from 2015 to 2016. These were by no means normal years for resource-rich countries. Commodity prices tumbled in 2014, and so the two subsequent years were characterized by important budget challenges in many resource-exporting countries. As a result, our research provides insight into how these fiscal rules performed under serious economic shocks. This report does not seek to evaluate the economic impact of having fiscal rules or their ability to combat economic volatility because these questions are difficult to measure in a robust way in these early stages. Instead, we review the degree of compliance and the role oversight actors played in ensuring compliance. This previously under-researched area is essential for creating policy recommendations for the development and implementation of fiscal rules.

1 George Kopits and Steven A. Symansky, *Fiscal Policy Rules*, (IMF 1998)

2 The data is available on www.resourcegovernanceindex.org

3 The background documents reviewed by researchers is available on www.resourcedata.org/ under Precept 7-8.

4 Unless otherwise indicated the supporting evidence is based on the Resource Governance Index research and available on the website.

1. What are fiscal rules?

A fiscal rule is a permanent quantitative constraint on government finances.⁵ It provides a numerical ceiling or target for some key budget aggregate, such as the budget balance, debt, or spending for many years ahead. Governments use them to contain spending pressures, to signal a commitment to fiscal responsibility and tie the hands of politicians who may be tempted to overspend, including to win elections. Independent research has shown that, through their promotion of macroeconomic stability and smaller deficits, they have the potential to improve investor confidence in a country, encourage better and more transparent planning, generate fewer debt crises and promote economic growth.⁶ A handful of governments have been using fiscal rules since the 1980s but following increased interest in them by academics and policy experts their adoption across the globe has surged in the last two decades.⁷

A fiscal rule, if appropriately designed and implemented, may help overcome three macroeconomic challenges associated with managing natural resource revenues: short- to medium-term pro-cyclical fiscal policy, long-run boom-bust cycles and “Dutch disease.”⁸ Governments seeking short-term political support may be inclined to spend all the resource revenue they receive, or in some cases to borrow in order to raise spending even further, in an effort to appeal to their electorate. Since commodity revenues are highly volatile, most resource-dependent governments exhibit “pro-cyclical fiscal policy.” Pro-cyclical fiscal policy is the tendency for governments to increase spending when revenues go up (often spending recklessly and without proper planning) and their subsequent need to decrease spending when revenues decline and they are unable to finance salaries or government operations. Oil, gas and minerals are finite resources. Nevertheless, many resource-rich countries do not save or invest for the benefit of future generations when they are receiving their revenue windfalls, leading to a long boom period followed by an economic recession or even a depression. Worse still, during peak production, governments may be flooded with a cash windfall. Spending it all abruptly, without adequate planning can result in a rise in domestic wages and prices without any substantive development outcome. The inflow of money can also lead to exchange rate appreciation, which will harm domestic non-resource exporters. Together, these effects, known as Dutch disease, can cause a decline in non-oil or non-mineral industries, and a lower standard of living for those disconnected from the resource sector.

Fiscal rules can be an important policy tools to help mitigate these macroeconomic risks. They can set a target on how much savings a country should accumulate before natural resource wealth is exhausted, or in order to avoid Dutch disease, fiscal rules can dictate how much can be spent in commodity boom times to make sure buffers are built up for downturns.⁹ (See Box 1 for a description of the types of fiscal rules.)

5 Andrea Schaechter, Tidiane Kinda, Nina Budina, and Anke Weber. *Fiscal Rules in Response to the crisis-Toward the Next Generation Rules. A new Dataset* (IMF, 2012).

6 Guillermo Perry. *Fiscal Policy and Procyclicality* (World Bank, 2008).

7 Francesca Caselli, Luc Eyraud, Andrew Hodge, Federico Diaz Kalan, Young Kim, Victor Lledó, Samba Mbaye, Adina Popescu, Wolf Heinrich Reuter, Julien Reynaud, Elif Ture, and Philippe Wingender. *Second-Generation Fiscal Rules; Balancing Simplicity, Flexibility, and Enforceability – Background Paper* (IMF, 2018).

8 Andrew Bauer and Perrine Toledano. *Managing the Public Trust: How to Make Natural Resource Funds Work for Citizens* (NRGI- CCSI, 2013).

9 Natural Resource Governance Institute, *Natural Resource Charter 2nd Edition* (2014), precept 7-8.

They can discourage overspending and waste by limiting a government's ability to grow expenditures too quickly. They provide a clear benchmark to measure progress in achieving long-term saving targets, and they can help guide macroeconomic policy to engage in counter-cyclical and sustainable behavior. Adopting fiscal rules can involve consensus building among decision-makers, help build political coalitions and strengthen the commitment to adhere to long-term objectives.¹⁰

Box 1. The International Monetary Fund (IMF) classifies fiscal rules in four categories.

- Debt rule (DR): Limit on public debt as a percent of GDP
- Budget balance rule (BBR): Limit on overall, primary or current budget balances in headline or structural terms
- Expenditure rule (ER): Limit on total, primary, or current spending, either in absolute terms, growth rates in nominal or real terms, or as a percentage of GDP
- Revenue rule (RR): Floor on overall revenue collection or ceiling on revenues entering the budget

In practice, governments often use some combination of these rules, and not all are equally common or used in the same way in resource-rich country settings. We discuss their prevalence in resource-rich countries in the next section.

Academic studies found mixed results on the impact of fiscal rules. A recent meta-analysis across 30 academic papers found that countries with fiscal rules have more fiscal discipline (as evidenced by smaller deficits), than those that do not. However, when comparing countries with similar characteristics, research shows that fiscal rules do not produce a statistically significant difference.¹¹ In oil-producing countries, studies found that fiscal rules had limited impact in holding back expenditure growth during the oil boom years.^{12,13} Another study of resource-rich countries finds that fiscal rules and resource funds have not reduced the procyclicality of government expenditure in a statistically significant way, but that strong institutions do help.¹⁴

Recent studies tend to emphasize that in order for fiscal rules to work, countries must tailor them to fit their own characteristics, including those of their resource sectors.¹⁵ Fiscal rules need robust design features that balance simplicity, flexibility and enforceability that supported by strong political institutions, consensus and commitment.¹⁶ Having well-functioning public financial management systems and transparency in place is also an important prerequisite to effective implementation of fiscal rules.¹⁷

10 Luc Eyraud, Xavier Debrun, Andrew Hodge, Victor Lledó, and Catherine Pattillo. *Second-Generation Fiscal Rules; Balancing Simplicity, Flexibility, and Enforceability*. (IMF, 2018).

11 Friedrich Heinemann, Marc-Daniel Moessinger and Mustafa Yeter. *Do fiscal rules constrain fiscal policy? A meta-regression-analysis*. (ZEW, 2016).

12 Correct citation: Rolando Ossowski, Mauricio Villafuerte, Paolo A. Medas and Theo Thomas. *Managing the Oil Revenue Boom: The Role of Fiscal Institutions* (IMF, 2008).

13 Rabah Arezki and Kareem Ismail. *Boom–bust cycle, asymmetrical fiscal response and the Dutch disease* (IMF, 2013).

14 Elva Bova, Paulo Medas, and Tigran Poghosyan. *Macroeconomic Stability in Resource-Rich Countries* (IMF, 2016).

15 *How to Select Fiscal Rules. A Primer* (IMF, 2018); Rolando Ossowski and Håvard Halland. *Fiscal Management in Resource-Rich Countries* (World Bank, 2016).

16 Eyraud, et al. *Second-Generation Fiscal Rules; Balancing Simplicity, Flexibility, and Enforceability*.

17 Ossowski and Halland, *Fiscal Management in Resource-Rich Countries*, 63.

2. Characteristics of fiscal rules across Resource Governance Index countries

Researchers have conducted various descriptive global and regional cross-country reviews of fiscal rules.¹⁸ Our work reviews and discusses the particular characteristics of national and supranational fiscal rules across established resource-rich countries and new producers as covered by the RGI. Of the 79 countries assessed in the RGI, 34 of them—43 percent—have fiscal rules in place.¹⁹ This ratio is nearly aligned with the global ratio: the IMF found 92 countries with fiscal rules in place in 2015, which represents 48 percent of all 193 United Nations (UN) member countries.

In most cases, fiscal rules set targets for the central government, but governments can also prescribe them at the regional and local level (e.g., the province of Alberta in Canada sets its own rules). National governments set most fiscal rules, but currency unions (such as Central African Economic and Monetary Union (CEMAC), Western African Economic and Monetary Union (WAEMU) and the European Union (EU)) have also set supranational rules for all their members. This review includes national and supranational rules, but not subnational fiscal rules. Fiscal rules are also often conflated with budget targets set out in medium-term fiscal frameworks (MTFF), which governments may revise annually. We limited our review to fiscal rules and did not review the adoption of MTFF.

Within our sample of countries, fiscal rules are similarly prevalent across various income categories. (See Table 1.) Some of the poorest countries, such as Liberia and Burkina Faso, have a fiscal rule, as do wealthier countries such as Norway and the United Kingdom. A large number of low-income countries have a fiscal rule in place (41 percent), however; only three countries (Liberia, Tanzania and Uganda) have national fiscal rules. The remaining countries are governed by supranational rules. Overall, there are very wide disparities in the adoption of fiscal rules regionally. (See Table 2.) None of the 15 Middle Eastern or Northern African countries in our sample have fiscal rules, though they have been widely adopted in Latin America, Africa and Western Europe. Out of the 14 countries with fiscal rules in sub-Saharan Africa, only five are governed by national rules. The remaining countries follow supranational mandates.

18 Juan Carlos Berganza. *Fiscal Rules in Latin America: A Survey* (Banco de España, 2012); Víctor Lledó, Sungwook Yoon, Xiangming Fang, Samba Mbaye and Young Kim. *Fiscal Rules at a Glance* (IMF, 2017).

19 We excluded the two subnational jurisdictions covered in the RGI—Alberta in Canada and Western Australia—in order to only compare national rules. In cases where the RGI assessed both the mining and hydrocarbons sectors separately, we only counted them once, as fiscal rules do not necessarily map to a specific commodity.

Income level	Number of countries in RGI	RGI countries with fiscal rules	Percentage with fiscal rules	RGI countries with national fiscal rules	Percentage with national fiscal rules
Low	17	7	41%	3	18%
Middle	51	23	45%	18	35%
High	11	4	36%	4	36%

Table 1. Fiscal rules prevalence by income group^{20, 21}

Region	Number of countries in RGI	RGI countries with fiscal rules	Percentage with fiscal rules	RGI countries with national fiscal rules	Percentage with national fiscal rules
Eurasia	9	4	44%	4	44%
Middle East and North Africa	15	0	0%	0	0%
Sub-Saharan Africa	28	14	50%	5	18%
Latin America and Caribbean	12	8	67%	8	67%
Asia-Pacific	12	5	42%	5	42%
Western Europe and U.S.	3	3	100%	3	100%

Table 2. Fiscal rules prevalence by region

As illustrated by the results in Table 3, there is a strong positive correlation between having a strong overall RGI score and having fiscal rules. The positive correlation is no surprise as having a fiscal rule improves a country’s RGI score, though it would still hold after excluding those particular questions from the index calculations. This positive correlation between good governance and fiscal rules is not sufficient to determine the direction of causality, however correlation highlights the salience of discussing fiscal rules in the context of governance, instead of merely considering it a technocratic policy question.²²

20 This and subsequent tables and graphs are based on author’s calculation using data collected for the 2017 Resource Governance Index.

21 Income level categories are based on the World Bank definition.

22 Causality would be very hard to establish, as countries generally establish fiscal rules as part of broader governance reforms. Yener Altunbaş and John Thornton. *Why Do Countries Adopt Fiscal Rules?* (The Manchester School, 2015).

RGI performance	Number of countries in RGI	RGI countries with fiscal rules	Percentage with fiscal rules	RGI countries with national fiscal rules	Percentage with national fiscal rules
Good	3	3	100%	3	100%
Satisfactory	11	9	82%	9	82%
Weak	28	14	50%	9	32%
Poor	27	7	26%	4	15%
Failing	12	1	8%	0	0%

Table 3. Fiscal rules by Resource Governance Index score

While country governments adopted some of the fiscal rules currently in place before the start of the commodity price boom in early 2000s, most of them are newer. A notable exception is Malaysia, which adopted a budget balance and debt rule in 1959 that is still in place. Since 2000, the number of countries adopting fiscal rules has increased substantially.²³ What’s more, a third of the fiscal rules included in the RGI are less than 10 years old.²⁴

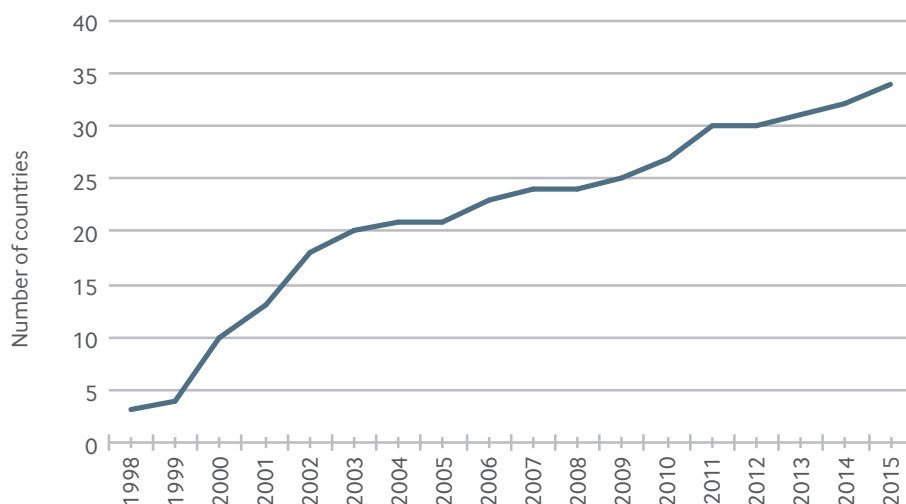


Figure 1. Number of Resource Governance Index countries with fiscal rule in place

Of the 34 countries with fiscal rules analyzed, 25 rules were adopted through legislation, while nine were set through other forms of government policy. (See Figure 2.) Though setting fiscal rules in laws is often described as preferable, our review finds mixed evidence.²⁵ Countries that do not legislate their fiscal rules include Botswana and Norway (where fiscal rules are based on a multi-party commitment), which researchers often cite as exemplars of good revenue management. However, Azerbaijan and Malaysia, which have had less success with revenue management, also do not include fiscal rules in legislation.²⁶

23 Xavier Debrun, Tidiane Kinda, Teresa Curristine, Luc Eyraud, Jason Harris and Johann Seiwald. *The Functions and Impact of Fiscal Councils*, (IMF, 2013), 22.

24 Uganda and Tanzania both adopted fiscal rules in 2015, which we reviewed, but these were yet to be operational in the period under review, so we did not evaluate compliance. Other countries, such as Ghana, for example, are in the process of adopting new fiscal rules that we do not consider in this study.

25 For an example, see the European Commission’s Fiscal Rule Strength Index.

26 Andrew Bauer and David Mihalyi. “Why Weren’t Governments Better Prepared for the Commodity Price Crash?” (NRGI, 2015).

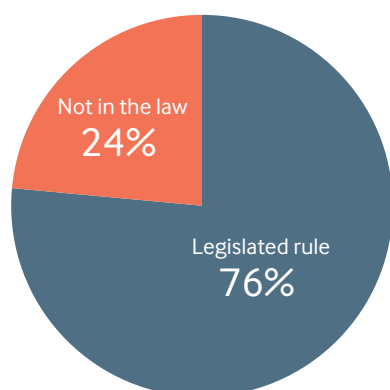


Figure 2. Resource Governance Index countries with fiscal rules legislated

Twenty-five countries have fiscal rules set at the national level, while nine have rules that were set at supranational level. Countries included in the RGI that have supranational fiscal rules include the members of the West African Economic and Monetary Union and those of the Central African Economic and Monetary Community.²⁷ (See Figure 3.)

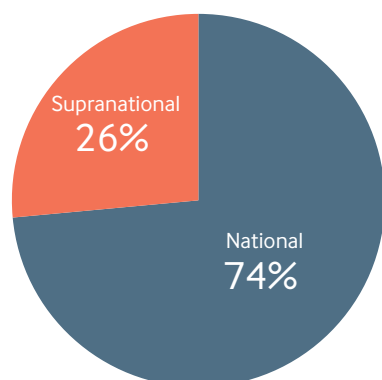


Figure 3. Resource Governance Index countries with national versus supranational fiscal rules

An examination of fiscal rules by type as illustrated in Figure 4 shows the prevalence of budget balance rules and debt rules, and highlights that most countries have more than one type of rule in place.²⁸

27 The U.K. opted out of the EU Fiscal Stability Treaty adopted in 2012, hence we only look at its domestic fiscal rules. The East African Monetary Union has agreed on convergence criteria but these only need to be achieved by 2021, and so do not act as fiscal rules for the period reviewed.

28 We examined 67 different rules across 34 countries.

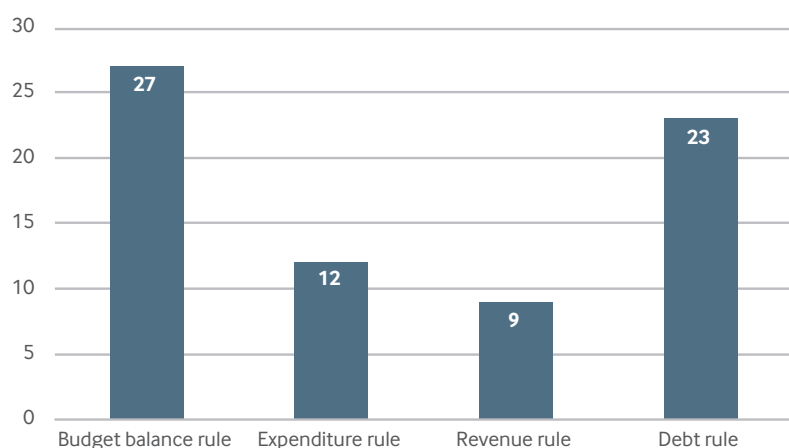


Figure 4. Types of fiscal rules across Resource Governance Index countries

The most common among the fiscal rules we examined are budget balance rules—27 countries had such a rule. The next most common are debt rules, which 22 countries have established. Expenditure and revenue rules are the least common in RGI countries.

BUDGET BALANCE RULES

Twenty-seven countries had a budget balance rule in place, making it the most common type of fiscal rule in our review. Budget balance rules can be further distinguished depending on the target indicator they set for themselves.

In 17 of these countries, the target was the overall fiscal balance, the difference between revenues and expenditures. Examples include Indonesia, Mexico, Nigeria and Philippines. This type of rule is simple to communicate and monitor, and straightforward for governments to operationalize. Depending on the target set, a budget balance rule can enable governments to accumulate savings or balance their budgets. However, budget balance rules are procyclical everywhere because they allow expenditures to increase with rising revenue, and if binding, they force expenditure cuts when revenues are declining. In resource rich countries, this is exacerbated as the rules simply transmit the volatility of resource revenue into fiscal policy. These rules do not provide flexibility in adjusting to larger commodity price drops, which may require governments to spend more to offset their economic costs if the fiscal position remains sustainable and financeable. For example, Nigeria has a flat three percent deficit ceiling, which it comfortably achieved in the oil boom years. However, the government allowed procyclical increases in spending during the resource boom, which in turn resulted in overall balances that did not generate significant savings. Ultimately, the government missed the ceiling after the oil price crash. In another example, the CEMAC area sets a zero balance target for all its members. In practice, the target proved overly ambitious—the six member states only complied 40 percent of the time over a 10-year period and none followed the rule after the commodity price crash of 2014.²⁹

Malaysia has a current balance rule, also called a “golden rule,” which targets the balance of revenues and recurrent expenditures. This in practice means that the government only borrows for developmental or capital spending.

²⁹ IMF, *Central African Economic and Monetary Community (CEMAC): Selected issues Country Report No. 17/393* (2017), 4.

Five countries—Chile, Colombia, Mongolia, Peru and the U.K.—have structural budget balance rules. Structural budget balance rules set a target to achieve over an economic cycle, and allow for adjusting the target depending on whether there is a boom or a downturn. These rules are particularly relevant in resource-rich countries, where governments generally design such structural rules to dampen and counter the effects of commodity cycles and the cycle of the domestic economy. While this type of rule provides the most flexibility to respond to shocks, it also requires strong statistical systems as it involves complex calculations. This also makes structural budget balance rules hard to communicate and monitor. In 2001, Chile introduced such a rule to improve fiscal management and reduce public debt.³⁰ For more than a decade, the Chilean rule had been an example of good fiscal management in Latin America. However, in 2015, the government changed the calculation of the cyclically adjusted balance (CAB) for a more complex formula than it had used during the previous decade, making it more difficult to monitor and interpret.³¹

Four countries—Tanzania, Norway, Botswana and Ecuador—use a non-resource budget balance target that is the difference between expenditures and all revenues except for resource revenues. Targeting this balance, which is more under the control of the government than the overall balance, allows the government to follow the same budget path irrespective of commodity revenue fluctuations, if the fiscal position is sustainable and financeable. As such, it can help insulate and decouple fiscal policy from resource revenue fluctuations, at least in the short run, and thus contribute to macroeconomic stabilization. Tanzania provides the clearest example: the non-gas deficit limit is set at three percent of GDP, meaning that any gas revenue above and beyond that level needs to be saved for times of poor economic performance or until after gas revenues are exhausted. Norway targets a structural non-resource balance, adjusted for the cycle of the nonoil economy. Botswana and Ecuador use a non-resource current balance (another variant of the golden rule), which targets the balance between non-resource current revenues and non-resource current expenditure. This rule emphasizes that resource revenues and borrowing are targeted at developmental and capital spending.³²

DEBT RULES

Twenty-three countries (or over 60 percent) of the RGI countries with fiscal rules had a debt rule in place, which sets a limit on public debt as percentage of gross domestic product (GDP). This type of rule is simple to communicate and monitor. However, debt rules do not provide a clear short-term guidance to policy makers because in the short run the level of debt is often less impacted by budgetary measures and policy choices, but more affected by changes in interest and exchange rates.³³ In resource-rich countries, such a rule may block a government from borrowing in a commodity price slump as GDP plummets, while in boom years the debt target might be so high that it does not provide meaningful guidance. For example, the Kyrgyz Republic adopted a debt rule in 2014 that set a debt ceiling at 60 percent of GDP. This government breached this rule in 2015 largely because

30 These are based on the GDP trend and long-term copper prices.

31 The new formula does not set specific targets, but it adjust over time base on changes on commodity prices and GDP trend. Decreto N° 1378, de 2015 (modifica el Decreto Supremo N° 892, de 03 de julio de 2014, del Ministerio de Hacienda), www.hacienda.cl/fondos-soberanos/legislacion/politica-fiscal/decreto-n-1378-de-2015-que-modifica.html, (3 July 2014).

32 Ossowski and Halland, *Fiscal Management in Resource-Rich Countries*, 60.

33 Schaechter, et al. *Fiscal Rules in Response to the Crisis*, 7.

of the sudden depreciation of the Kyrgyzstani som (alongside the Russian ruble and the Kazakhstani tenge), which caused a spike in value of the foreign currency denominated debt.

EXPENDITURE RULES

Twelve of the countries reviewed used expenditure rules. Countries with expenditure rules include Brazil, Botswana, Mexico, Peru and the U.S. Some of these rules set ceilings on total, primary (excluding interest) or current (excluding capital) government spending. Others provide a cap on the growth rates of spending, either in nominal or in real terms, for a number of years. These rules address spending pressures directly. They also accommodate revenue shortfalls (which do not have to be compensated), thereby providing some stabilization effects in downturns. They are easy for governments to operationalize, and relatively easy to monitor and communicate. However, governments can circumvent rules by engaging in off budget spending, not providing flexibility to respond counter-cyclically to commodity price shocks and not distinguishing between productive and unproductive spending. Governments may try to comply with an expenditure rule by cutting productive spending. Countries with new resource discoveries but limited spending capacity may consider using expenditure rules to surmount pressures to spend based on expectations of future wealth. For example, Tanzania set a limit on its recurrent expenditure growth, capping growth in nominal GDP, and adopted a cap on total spending at 40 percent of GDP. This, however, can be highly pro-cyclical if rapidly rising resource GDP boosts nominal GDP.

REVENUE RULES

Nine of the countries reviewed use revenue rules. These rules typically set a minimum floor on government revenue collection. An example is the target to collect at least 20 percent of GDP in revenues across WAEMU members. These rules are easy to monitor and communicate. Resource-rich countries have set up regulations to limit how much resource revenue should enter the budget and how much they should deposit into a sovereign wealth fund. These will only constrain government finances if complemented by other rules that limit borrowing or debt. Otherwise, governments can save a portion of revenues, while borrowing at the same time and fail to achieve their objectives. Therefore, we do not consider the resource revenue deposit and withdrawal rules used for sovereign wealth funds as fiscal rules (as in the cases of Ghana, Iran, Kazakhstan or Timor-Leste), unless countries use them in combination with other types of rules.³⁴ An example of this is Botswana, which requires resource revenues to either be saved in the Pula Fund (its sovereign wealth fund) or invested domestically. Botswana complements this rule with expenditure and debt limits that ensure that not only the letter but also the spirit of the rule is followed.

34 Professional opinions differ on this: the World Bank review of fiscal rules in resource rich country does not consider them to be fiscal rules. The IMF considers revenue deposit and withdrawal rules used in sovereign wealth funds, as long as they remain unchanged for at least three years, as numerical fiscal rules.

Three quarters of the countries with fiscal rules reviewed have more than one type of rule in place.³⁵ In these cases, we should evaluate no single rule on its own; rather we should assess their combined impact.³⁶ For example, Peru's system of fiscal rules combines a budget balance rule and a debt rule. Mongolia combines all four main types of fiscal rules.

Fifteen countries, or about half of the sample, have fiscal rules that explicitly incorporate oil or mineral sector performance. The most common is in the form of non-resource budget balance rules mentioned above, such the non-oil deficit limit in CEMAC countries and Nigeria, the structural non-oil deficit target of Norway, or the non-oil recurrent deficit target in Ecuador. However, mineral sector performance can also feature in other types of rules. Mongolia, for example, caps expenditure growth at the growth rate of non-mineral GDP. The governments of Azerbaijan and Botswana tie resource revenues to spending on investment.

Other governments use commodity revenue projections to set their budget envelopes as part of various fiscal rules, at least in theory. Chile, Mongolia, Peru and Russia all claim to stabilize expenditures by paying down public debt or saving a portion of their oil or mineral windfalls when revenues are above average and borrowing or drawing down on those savings when revenues are below average. These countries employ different approaches to calculate a reference commodity price for use in their projections. In Chile, the government uses an independent panel of experts to determine the reference price; Mongolia and Russia base their rules on historical prices; and Mexico uses a combination of historical prices and estimated future prices.³⁷ However, in practice, it is unclear that countries calculate projections as objectively as they claim.

In the next section, we review the degree of compliance observed with these rules.

35 The IMF review found that among the countries that adopted fiscal rules since 2000, only 40 percent of them adopted a combination of rules. Schaechter, et al., *Fiscal Rules in Response to the Crisis*, 14.

36 We do not discuss how to set appropriate target for a fiscal rules here. *Fiscal Frameworks for Resource-Rich Developing Countries* (IMF, 2012), *How to Select Fiscal Rules. A Primer* (IMF, 2018) provides some insight on setting a target depending on resource horizon and scarcity of capital.

37 *Managing the oil economy – Can Mexico do it better?* (OECD, 2009).

3. Compliance with fiscal rules during the commodity price crash

Having fiscal rules in place by no means guarantees that the government will follow them. An earlier review of fiscal rule compliance across the globe by the IMF showed that governments comply with fiscal rules approximately 60 percent of the time and that among the different types of rules expenditure rules have the highest level of compliance.³⁸ New IMF research shows that countries are more likely to follow budget balance rules when these rules are combined with debt or expenditure rules.³⁹ Another review of rules in the EU found that fiscal rules are followed 50 percent of the time.⁴⁰

The present study brings additional insight on compliance from resource-rich countries during commodity bust years. The earlier IMF and EU cross-country studies on compliance with fiscal rules treat compliance as binary—the government either follows or does not follow the fiscal rule. In contrast, our work dives into the various ways non-compliant countries choose to sidestep their fiscal rules: whether they chose to suspend or modify the rule, invoked an escape clause, admitted the violation, or simply ignored the rule.

We reviewed compliance with fiscal rules in the 34 RGI countries in 2015 and 2016. These were no ordinary years as the decline in commodity prices was substantial and enduring. The market crash unleashed serious challenges to public finances in the countries covered by the RGI. Shrinking foreign exchange earnings immediately impacted major exporters and countries with large sectors needed to deal with the declining profits from natural resources. Moreover, new and future resource producers (e.g., Uganda and Sierra Leone) had to shed or revise their aspirations of soon becoming resource-rich.



Figure 5. Average of GDP growth per capita across Resource Governance Index countries versus global growth rate⁴¹

38 Till Cordes, Tidiane Kinda, Priscilla Muthoora and Anke Weber. *Expenditure Rules: Effective Tools for Sound Fiscal Policy?*(IMF, 2015), 10.

39 Caselli, et al. *Second-Generation Fiscal Rules; Balancing Simplicity, Flexibility, and Enforceability*, 43.

40 Wolf Heinrich Reuter. *When and why do countries break their national fiscal rules?*(German Council of Economic Experts, 2016), 21.

41 IMF, *World Economic Outlook Database*, Fall 2017.

The countries in the RGI sample grew significantly faster than the world’s average growth rate during decade-long commodity boom, which ended abruptly in 2014. The average country in the RGI was growing at three percent per year per capita in 2001-2013, whereas its growth fell to 1.3 percent per capita in 2015-16. The RGI countries were growing at about double the global average before the price crash, but after the price crash, their growth dipped below the world average on a per capita basis. This highlights how difficult the two years we reviewed were for the countries in our sample.

In our review of fiscal rule compliance in 2015 and 2016, we found that overall, only six countries fully adhered to fiscal rules in both years.⁴² In 25 cases, the rule was suspended, modified or disregarded. Only one country, Peru, invoked a well-defined (and sensible) escape clause, rather than modify or break its fiscal rule. Two other countries—Tanzania and Uganda—adopted their rules in 2015, hence are only beginning to implement their fiscal rules now. This means countries complied with their rules in roughly one in five country cases. No country complied with supranational fiscal rules. (See Appendix 1 for detailed results.)

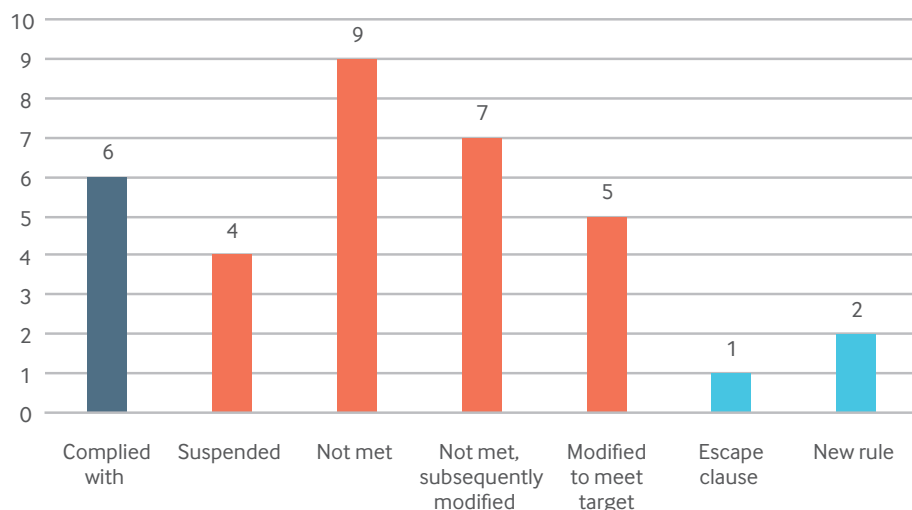


Figure 6. Number of Resource Governance Index countries in compliance with fiscal rules in 2015 and 2016⁴³

RULE COMPLIANCE

Out of the 34 countries reviewed, only six countries followed their fiscal rules fully in both 2015 and 2016: Botswana, Colombia, Indonesia, Liberia, Malaysia and Norway.

Colombia adopted a fiscal rule in 2011 and was able to follow it in the economic downturn despite difficult economic times. This is because under its structural budget balance rule, Colombia had to adjust much less harshly than if it had an overall balance rule: both the structural oil price adjustment and the adjustment for the cyclical position of the economy provided additional fiscal room.

⁴² We review both 2015 and 2016 and only categorize a country as compliant if a country followed and did not change their rule throughout both years. A number of countries first broke the rule in 2015, and then modified it in 2016.

⁴³ Author’s calculation based on Resource Governance Index 2017

Norway's rule, adopted in 2001, did not require much adjustment to government spending. The rule targets non-oil structural deficit, and therefore is decoupled from oil price fluctuation and accommodates any potential slow-down in the non-oil economy. In practice this means that Norway can draw down and spend more from its large sovereign wealth fund, when oil prices drop. Therefore Norway did not only comply with its own fiscal rule during the oil price crash in both 2015 and 2016, but the government then decided to revise its rule in 2017 to make it somewhat stricter. It changed the cap on the maximum deficit from four percent of savings accumulated in the oil fund to three percent.⁴⁴

Botswana first set fiscal rules in 1994 based on the "Sustainable Budget Index" principal, a non-resource recurrent balance rule, which ensures that government either saved resource revenues or spent them on domestic investment. Since then, it has additionally implemented an expenditure ceiling and a debt ceiling.⁴⁵ The budget balance target and additional expenditure caps are not legislated, rather are set in the six-year National Development Plans. On top of these, there is also a legislated debt rule in place. Countries generally followed the various fiscal rules throughout the years, but the IMF findings show that the budget balance rules "have been generally observed with some flexibility."⁴⁶ However, Botswana is also a special case, as the per-carat price of diamonds rose in 2015-2016 compared to 2013.⁴⁷ Rather than dealing with a commodity price crash like that endured by the oil- and metal-producing countries, Botswana instead enjoyed an upturn in its commodity pricing, thus making it easier for the country to comply with its rule.

Indonesia complied with its budget balance rule and debt rule in both years reviewed. This follows a strong track record of compliance since the rules were legislated and incorporated into a coalition agreement in 2003. Indonesia's budget is less dependent on oil revenues than budgets in other oil producers reviewed.⁴⁸ The government also spent large amounts on fuel price subsidies, which became easier to phase out as oil prices dropped.⁴⁹ The lessened impact of oil price drop on budget revenues and its beneficial impact on spending made it considerably easier for the government to comply with its overall balance fiscal rule in the period reviewed.

The fact that Liberia complied with its fiscal rule is unsurprising given how the rule is written. Liberia adopted a debt ceiling in 2009, the year before obtaining almost complete debt relief.⁵⁰ With the debt ceiling set at 60 percent of GDP, while the country's debt shrunk to 30 percent, the debt rule was clearly too loose to provide any meaningful restrictions on government action. However, recent forecasts suggest that the debt limit now is coming increasingly close, which will soon put the rule to a more challenging test. (See Figure 6.)

44 OECD, *Economic Surveys, Norway* (2018), 4.

45 These two ceilings are set at relatively high levels compared to current trends, so are less likely to act as a critical constraint on government policies.

46 IMF Macroeconomic Policy Frameworks for Resource-rich Developing Countries Background Paper 1, 2012, p.34.

47 Historical diamond prices per carat, according to Statista.

48 Oil revenues only constituted about 10 percent of total central government revenues in 2014-2016. IMF CR 18/32.

49 It reached 20 percent of total central government spending in 2013. Audit Board of the Republic of Indonesia. Annual audit report 2013, BPK

50 Liberia Qualifies for Complete Debt Relief under HIPC Initiative. IMF. "IMF Survey: Liberia Wins \$4.6 Billion in Debt Relief from IMF, World Bank" www.imf.org/en/News/Articles/2015/09/28/04/53/socar062910a# (accessed 13 November 2017)

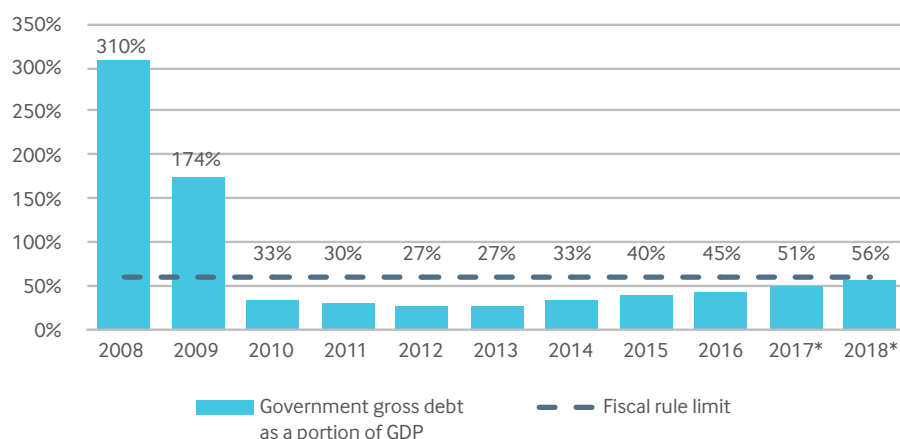


Figure 7. Liberia’s debt versus its fiscal rule⁵¹

According to the Malaysian Central Bank, the government complied with its public debt ceiling of 55 percent of GDP in both 2015-2016.⁵² However, the newly elected Malaysian government recently claimed that the debt was much higher than previously disclosed, citing that the previous administration excluded contingent liabilities and other debts from the official figures. If these figures were included public debt would have reached 80 percent of GDP at the end of 2017.⁵³ Though we assess that the numerical rule was complied with in 2015 and 2016, the large off-budget liabilities and irregularities relating the country’s development bank, 1Malaysia Development Berhad (1MDB), put into question whether the spirit of the fiscal rule was followed.⁵⁴

RULE SUSPENDED

In four countries—Argentina, Azerbaijan, Russia and Venezuela—the rule was essentially suspended during the period reviewed. Argentina had delayed setting its rule even, before the fall of commodity prices. The Fiscal Responsibility Law of Argentina set fiscal rules (a budget balance rule and an expenditure rule) in 2004, which covered both provinces and municipalities. However, in 2009 a coalition of legislators reversed the rule, allegedly in response to the global financial crisis. This vote suspended the government’s obligation for meeting macroeconomic targets, letting provinces accumulate debt to cover government wages. Argentina reactivated its fiscal rule in 2016.

51 2017 and 2018 data represent IMF forecasts. IMF, World Economic Outlook Database, Fall 2017.

52 Federal government domestic debt in 2015 (54.5 percent of GDP); and 2016 (52.7 percent of GDP). Bank Negara Malaysia. Statutory requirement. www.bnm.gov.my/files/publication/ar/en/2015/ar2015_book.pdf (2015), 123; www.bnm.gov.my/files/publication/ar/en/2016/ar2016_book.pdf (2016), 83.

53 Anisah Shukry and Michelle Jamrisko. Malaysia’s 1 Trillion Ringgit Government Debt Explained. www.bloomberg.com/news/articles/2018-05-24/malaysia-s-1-trillion-ringgit-government-debt-explained (accessed 5 June 2018).

54 Malaysia 1MDB Controversy. Bloomberg. www.bloomberg.com/news/special-reports/malaysia-1-m-d-b-controversy (accessed 5 June 2018).

Similarly, Russia implemented a first fiscal rule in 2007, but suspended it two years later to accommodate more spending in response to its financial crisis.⁵⁵ The Russian government introduced a new expenditure rule in 2013. This second rule allowed for overly generous spending, which the dwindling reserves in Russia's oil fund simply could not accommodate. Therefore, Russia suspended the rule in 2015 in response to low oil prices and sanctions. It removed this rule in 2017, and is currently drafting a new one.⁵⁶

Venezuela introduced its first fiscal rule in 2000, capping government expenditure of oil and gas revenues at 62 percent, with a plan to gradually reduce expenditures to 50 percent.⁵⁷ The Venezuelan government earmarked up to 20 percent of revenues from oil and gas taxes to finance public debt-service reduction. However, the current law soon overturned the rule by establishing various spending and deficit limits.⁵⁸ The current law provides ample room for discretion and has been modified seventeen times since its adoption with negligible public awareness of those changes and with little adhesion to the targets.^{59,60,61} In practice, the fiscal rules are not being implemented anymore.⁶²

FAILURE TO COMPLY

Sixteen countries failed to comply with their fiscal rules in at least one of the two studied years. Seven of these countries decided to subsequently modify the rules.

Both the CEMAC and WAEMU supranational rules had very low compliance rates with multiple rules broken by all their members. No member country managed to follow the budget balance rules in 2016. The majority of members violated the WAEMU rule that provides a floor on revenue collection and the CEMAC rule that limits the accumulation of payment arrears. Most countries met the debt rule, which sets a ceiling of 70 percent of GDP for debt, by a wide margin. Of the countries we reviewed, only the Republic of Congo breached its debt rule, surpassing the limit in 2015, and then defaulted on its debt the next year.⁶³ This highlights that ambitious deficit rules were mostly missed, in contrast to the debt rule, which was so lax that it

55 Lledó, et al. *Fiscal Rules at a Glance*, 65.

56 Apurva Sanghi and Naoko Kojo. "Will Russia's new fiscal rule end its oil and gas dependence?" Brookings Institution. www.brookings.edu/blog/future-development/2017/12/06/will-russias-new-fiscal-rule-end-its-oil-and-gas-dependence/ (accessed 1 April 2018).

57 Ley organica del regimen presupuestario LORP. Organic Budget Law 2000 www.onapre.gob.ve/index.php/publicaciones/descargas/finish/32-ley-organica-de-regimen-presupuestario-lorp/199-ley-organica-de-regimen-presupuestario-lorp (22 March 2000)

58 Ley Organica de la administracion financiero del sector público 2000. The Organic Law of Financial Administration for the Public Sector www.oas.org/juridico/spanish/ven_res35.pdf (5 September 2000)

59 Osmel Manzano and Jose Sebastian Scrofina. *Resource Revenue Management in Venezuela: A consumption-based poverty reduction strategy* (Revenue Watch, 2013), 1.

60 Latest modified on Decree 6.210 (30 December 2015).

61 Transparencia Venezuela "Ejecutivo adeuda estimaciones para el presupuesto 2017." transparencia.org.ve/otra-mas-para-la-cuenta-el-ejecutivo-adeuda-estimaciones-para-el-presupuesto-2017/ (accessed 12 January 2018).

62 Berganza. *Fiscal Rules in Latin America: A Survey*, 31.

63 Robin Wigglesworth. "Republic of Congo in default amid crude slump – S&P," *Financial Times*. www.ft.com/content/28cfa220-ff8f-3122-a134-4e67f2022e62, 2 August 2016.

only constrains government when it is too late. CEMAC has revised its fiscal rules in response to the failure to set targets that were both sustainable and complied with and has replaced them with new rules effective January 2017. The new debt rule will look at not only the absolute levels of debt, but also the speed of accumulation. The new budget balance rule will set different targets for countries depending on how much oil revenues they should save.⁶⁴

The Kyrgyz Republic had a debt ceiling of 60 percent of GDP. After breaching the threshold in 2015 and 2016, the country abandoned this fiscal rule in 2017. The government of the Philippines set itself a deficit ceiling of two percent of GDP and complied with it until 2015, but breached it in 2016. From 2017 onwards, the government set a new target of three percent GDP.

RULE MODIFIED

Countries often amended fiscal rules as a response to the price crash. Five countries preemptively modified their respective rules to meet the numerical target more easily. This is in addition to the seven governments that broke their respective rules first, and then modified them in subsequent years. For example, the Ecuadorian government amended the public debt calculation in 2016 in order to use consolidated debt figures rather than aggregate figures. This relies on netting out certain transactions between state entities, a process generally encouraged by statistical authorities. Unfortunately, the modification of the formula for debt calculations, predictably led to a large drop in reported debt. Before the modification, the Ecuadorian public debt level was close to the fiscal rule limit (40 percent of GDP). Once modified, the adjusted official public debt figure declined to 26.7 percent of GDP, providing additional space for public borrowing within the fiscal rule limits.^{65,66}

Some countries regularly modify their fiscal rules. Mongolia provides an example of rule modification for political expediency. The Fiscal Stability Law of 2013 set a threshold budget deficit of two percent of GDP and 40 percent of GDP for debt ceiling. The government missed these targets repeatedly, but went on to amend the rules in the Fiscal Stability Law four times over four years, each time providing higher debt limits, as government debt rose to about 90 percent of GDP.⁶⁷

64 IMF. *Country Report No. 13/393* (2017), 13.

65 Presidential decree 1218 www.multiplica.com.ec/sites/default/files/archivos_informativos/Decreto%20cambio%20c%C3%A1culo%20deuda%20p%C3%BAblica.pdf (5 February 2018)

66 "Decreto de Rafael Correa 'maquilló' la deuda, concluyó auditoría." *El Universo* www.eluniverso.com/noticias/2018/03/15/nota/6667081/decreto-correa-maquillo-deuda-concluyo-auditoria (1 April 2018).

67 In addition, the fiscal rules were circumvented by assigning quasi-fiscal expenditures to the development bank, which was outside the rules and financed by foreign loans. This has since been fixed and the development bank is now under the rules.

Countries with long histories of fiscal compliance also modified their rules during the commodity price downturn. Chile has been a model of strong fiscal discipline since it adopted the CAB-based fiscal rule in 2001. Originally, the government targeted an annual fixed surplus of one percent of GDP, later downgraded to zero percent during the international financial crisis in 2009. In 2014, a government decree modified the rules and set a new gradual target. The plan was to reach the zero structural deficit gradually through the 2014-2018 period.⁶⁸ However, only a year later, in 2015, the government sanctioned a decree reversing the previous rule, extending and modifying the path by which it should reach the target in 2018.⁶⁹

The United States is another example of a country that regularly changes its fiscal rules. The U.S. congress adopted the Budget Control Act in 2011, which set out new expenditure limits for every year until 2021. If Congress were to appropriate larger total spending, the rule would trigger automatic large spending cuts on defense and other discretionary spending, which was labeled “the sequester.” Rather than meeting the spending targets, or letting the cuts of “the sequester” happen, Congress modified the expenditure targets three times in budget years 2013, 2015 and 2018. For the years in question analyzed, the Bipartisan Budget Act of 2015 modified the discretionary spending reductions for 2016 and set new caps.

ESCAPE CLAUSES

Escape clauses can provide governments with flexibility to respond to major shocks such as the dramatic fall in commodity prices. However, they can also defy the spirit of fiscal rules, if governments use them repeatedly. Many countries have escape clauses in their fiscal rules. In Latin America, Brazil, Mexico, Peru and Colombia all have an escape clause, though only Peru has specific operational guidance on how to activate the escape clause in event of a natural disaster or international crisis.⁷⁰

68 Decree 892, Establece las bases de la Política Fiscal, de acuerdo a lo dispuesto en el artículo 1° de la Ley N° 20.128 www.hacienda.cl/fondos-soberanos/legislacion/politica-fiscal/decreto-n-892-de-2014-establece-las.html (3 June 2014)

69 Decreto N° 1378, de 2015 (modifica el Decreto Supremo N° 892, de 03 de julio de 2014, del Ministerio de Hacienda) www.hacienda.cl/fondos-soberanos/legislacion/politica-fiscal/decreto-n-1378-de-2015-que-modifica.html (29 September 2015)

70 Decreto Supremo que aprueba el Reglamento de la Ley N. 30000 – Ley de Fortalecimiento de la Responsabilidad y Transparencia Fiscal. cf.gob.pe/nosotros/marco-legal/decreto-supremo-que-aprueba-el-reglamento-de-la-ley-no-30099-ley-de-fortalecimiento-de-la-responsabilidad-y-transparencia-fiscal/ (29 September 2015)

Box 2. Peru's escape clause

If real GDP declines or another emergency occurs, Congress can declare, at the request of the Executive, that the deficit ceiling be relaxed up to 2.5 percent of GDP. The Executive must specify deficit and expenditure ceilings that will apply during the exception period. In either case, a minimum adjustment of 0.5 percent of GDP is required until the one percent deficit ceiling is reached. Peruvian Fiscal Responsibility Law (FRL) 30099 defines the mechanisms to activate the escape clause.

Act 16 mandates that the Finance Ministry will present a report no longer than five calendar days after national emergency is declared, requiring the approval of the Council of Ministers. Once submitted to Congress, the new bill must include:

- Proposals to mitigate the natural disaster or national emergency;
- New expenditure targets of the Non-Financial Public Sector (NFPS) for the next three years;
- A step-by-step description of how to return to the fiscal targets set prior to the escape clause;
- Fiscal adjustments for the regional and local governments.

The Congress passes the new bill onto the Peruvian Fiscal Council to give an opinion on the proposal within five calendar days

Peru invoked its escape clause due to exceptional circumstances in August 2015. The emergency decree argued that the *El Niño* natural disaster and the fall in international commodity prices justified an increase in the deficit target from one to three percent of GDP.⁷¹ Between 2003 and 2011, Peru had changed its fiscal rules frequently.⁷² However, the strengthened fiscal framework adopted in 2013 provides fewer and clearer targets, complemented with operational guidance on how to activate the escape clause during shocks like these.

In contrast, some escape clauses, such as that of Uganda are overly broad. Governments can use escape clauses not only in cases of natural catastrophes or sharp declines in short-term economic activity, but also in case of “any other significant unforeseen event that cannot be funded under the rule.” (See Box 3 below.) Another similar example is India, where the escape clause allows the government not to comply with the targets in exceptional circumstances “as the central government may specify.”⁷³

71 Emergency Decree 003-2015. www.mef.gob.pe/es/por-instrumento/decreto-de-urgencia/13092-directiva001-2009ef9301/file (28 August 2015)

72 IMF Peru, *Fiscal Transparency Evaluation*, (2015), 46.

73 Teresa Ter-Minassian. *Preconditions for a successful introduction of structural fiscal balance-based rules in Latin America and the Caribbean: a framework paper*. (Inter-American Development Bank, 2010).

Box 3. Uganda's escape clause

Section 7(1) of Uganda's Public Finance Management (PFM) Act 2015 provides circumstances in which the minister of finance may deviate from the fiscal rules set out in the Charter of Fiscal Responsibility if those are approved by parliament. These circumstances are:

- A natural disaster;
- An unanticipated severe economic shock;
- Any other significant unforeseen event that cannot be funded under the PFM Act 2015 or using prudent fiscal policy adjustments.

Note: The minister is required to publish reasons for deviations in the national gazette.

Mexico's government has had a mixed record in achieving its zero balance target established in 2006. Mexico's fiscal balance deteriorated sharply after the global financial crisis.⁷⁴ In response, rather than complying with or revising the rule, the government evoked an escape clause in 2010, 2011 and 2012, which boosted expenditures and the deficit.⁷⁵ The IMF found that the escape clause was too lax and allowed for excessive discretion in evoking it.⁷⁶ The government revised the fiscal rule in 2013. The rule now requires the Mexican government to use a more comprehensive measure to calculate its deficit target, which is set at 2.5 percent.⁷⁷ It also added a new cap on the growth rate of discretionary recurrent expenditures, thus limiting its real growth rate to that of potential GDP, but also setting temporary targets of two percent for 2015 and 2016.⁷⁸ The government met its deficit target while expenditures grew faster than the temporary limit in both 2015 and 2016.^{79,80} Ultimately, Mexico did not meet all its fiscal targets in the years reviewed, but it provides an illustration as to how the use of escape clauses and transitory provisions may become the norm rather than the exception in certain countries.

Emerging lessons from country compliance and non-compliance

The fall of commodity prices was a major shock in resource-rich countries. Three years later, commodity prices and especially energy prices remain much lower than they were in the last decade. (See Figure 8.) Such large and lasting shock may well warrant significant departure from previous fiscal policy. We saw that only a fifth of all countries continued to implement their fiscal rules. Some countries missed their targets, others modified or abandoned their fiscal rules and in certain cases, countries pursued a combination of these two options.

74 Hernández García, Jesús Ismael. *Las Reglas fiscales y las finanzas públicas: El caso Mexicano 2000-2030* (CEFP, 2016), 7.

75 CEFP. *Las Reglas fiscales*, 18.

76 Excessive discretion to the government, once "exceptional circumstances."

77 IMF, *Mexico, Selected issues* (2015), 53.

78 So-called Structural Current Spending (SCS). It excludes capital expenditure, pensions, subsidies for electricity and various non-programmable expenditures.

79 Quarterly update by the Mexican parliament. www.gob.mx/cms/uploads/attachment/file/54577/comunicado_012_2016.pdf (29 January 2015).

80 Quarterly public finance report by CEFP. www.cefp.gob.mx/publicaciones/documento/2017/cefp0052017.pdf (28 February 2017), 16.

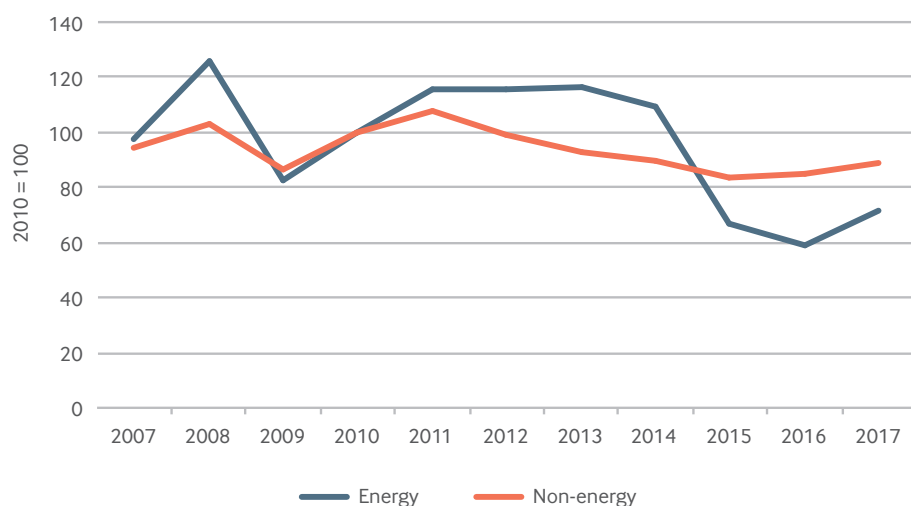


Figure 8. International commodity prices, 2007-2017⁸¹

Two lessons emerge from this chapter of the report. First, the low compliance and large number of modifications suggests there may be a need to rethink fiscal rule design, specifically, how fiscal rules could accommodate or even provide more room to respond to large shocks adequately without breaching or modifying them.⁸² Fiscal rules in resource-dependent countries should ideally be at least acyclical or counter-cyclical to allow governments to dampen economic shocks. Governments may achieve this by setting structural balance targets (which allow for more spending in downturn) or non-resource balance targets (to at least insulate short-run fiscal policy from resource revenue volatility) rather than pure budget balance or debt targets. Setting targets in some absolute term or non-resource GDP term rather than as a percentage of GDP may also help dampen economic shocks.⁸³ Half of the countries that followed their rules in 2015-16 used a structural or a non-resource balance rule (Botswana, Colombia and Norway).⁸⁴ However, the institutional capacity, fiscal reporting and statistical quality preconditions for adopting structural rules are very demanding. Some of the rules have been difficult to implement in response to the shock (e.g., the Kyrgyz Republic’s debt rule). Accordingly, another lesson may be to include well-defined and sensible escape clauses with clear operational guidance that prove useful to accommodate shocks without making the rules overly complex.

Second, there is often a large disconnect between having a fiscal rule on paper and actually following it. The low compliance rate in the period reviewed, the fact that a number of countries did not follow their rules even in periods of economic stability (e.g., members of CEMAC), as well as the questionable practices certain countries used in modifying their fiscal rules (e.g., Ecuador or Mongolia) suggests that more also needs to be done on the side of monitoring compliance with the fiscal rule. In the next section, we review what oversight actors did.

81 IMF. *Primary Commodity Prices*, 2018.

82 Modifying or abandoning a fiscal rule may be a better choice than adhering to an inappropriate rule.

83 Commodity prices affect GDP directly, therefore when commodity prices increase/decrease the target correspondingly becomes easier/harder to achieve.

84 There is also a debt and expenditure rule in Botswana, but it is set relatively high.

4. Monitoring fiscal rules

Eleven countries among the 34 examined in this study have an external oversight body tasked with monitoring compliance with their fiscal rules.⁸⁵ These are either supreme audit institution (SAI), fiscal councils (FC) or parliamentary budget offices (PBO). The aims, mandates and limitations of these institutions vary depending on the legal, political and institutional environment of each country. In this chapter, we review how these organizations carried out the oversight of fiscal rules.

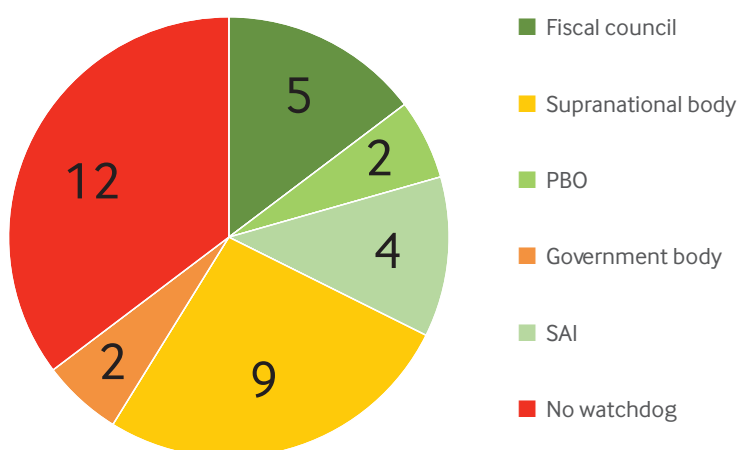


Figure 9. Oversight institutions monitoring fiscal rule compliance across Resource Governance Index countries

Supreme audit institutions (SAIs) are a well-established pillar of public finance in almost all countries. As fiscal rules are more widely adopted, SAIs are increasingly playing a role in overseeing these rules, generally as part of ex-post reviews of overall government spending and revenues. As we have argued before, SAIs can play an important role in resource governance as they oversee compliance with rules across the whole extractive decision chain.^{86,87} They are well placed to monitor whether the law was followed and if budgetary and fiscal targets have been met. However, audits are protracted in time, often completed more than a year after budget execution, which hinders their ability to warn about impending risks.⁸⁸

A number of fiscal councils have existed for decades, but many new ones were established after the global economic crisis. Fiscal councils' main aim is to promote sound fiscal policy and long-term sustainability of public finances. Unlike audit institutions, fiscal councils generally conduct ex-ante evaluations of compliance with the rule through forecasts and provide inputs into the planning and policy formulation process (e.g., by estimating costs of measures), often making explicit

85 This excludes Argentina and Malaysia, where the oversight body comprises of government officials.

86 Dana Wilkins. "Why Supreme Audit Institutions are Guardians of Resource Governance," resourcegovernance.org/blog/why-are-supreme-audit-institutions-guardians-resource-governance (accessed 29 November 2017)

87 Working Group on the Audit of Extractive Industries WGEI. www.wgei.org/ei-audit-experience-by-country/ (2018).

88 Ter-Minassian. *Preconditions for a successful introduction of structural fiscal balance-based rules in Latin America and the Caribbean: a framework paper*, 24.

recommendations on fiscal sustainability.⁸⁹ Unfortunately, the technical expertise needed for a well-functioning fiscal council remains a challenge across low-income countries.⁹⁰

A parliamentary budget office's role is to provide technical support to parliamentarians in their legislative and oversight functions. They often do this by supporting the work of the main budget committees, or evaluating or costing various new bills. Some also review compliance with fiscal rules.

Brazil, India and Indonesia are examples of countries where supreme audit institutions oversee fiscal rules. The Brazilian Federal Court of Accounts, the Tribunal de Contas da União (TCU), conducts inspections and audits on its own initiatives or by request of the National Congress. The TCU and the public prosecutor's office scrutinized the *pedaladas fiscais*, the name given of attempts to circumvent the fiscal rules in Brazil, for over two years. (See Box 4). The house of representatives elects the audit board of the Republic of Indonesia, the Badan Pemeriksa Keuangan (BPK). The BPK provides periodic reports on state finance accountability, including periodic reports on fiscal compliance. In India, however, the president elects the comptroller and auditor-general members. The Indian audit institution's mandate is vague in respect of fiscal rules oversight, but it does report on compliance regularly.

Colombia created a fiscal council in 2011 with a mandate to support the calculation of the cyclically adjusted balance as well to oversee compliance with the fiscal rule. Peru also mandates the Consejo Fiscal del Peru to oversee compliance of fiscal rules, but only those that apply to states and local governments. The Brazilian TCU only reviews compliance with fiscal rules ex post, however, in November 2016, the federal senate created the Instituição Fiscal Independente (Independent Fiscal Institution) which will act as a fiscal council, including overseeing and evaluating forecasts, assessing fiscal policy and overseeing the fiscal rules for the federal government.⁹¹ The U.K.'s Office for Budget Responsibility reviews compliance with fiscal rules, evaluates the impact of new policies by costing newly-announced tax and policy expenditures and provides long-term projections of fiscal sustainability.

Both the U.S. Congressional Budget Office (CBO) and the Centro de Estudios de las Finanzas Publicas (CEFP) in Mexico are examples of parliamentary budget offices. They provide analysis and costing of new policy proposals to parliamentarians. Neither institution is legally mandated to monitor compliance with the fiscal rules. Nevertheless, in the U.S., the CBO's regular long-term forecasts can be used to assess compliance with fiscal rules. Mexico's CEFP also started publishing quarterly public finance reports in 2016, which can be used to monitor the rules.

Some countries are considering establishing fiscal oversight agencies to oversee fiscal rules (e.g., Ghana or Mongolia). In the cases where there is limited technical capacity but already one established institution working on public finance, it may be beneficial to build on it and expand its remit, rather than setting up a new institution.

89 Debrun, et al. *The Functions and Impact of Fiscal Councils*, 15.

90 Ossowski and Halland, *Fiscal Management in Resource-Rich Countries*, 67.

91 IMF. *Brazil Fiscal Transparency Evaluation* (2017), 7.

OVERSIGHT BODY INDEPENDENCE

These oversight bodies within government not only vary in their institutional set-up and role but also in their degree of independence from the executive.⁹² In some cases, they are clearly neither independent nor external, such as in the cases of Malaysia or Argentina. In 2013, Malaysia created its fiscal policy committee to endorse fiscal policy strategies and oversee compliance with the rules. It is comprised of government officials, including the deputy prime minister, the minister of finance and the governor of the central bank as its permanent members.⁹³ It receives assistance from the fiscal policy office, which is staffed and housed within the treasury.⁹⁴ Similarly, in Argentina, government officials from provinces that have adopted the fiscal responsibility law in their jurisdictions form the fiscal responsibility council. Unlike the other oversight institutions discussed in this section, we do not consider these two as external oversight bodies.

In other cases, the degree of independence is more difficult to evaluate. For example, in the cases of the U.K. and Chile, the executive appoints members/heads, but they retain autonomy and have a reputation for technocratic expertise. In Chile, the fiscal advisory council is comprised of five renowned fiscal experts all appointed by the government, but it has no staff or budget. The U.K. also houses its Office of Budget Responsibility under the executive, but has a highly qualified staff of 27 civil servants. Oversight bodies that are working for the parliament (e.g., the CBO in the U.S. and the Center for Public Finance Studies in Mexico) are considered a step more removed and independent from the executive. One step further removed is the audit board of the Republic of Indonesia (BPK RI), which is established in the constitution and is independent from both the legislative and executive branches of government.⁹⁵

Supranational bodies generally oversee supranational rules.⁹⁶ In the case of both the CEMAC and the WAEUMU rules reviewed, there is a regional commission tasked with monitoring the rules with legal independence from member states. Given the low compliance with supranational rules reviewed, it may be beneficial to delegate some oversight tasks to national entities.

However, legal independence is only part of the story. Some institutions have further guarantees of operational independence. For example, such provisions can prevent the dismissal of the head of the oversight body by the government or safeguard their budget. Nevertheless, all oversight bodies depend on and need to collaborate with various government agencies to operate smoothly, including gaining access to documents and data in time and ensuring appropriate budget, staffing and autonomy to fulfill their mandate.

92 This section draws heavily on IMF Fiscal Council database 2016.

93 Lledó, et al. *Fiscal Rules at a Glance*, 49.

94 IMF. *2013 Article IV Consultation, Malaysia*. IMF Country Report No. 14/80 (2014), 27.

95 Audit Board Indonesia. www.intosaiitaudit.org/mandates/writeups/indonesia.htm (accessed 22 January 2018).

96 Though in the case of EU rules, national fiscal councils also play an important oversight role.

OVERSIGHT BODY REPORTS ON COMPLIANCE

The effectiveness of an oversight body ultimately relies on its ability to monitor, inform and shape fiscal policy. This requires independence, autonomy (or “strict non-partisanship”) and the capacity to evaluate the budget.⁹⁷ Consequently, we reviewed how oversight bodies report on compliance with the fiscal rules.

In the countries that followed their rules or used an escape clause, we find that there was also an increased level of monitoring. Colombia, Indonesia and Peru are all examples of countries with strong oversight bodies publishing yearly reports on fiscal rule compliance. Norway does not have an oversight body for its rule, but the government did task a public expert commission to review compliance with the rule.⁹⁸ Malaysia has no independent oversight, though it has an internal government body. Botswana and Liberia on the other hand have followed their fiscal rules despite not having formal oversight.⁹⁹ Overall, countries with national oversight are more likely to follow fiscal rules than countries with no formal oversight across RGI countries (33 percent of cases with oversight versus 14 percent of cases with no domestic oversight). Causality is not implied, as it seems plausible that governments that are more likely to follow their fiscal rules are also more likely to set up domestic oversight.

In practice, we also observe that there has been quite some variation in how these oversight bodies performed their oversight duties.¹⁰⁰ For example, Peru’s oversight body drafts insightful and accessible reports, while conversely the oversight body in Nigeria writes none. In Chile, the reports do not provide straightforward statements on compliance. In India, the report addresses not only issues of compliance with the law, but also data quality and compliance with transparency provisions. With some exceptions, most reports do not discuss in detail whether revising or violating the fiscal rule was an appropriate response to the rapid fall in commodity prices and commodity shocks that many of these countries suffered.

The Peruvian fiscal council reports provides a description of fiscal targets established in the FRL and a detailed explanation of which targets the government did and did not meet.¹⁰¹

97 Debrun, et al. *The functions and impact of fiscal councils*, 4.

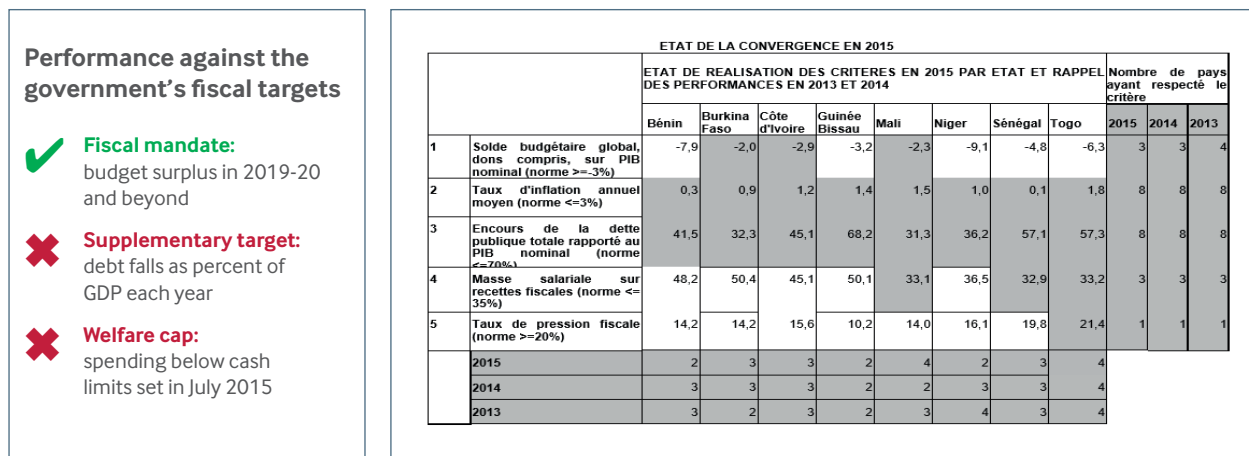
98 Official Norwegian Reports NOU 2015: 9, Chapter 1, *The Application of the Fiscal Rule: The assessments and main conclusions of the Commission* (2015), 10.

99 As argued in Section 2, these rules are less demanding.

100 See Annex 2 for a list of oversight body yearly reports on fiscal rules.

101 Reporte Técnico N° 002-2016 – *Análisis de la Declaración de Cumplimiento de la Responsabilidad Fiscal al 31 de diciembre de 2015*. cf.gob.pe/documentos/reportes-tecnicos/reportes-tecnicos-n-002-2016-analisis-de-la-declaracion-de-cumplimiento-de-la-responsabilidad-fiscal-al-31-de-diciembre-de-2015/ (31 December 2015).

Figure 10. Assessment of the U.K.’s Office of Budget Responsibility (left) and of WAEMU (right)¹⁰²



Source: U.K. Office for Budget Responsibility, Economic and Fiscal Outlook (2016), p 197 - 199 <http://cdn.obr.uk/Nov2016EFO.pdf> (left), Waemu Rapport Semestriel D'Exécution de la Surveillance Multilatérale 2015, p 93 http://www.uemoa.int/sites/default/files/bibliotheque/rapport_semestriel_d_execution_de_la_surveillance_multilaterale_juin_2017.pdf, (right)

The Colombian committee reports on compliance with the fiscal rules as part of relatively brief documents (twelve pages each), which provide straightforward statements about fiscal compliance:

According to the fiscal legislation, fiscal deficit should be gradually reduced for years 2014, 2018 and 2022, in percentages of 2.3, 1.9 and 1.0, respectively. In 2016, the structural deficit was 2.19 percent of GDP, lower than the previous year (2.25 percent of GDP in 2015). Therefore, fiscal target was accomplished as established in the fiscal responsibility law.¹⁰³

In India, the Auditor General’s fiscal report for 2015-2016 provides a section on the “deviation in performance from the Act and Rules” and details the lack of compliance with fiscal targets and how the government subsequently postponed them:

For financial year 2015-16, in respect of effective revenue deficit, revenue deficit and fiscal deficit the annual reduction targets set out by the Government in the Budget were not in accordance with the provisions of the Act/Rule applicable. The government deferred effective revenue deficit and fiscal deficit targets in budgets for 2016-17 and 2017-18 without corresponding amendments in the Act.¹⁰⁴

102 U.K. Office for Budget Responsibility, Economic and Fiscal Outlook (2016); IMF.WAEMU *Convergence Report* (2016).

103 Informe de cumplimiento de Regla Fiscal en 2015 - Report on Compliance of the Fiscal Rule in 2015 www.camara.gov.co/sites/default/files/2017-07/Informe%20de%20Cumplimiento%20Regla%20Fiscal%202015%20H.pdf (June 2016) and Report on Compliance of the Fiscal Rule in 2016, www.camara.gov.co/sites/default/files/2017-07/Cumplimiento%20regla%20fiscal%202016%20x.pdf (14 June 2017).

104 Report on Compliance of the Fiscal Rule and Budget Management Act, 2003. www.cag.gov.in/sites/default/files/audit_report_files/Report_No.32_of_2017_-_Compliance_Audit_on_Department_of_Economic_Affairs_Ministry_of_Finance.pdf (2017).

The Indian report further also comments on lack of transparency and quality of data disclosed in their conclusion:

“Transparency in fiscal operations of the Government is an important ingredient to achieve the accurate target of fiscal indicators envisaged under the FRBM Act. However, there was lack of transparency in disclosing the deficit figures in Budget at a Glance and Annual Financial Statements.” (. . .) “The disclosures made by the Government through various Forms envisaged under the FRBM Act were not complete and at variance with corresponding information contained in Union Government Finance Accounts.”¹⁰⁵

Some oversight bodies prepare long-term forecasts as part of fiscal targets in their fiscal evaluation reports. The U.K.’s 2016 Economic and Fiscal Outlook prepared by the Office of Budget Responsibility provides detailed economic forecasts and monitors whether the government is on track to meet its various fiscal targets. It also clearly communicates whether the government is breaching rules.¹⁰⁶ (See Figure 10.)

The Chilean Public Finance Evaluation Reports for 2015 and 2016 do not provide straightforward statements on compliance. Their opacity is in part due to the recent amendment of the calculation of the CAB, which created further complexity.¹⁰⁷ The latest formula estimated three CAB results for 2015, adding later changes in structural parameters (copper prices and GDP trend). The fiscal reports can be difficult to follow since there is no reference fiscal target to look for and the target is constantly adjusted based on commodity prices and GDP trend. A Chilean think tank highlights the weakness in the current CAB calculation, arguing that the new system is creating confusion and arguably results in less transparency.¹⁰⁸

Not all oversight bodies make public yearly reports on compliance. The Fiscal Responsibility Commission of Nigeria never produced any and is now being shut down by the Federal Government. Malaysia’s Fiscal Policy Committee has also not produced any reports on compliance. After Argentina suspended its fiscal rules in 2009, the members of the Consejo de Responsabilidad Fiscal did not meet for almost five years (2011- 2016) nor produce any reports.¹⁰⁹

Moreover, monetary unions monitor compliance and non-compliance differently than each other. In the WAEMU, the commission produces two reports per year measuring different levels of compliance across members and years (see Figure 11). This stands in contrast to monitoring efforts in the CEMAC regions, where the CEMAC commission has not released its own reports on compliance in the years under review. We were only able to review compliance through IMF reports.

105 Government of India. *Report on Compliance of the Fiscal Rule and Budget Management Act 2003*, 55.

106 Office for Budget Responsibility: Economic and fiscal outlook, cdn.obr.uk/March2016EFO.pdf (March, 2016), 187.

107 The CAB makes calculations by adjusting “comparable” structural parameters: changes in GDP trend and copper prices on a yearly basis.

108 Libertad y Desarrollo. *Presupuesto 2018 y Regla Fiscal* (2017), 3.

109 Ambito. “Se reunió el consejo Federal de Responsabilidad Fiscal,” www.ambito.com/854639-se-reunio-el-consejo-federal-de-responsabilidad-fiscal (accessed 15 September 2017).

PENALTIES FOR NON-COMPLIANCE

Penalties for non-compliance may sound like a simple and effective solution in theory, but are a difficult to implement in practice. Without meaningful consequences for breaching fiscal rules, governments will for sure be less inclined to follow them. However, having punitive measures in the law will not yield automatic compliance either. Because it is the government's job to enforce punishments, they could suspend or modify punishments in the same manner it does with fiscal rules. It is possible that if breaching the fiscal rules were a punishable offense, governments would be even more likely to abandon or modify their rules or make compliance harder to assess. Moreover, as discussed in Section 3, unforeseen events such as the commodity price crash can make sticking to certain rules undesirable. These reasons may help explain why in the cases reviewed, breaching the fiscal rules did not generally attract strict penalties.

Brazil is the one country reviewed where trying to circumvent the fiscal rule had tough legal consequences, ultimately leading to the impeachment of the president. However, as described in Box 4, the rules were not sufficient alone, but rather dramatic political changes ultimately provided political support for impeachment. A revealing counter-example is the WAEMU commission, which had the legal provisions to induce monetary penalties under the WAEMU convergence criteria (until revised in 2015), but did not use them due to the practical difficulty in enforcing them.¹¹⁰ A third example is the United States, where the imminent risk of breaching the debt ceiling in 2013 provoked a 16-day government shutdown. Both the debt ceiling and the sequester rules, which were designed to cap debt and expenditures, rely on a three-fifth majorities in the senate to change the rules. In practice, achieving this majority requires bipartisan support. The resultant automatic spending cuts and the government shutdown caused government to modify the rules repeatedly.¹¹¹

110 Ermal Hitaj and Yasin Kursat Onder. *Fiscal Discipline in WAEMU: Rules, Institutions, and Markets* (IMF, 2013).

111 Roy T. Meyers. *The Implosion of the Federal Budget Process: Triggers, Commissions, Cliffs, Sequesters, Debt Ceilings, and Shutdown* (University of Maryland, 2014), 2.

Box 4. Fiscal mismanagement: the case of Brazil

Pedaladas fiscais was the fiscal arrangement in Brazil that resulted in the presidential impeachment of Dilma Rousseff. The national treasurer allowed public and private banks to finance Dilma Rousseff's flagship social programs, including low-cost housing programs such as Minha Casa and Minha Vida and a monthly cash transfer for the poor entitled Bolsa Família. Banks paid for these social programs with the understanding that the government would repay them later.

This not only circumvented the spirit of Brazil's fiscal rules, but the Brazilian Fiscal Responsibility Law also prohibits such practices explicitly (Article 36: *Credit operations between a state financial institution and the member of the federation*).

In 2014, Brazilian media revealed that the government had been using irregular procedural practices since 2013, and the Tribunal de Contas da União (TCU) and the public prosecutor's office launched investigations. Although the TCU's rule is not judicially binding, it provided sufficient evidence to support the congress in declaring a fiscal rule violation.

Congress voted in favor of the sanctions and impeached Dilma Rousseff. That legislators imposed these strict penalties rather than pardon her, was strongly linked to the Petrobras scandal. When this \$10 billion corruption case involving the national oil company and illegal party financing was revealed, the allegations against Rousseff and her party led to a collapse of her political support. Her impeachment was based on clauses in the Fiscal Responsibility Law but enabled by broader political events.

A similar case is unfolding in Ecuador, where the Comptroller General of the State (Ecuador's SAI), accused the ex-president of changing the formula to calculate debt under the fiscal rule in order to circumvent it and borrow more.¹¹² The audit report is not yet public, but the state prosecutor's office has opened an investigation of the ex-president and former government officials based on the report's findings.¹¹³

One method to combat fiscal mismanagement is to introduce a system of tiered penalties. For minor offenses, lenient penalties could require the minister of finance to face public hearings or to give detailed explanation on any departures from fiscal rules. Harsher penalties could be imposed for practices that intentionally violate fiscal rules or circumvent procedural aspects of the fiscal rules. Such transgressions may include borrowing without authorization from the legislature, off-budget spending or forged statistics relating to numerical targets under the fiscal rule. In lieu of strict punishments, governments can also protect fiscal rules by requiring large parliamentary majorities for major changes or extensive consultation of experts and oversight actors.

112 El Universo. "Decreto de Rafael Correa 'maquilló' la deuda, concluyó auditoría," *El Universo*. www.eluniverso.com/noticias/2018/03/15/nota/6667081/decreto-correa-maquillo-deuda-concluyo-auditoria (accessed 20 March 2018).

113 Ecuador's Comptroller office. "Contraloría: Deuda pública 2012-2017 asciende a U.S.\$65.700 millones de dólares". www.contraloria.gob.ec/CentralMedios/PrensaDia/17867 (accessed 20 March 2018).

PUBLIC MONITORING OF THE RULES

Fiscal rules tend to be poorly publicized among the population, mainly because they are complex and divorced from peoples’ day-to-day experiences. However, in countries where oversight bodies are scrutinizing fiscal mismanagement, these bodies may use their mandate to inform citizens about the rules. They can publicize their activities through hearings in Parliament or press briefings. Where there are penalties for non-compliance with numerical or procedural rules (as in the case of the *pedaladas fiscais* in Brazil), citizens are more likely to be exposed to the existence of fiscal rules. However, citizen attention should not only be drawn by misbehavior, but also by admirable rule adherence. Civil society organizations, think tanks and financial sector institutions can play an important role in creating more awareness of fiscal rules.

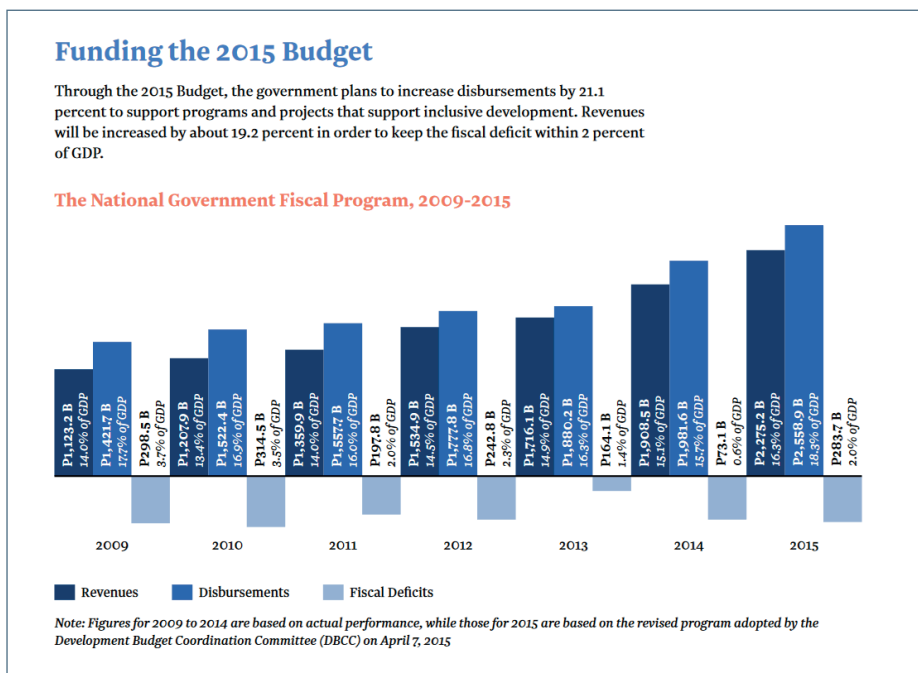


Figure 11. 2015 citizen budget of the Philippines¹¹⁴

In recent years, governments have also adopted “citizen budgets” to present key public finance information to a general audience. The government writes these reports in accessible language to help non-specialist readers understand key budget information. In the Philippines, every year the government uses graphic representation to visually describe macroeconomic performance for its citizens.¹¹⁵ These reports present an opportunity to inform citizens about fiscal rules, for example by illustrating visually what limits the fiscal rule set and what measure the government has taken to comply with them. According to the International Budget Partnership, other countries such as Chile, Brazil, Mexico and Norway also prepare citizens budgets.¹¹⁶ These reports could provide a way to familiarize the public with fiscal rules. Other instruments to raise awareness among citizens may include radio debates, dedicated websites or even public displays such as the U.S. and Polish national debt clocks. (See Figure 12.) Financial firms involved in the trade of government debt could also play a more active role in reviewing compliance

¹¹⁴ Republic of the Philippines. Department of Budget and Management, *People’s Budget 2015* (2015), 12.

¹¹⁵ *Ibid.*

¹¹⁶ International Budget Partnership. “Citizens Budget,” www.internationalbudget.org/open-budget-survey/resources-for-governments/citizens-budgets/ (accessed 23 February 2018).

with fiscal rules. For example, when credit rating agencies rate government bonds, they seldom report on a country's fiscal rules. When they do mention the rules they only present them, rather than review compliance.¹¹⁷ IMF country reports and academic studies of fiscal policy are the richest source of information on fiscal rule characteristics, but these tasked with monitoring fiscal rule compliance and clear policy lessons can be hard to discern from the text.



Figure 12. U.S. national debt clock in New York¹¹⁸

There are 12 countries where there is a fiscal rule but no oversight body is tasked to monitor the rule. Papua New Guinea is one such example, but fortunately, a local think tank has been monitoring the rule and provides regular updates on compliance.¹¹⁹ In Mongolia, Gerege Partners and NRGi prepared the first fiscal sustainability report, which uses a macroeconomic model to review whether the government is likely to meet the fiscal rules.¹²⁰ Similarly, in Ecuador, where the fiscal rule has been in place since 2010, local organizations have overseen fiscal compliance and generated public debate on it.¹²¹ This is a promising avenue, especially as these reports are more likely to monitor not only the letter of the fiscal rule but also whether the spirit of the rule is followed, especially in times of shock and when the rules are revised. Nevertheless, this is no replacement for a well-staffed official oversight agency with capacity, access to timely information and independence to oversee adherence to rules and to help decision-makers stick to sustainable management of resource revenues.

117 A good counter-example is Chile, where the credit rating agency Fitch reports regularly on the rules and comments on changes to the rules. Fitch Ratings. "Chile Full Rating Report," www.fitchratings.com/site/re/892214 (accessed April 23, 2018).

118 Wikipedia, "U.S. National Debt Clock" upload.wikimedia.org/wikipedia/commons/5/5e/U.S._nat_debt_clock_2004.jpg (accessed 4 February 2018).

119 PNG Economics. "Deficit and debt blow-out confirmed," pngconomics.pngconomics.org/2017/04/budget-and-debt-blow-outs-confirmed/ (accessed 4 December 2017).

120 Andrew Bauer, Ragchaasuren Galindev, Munkh-Orgil Lkhagvajav, David Mihalyi and Nomuuntugs Tuvaan. *Fiscal Sustainability in Mongolia* (NRGI, 2017).

121 Juan Jose Herrera. *La Agenda de la Sociedad Civil frente a las industrias extractivas en Ecuador* (NRGI, 2017).

5. Conclusion and recommendations

Fiscal rules—permanent quantitative constraints on government finances—are an important tool to help mitigate the macroeconomic challenges associated with managing natural resource revenues. They can act as a commitment mechanism, binding successive governments to a long-term budgetary ceiling or target and helping politicians fight the urge to overspend during election years. They can also help prevent fiscal crises and can encourage governments to save or pay down debt in good times so that they have fiscal space to spend during recessions, an issue of vital importance in natural resource-dependent countries.

Our paper reviews national-level fiscal rules in countries assessed in the Resource Governance Index. Out of the 79 countries covered by the index, 34 have at least one fiscal rule in place. Countries with stronger resource governance are much more likely to also have a fiscal rule. The most common types of rules are debt ceilings and various types of budget balance targets.

Our review of compliance with fiscal rules in 2015 and 2016, the years directly following the commodity price crash, found that governments adhered fully to the rules in only six countries. These are Botswana, Colombia, Indonesia, Liberia, Malaysia and Norway. In 25 cases, governments either suspended, modified or disregarded their rules. Governments breached rules in a wide range of countries, rich and poor, including Brazil, Chad and the U.K. Only one country, Peru, invoked a well-defined and justified escape clause, rather than modifying or breaking its fiscal rule. Two countries, Uganda and Tanzania, adopted their rules in 2015, so are only beginning implementation now. This means that governments complied with rules in roughly one in five country cases.

Some key lessons emerge from the very low level of compliance observed. First, many of the fiscal rules reviewed are not appropriately designed. For example, in many resource-dependent countries, the fiscal rules allowed expenditures to rise pro-cyclically during the boom, and then forced abrupt fiscal adjustments (e.g., Nigeria). Also, some rules (especially debt ceilings) were easy to accommodate and made compliance trivial (e.g., Liberia), while other rules prove very constraining given the shock precipitated by the commodity price drop (e.g., Kyrgyz Republic). Few governments have well-defined escape clauses, such as Peru, to evoke when faced with the commodity price shock.

Second, a number of countries did not follow their rules in good times either (e.g., CEMAC members), or used questionable practices to modify or disregard their fiscal rules (e.g., Ecuador). Compliance was especially weak in countries with limited or no national oversight of fiscal rules. No countries complied with supranational rules in the period reviewed.

Only a third of the countries with fiscal rules have a national oversight organization monitoring observance of these rules. The most common are supreme audit institutions, fiscal councils or parliamentary budget offices. These institutions vary considerably in their independence and capacities, and not all of them produce reports that clearly show whether governments are observing the rules.

Across the countries we reviewed, there is often limited and only technical public information on fiscal rules and whether governments are complying with them. The lack of public engagement on fiscal issues ultimately makes them easy for governments to discard. This limits the effectiveness of these long-term commitments, which governments often sacrifice in favor of short-term political gains.

Based on the country experiences reviewed and the evidence from the literature reviewed, we recommend that:

- 1 Resource-dependent governments or new producers without fiscal rules should consider adopting them as a useful tool to promote fiscal sustainability and promote counter-cyclical spending. When doing so, they should tailor them to their resource endowments, economics situation and countries' governance contexts; there is no one-size-fits-all solution for fiscal rules.
- 2 Fiscal rules in resource-dependent countries should generally be strongly counter-cyclical. This enables countries to avoid boom and busts cycles, and will yield rules that governments are more likely follow. To do this, governments must avoid overall budget balance rules; or just setting a debt ceiling as a percentage GDP. Expenditure rules, non-resource balance or structural balance rules are generally more appropriate and targets should be set in absolute numbers or as a percentage of non-resource GDP.
- 3 Fiscal rules should be simple to calculate and easy to monitor and enforce, especially in countries where there is no established oversight actor with strong technical capacity. All fiscal rules need good public financial management and fiscal transparency. Only countries with exceptionally strong capacity and institutional independence should use structural balance rules.
- 4 Governments should incorporate reasonable and well-specified escape clauses into fiscal rules. These could explicitly include commodity shocks over a certain size. However, if governments do not specify these escape clauses or detail operational guidance, they can become a source of ambiguity and abuse, undermine the rule's credibility and raise questions of accountability.
- 5 Governments should consider adopting supranational fiscal rules into domestic law and establishing domestic oversight of these rules, given the limited compliance with supranational fiscal rules.
- 6 Strong political support is key for success. Governments should build consensus around fiscal rule adoption or modification. They can do this by requiring large parliamentary majorities for major changes, seeking support from multiple political parties and engaging with the public when designing the fiscal rule.
- 7 Soft penalties that require public hearings or additional reporting when the rules are violated may be useful for encouraging compliance. Oversight bodies can use harsher penalties more severe violations, such as trying to circumvent procedural aspects of the rule: unauthorized borrowing, off-budget spending or fraudulent statistics relating to numerical targets.

- 8 Government oversight organizations should play an important role in bringing accountability to public finances. They should have the independence, legal mandate and resources they need to monitor fiscal rule compliance routinely. Attaching them to parliament might be a fruitful avenue in countries with low capacity but strong parliamentary tradition, rather than establishing new institutions.
- 9 Fiscal rules need strong awareness and oversight from followers of public policy. Governments could do more in informing citizens about the rules through the budgetary process (e.g., citizen's budget). The media, parliament, civil society organizations, think tanks, financial sector institutions and credit rating agencies should also play a role in monitoring the rules.
- 10 The international community and economists/experts should do more to inform stakeholders as to why counter-cyclical and sustainable fiscal policy is key to growth and diversification. More effort should go into supporting implementation rather than codifying new fiscal rules.

Appendix 1. Fiscal rules in Resource Governance Index countries

Country	Year rule was established	Quantitative fiscal rules	Type of rule(s)	Legal basis
Argentina	1999	All jurisdictions are required to balance revenues and expenditures; primary expenditure cannot grow faster than nominal GDP	OBBR ER	Law 25917- Fiscal Responsibility Law
Azerbaijan	2004	Expenditure growth fixed in real-term, saving proportion of oil revenues depending on their levels	RR, ER	Not law, a presidential decree
Botswana	2003	Debt limit at 40% GDP, expenditure ceiling at 40% GDP, golden rule - based on Sustainable Budget Index i.e. mineral revenues need to be saved or invested.	NRCBR, ER, DR, RR	Not law, targets committed to in National Development Plan
Brazil	2000	Personnel expenditure is limited to 50% of net current revenue for the federal government, and 60% for states and municipalities: Senate sets debt limits for all levels of government (there is no debt limit for central government)	DR, ER	The Brazilian Fiscal Responsibility Law
Burkina Faso	2000	Debt limit of 70%, deficit limit of 3%, floor on revenues at 20% of GDP	OBBR, DR, RR	WAEMU treaty
Cameroon	2002	Debt limit of 70% GDP, basic fiscal balance should be in surplus.	OBBR, DR	CEMAC treaty
Chad	2002	Debt limit of 70% GDP, basic fiscal balance should be in surplus.	OBBR, DR	CEMAC treaty
Chile	2001	Structural budget balance target initially set at +1% GDP	SBBR	Law 20128 - Fiscal Law
Colombia	2011	Structural deficit ceiling of 2.3% by 2014, 1.8% by 2018 and 1% by 2022	SBBR	Law 1473 - Fiscal Law
Congo	2002	Debt limit of 70% GDP, basic fiscal balance should be in surplus.	OBBR, DR	CEMAC treaty
Côte d'Ivoire	2000	Debt limit of 70%, deficit limit of 3%, floor on revenues at 20% of GDP	OBBR, DR, RR	WAEMU treaty
Ecuador	2010	Permanent expenditure cannot be higher than permanent revenue, debt ceiling of NFPS to 40% of GDP and 200% for decentralized entities	NRCBR, DR	Planning and Public Finance Code
Equatorial Guinea	2002	Debt limit of 70% GDP, basic fiscal balance should be in surplus.	OBBR, DR	CEMAC treaty
Gabon	2002	Debt limit of 70% GDP, basic fiscal balance should be in surplus.	OBBR, DR	CEMAC treaty
India	2003	Deficit limit of 3% of GDP	OBBR	Fiscal Responsibility and Budget Management (FRBM) Act 2003
Indonesia	2003	Total Debt ceiling of central and local governments 60% of GDP, budget deficit limit 3% of GDP	OBBR, DR	Law of the Republic of Indonesia Number 17 of 2003
Kyrgyz Republic	2014	Debt ceiling of 60% GDP	DR	Law on Public and Non-public Debt

122 Lledó, et al. *Fiscal Rules at a Glance*, 9.123 Kenan Aslanli. *Fiscal sustainability and the state oil fund in Azerbaijan* (Journal of Eurasian Studies, 2015), 117.124 Tribunal de Contas da União, *GRUPO II – CLASSE II – Plenário TC 023.410/2016-7* (2016), 7.125 UEMOA, *Rapport Semestriel D'Exécution de la Surveillance Multilatérale* (2017), 96.126 IFM. Central African Economic and Monetary Community (CEMAC). *Common Policies of member countries, and common policies in support of member countries reform programs – press release; staff report; and statement by the executive director. IMF CR389/17* (2017), 27.

127 IFM. Central African Economic and Monetary Community (CEMAC), 27.

Compliance 2015/16	Description of compliance problem	Description of modification
Suspended	Suspended between 2009-2016. ¹²²	
Suspended	Hard to monitor. Aslanli (2015) calculates that government violated revenue rule most years since 2008 ¹²³	Preparation of new rules were announced
Complied with	Complied with all years except 2008	Not modified
Not met	Staff expenses were above the limit set by FRL in 2015. ¹²⁴	
Not met	Missed deficit target in 2016. ¹²⁵	WAEMU rules were revised in January 2015
Not met, subsequently modified	Cameroon missed budget balance target in 2016. ¹²⁶	New CEMAC rules adopted in 2015 will take effect in 2017.
Not met, subsequently modified	Chad missed budget balance target in 2015 and 2016. ¹²⁷	New CEMAC rules adopted in 2015 will take effect in 2017.
Modified to meet target	In 2015, government postponed the achievement of zero structural balance due to lower revenues from lower commodity prices in Decree 1378.	New target: Reduce the structural deficit in a quarter of a percentage point of GDP every year, and achieve zero balance starting from 2016 until 2018. Decree 1378
Complied with	In 2016, the structural deficit was 2,19% of GDP, lower than the previous year (2,25% GDP in 2015). Fiscal deficit shows a gradual reduction from 2015 to 2016, as stated in the FRL	
Not met, subsequently modified	Congo missed debt and budget balance target in 2015 and 2016. ¹²⁸	New CEMAC rules adopted in 2015 will take effect in 2017.
Not met	Missed deficit target in 2016. ¹²⁹	WAEMU rules were revised in January 2015
Modified to meet target	No problems listed by the government. Justification of the modification was elaborated "following the statistical manual of the IMF"	Modified public debt calculation in 2016, using consolidated debt (which excludes debt between inter gov. agencies) instead of aggregate debt (as initially established)
Not met, subsequently modified	EG missed budget balance target in 2015 and 2016. ¹³⁰	New CEMAC rules adopted in 2015 will take effect in 2017.
Not met, subsequently modified	Gabon missed budget balance target in 2016. See IMF CR389/17	New CEMAC rules adopted in 2015 will take effect in 2017.
Modified to meet target	Targets were deferred by the government in budget 2016-17 and 2017-18 without corresponding amendment in the Act P.2. ¹³¹	In May/June 2015, the FRBM act/rules were further amended shifting the target year of the three deficit indicators (effective revenue deficit, revenue deficit and fiscal deficit) to 31 March 2018. In Budget 2017-18, targets were shifted again to 31 March 2019.
Complied with	Fiscal deficit in 2015 (2.58% of GDP) and 2016 (2.49% of GDP) lower than target. According to IMF, central government debt in 2015 (27.5% of GDP) and 2016 (28.4% of GDP). ¹³²	
Not met, subsequently modified	Public debt was 63.4% GDP in 2015 and 56.6% GDP in 2016 against limit of 60%. ¹³³	Government abandoned rule in 2017. New rule being discussed.

128 IFM. Central African Economic and Monetary Community (CEMAC), 27.

129 UEMOA, *Rapport Semestriel D'Exécution*, 96.130 UEMOA, *Rapport Semestriel D'Exécution*, 27.

131 Government of India. Report on Compliance of the Fiscal Rule and Budget Management Act 2003 (2017), 2.

132 Financial report of the Government of Indonesia *Laporan Keuangan pemerintah pusat tahun 2015* (2016), 39; Financial report of the Government of Indonesia *Laporan Keuangan pemerintah pusat tahun 2016* (2017), 79.133 IMF, *Fourth and fifth reviews under the three-year arrangement under the extended credit facility, and request for modification of performance criteria – press release and staff report for the Kyrgyz Republic* (2016), 11.

Country	Year rule was established	Quantitative fiscal rules	Type of rule(s)	Legal basis
Liberia	2009	Debt ceiling of 60% GDP stipulated in PFM regulations	DR	Not law, PFM regulation
Malaysia	1959	Debt limit at 55% of GDP, golden rule: only borrow for capital investment;	CBR,DR	Loan (Local) Act 1959
Mali	2000	Debt limit of 70%, deficit limit of 3%, floor on revenues at 20% of GDP	OBBR, DR, RR	WAEMU treaty
Mexico	2006	Balanced budget for the federal government. Structural current spending (SCS) growth capped at a real rate of 2% for 2015 and 2016 and potential GDP growth afterwards.	OBBR, ER	Federal law of Budget and Treasury Responsibility - LFPRH
Mongolia	2010	Debt limit 40%, structural deficit limit 2%, expenditure growth limited to non-mineral GDP growth, mineral revenue rules allocated in parts to SWF	SBBR, DR, ER	Fiscal Stability Law (FSL)
Niger	2000	Debt limit of 70%, deficit limit of 3%, floor on revenues at 20% of GDP	OBBR, DR, RR	WAEMU treaty
Nigeria	2007	Overall deficit ceiling of 3% GDP.	OBBR	Fiscal Responsibility Commission (Establishment) Act, 2007
Norway	2001	Non-oil structural deficit kept at 4% GDP	NR SBBR	Not law, but a multi-party agreement
Papua New Guinea	2006	Gross government debt ceiling 30% of GDP, budget deficit limit 2.5% of GDP from 2015 onwards	DR, ER	Papua New Guinea Fiscal Responsibility (2013 Budget) (Amendment) Act 2012
Peru	2001	Structural deficit limit of 1% of GDP; debt ceiling at 30% of GDP (gradually reduced to 27% by 2021)	SBBR, DR,ER	Law 30099 Ley de Fortalecimiento de la Responsabilidad y Transparencia Fiscal (LFRTF)
Philippines	2011	Fiscal targets set in development plan for 2011-2016 period. 2% deficit and various revenue targets	OBBR, RR	Not law, targets committed to in the National Development Plan
Russia	2013	Oil price based expenditure rule.	ER	Federal Law of the Russian Federation, No. 63-FZ
Tanzania	2015	Oil and Gas Revenues Management Act sets deficit limits, recurrent expenditure growth rules, expenditure ceiling	NRBR, ER	Law - Oil and Gas Revenue Management Act
Uganda	2015	Charter of Fiscal Responsibility: 50% debt limit, 3% deficit cap	DR, OBBR	Not law, it is a Charter
United Kingdom	1997	Achieve budget balance by 2016/17 and keep debt on decreasing path	SBBR, DR	Not law, targets are set in a Charter for Budget Responsibility
United States	2011	Budget Control Act of 2011 sets out expenditure limits (cuts based on the sequester) until 2021 specified in \$ terms. It also set a new debt ceiling.	ER, DR	Law, the Budget Control Act
Venezuela	2000	Various spending, debt and deficit limits changing over time based on MTFF. A portion of recurring revenues to be saved for "budget corrections."	DR, ER, OBBR, RR	The Organic Law of Financial Administration for the Public Sector (LOAFSP)

Abbreviation of the type of fiscal rules: DR: Debt rules, ER: Expenditure rules, OBBR: Overall budget balance rule, CBR: Current balance rule, NRBR: Non-resource balance rule, NRCBR: Non-resource current balance rule, NR SBBR: Non-resource, Structural budget balance rule, SBBR: Structural budget balance rule, RR: Revenue rules

134 UEMOA, *Rapport Semestriel D'Exécution*, 96.

135 Secretaria de Hacienda y crédito público, *Informes sobre la situación económica, las finanzas públicas y la deuda pública* (2016), 1.

136 Centro de Estudios de las Finanzas Públicas CEF, *Análisis de los informes sobre las finanzas Públicas y la Deuda Pública al cuarto trimestre de 2016* (2016), 16.

137 Oxford Business Group, "New law being discussed for managing Mongolia's debt," <https://oxfordbusinessgroup.com/analysis/forward-planning-managing-debt-new-law-under-discussion> (accessed 2 March 2018)

138 UEMOA, *Rapport Semestriel D'Exécution*, 96.

139 IMF, Nigeria: 2017 Article IV Consultation- Press Release; Staff Report; and Statement by the Executive Director for Nigeria (2017), 5.

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141 PNG Economics, "Deficit and debt blow-out confirmed," pngconomics.org/2017/04/budget-and-debt-blow-outs-confirmed/ (accessed 4 December 2017).

142 Republica del Perú. Marco Macroeconómico Multianual 2017-2019 revisado (2016),15.

143 Poder Ejecutivo del Perú, Decreto de Urgencia N 003-2015 (2015)

Compliance 2015/16	Description of compliance problem	Description of modification
Complied with	Public debt was 25.4% and 30.1% against debt limit of 60%. See IMF CR348/17	Not modified
Complied with	Federal government domestic debt 2015 (54.5% of GDP); 2016 (52.7% of GDP). 2015: p.123 www.bnm.gov.my/files/publication/ar/en/2015/ar2015_book.pdf / 2016: p 83 www.bnm.gov.my/files/publication/ar/en/2016/ar2016_book.pdf	
Not met	Missed deficit target in 2016. ¹³⁴	WAEMU rules were revised in January 2015
Not met	Structural current spending (SCS) not met in 2015 (3.4%) and 2016 (3.4%)/Public sector borrowing requirements (PSBR) met in both years 2015 (4.1%) ¹³⁵ and 2016 (3.5%). ¹³⁶	
Modified to meet target	Met after modifications. ¹³⁷	The debt limit was increased to 58.3% (in 2015) and to 88% (in 2016)
Not met	Missed deficit target in 2015 and 2016. ¹³⁸	WAEMU rules were revised in January 2015
Not met	Fiscal deficit 2015 (3.5% of GDP) and 2016 (4.7% of GDP) surpassing the fiscal deficit cap of 3% of GDP. ¹³⁹	
Complied with	Within target. -2.7 (2015) and -2.6 (2016) vs -4% cap. ¹⁴⁰	Not modified in 2015/2016. In 2017 gov changed 4% target to 3% (more ambitious)
Not met	Public Debt 2015 (35.2% of GDP), and 2016 (32.6% of GDP); fiscal deficit 2015 (5% of GDP) and 2016 (4.6% of GDP). ¹⁴¹	
Escape clause	Accomplished deficit rule of Non-Financial Public Sector (NFPS) after escape clause in 2015 allowed to increase deficit of NFPS from 1% to 3% of GDP. Met debt rule in 2015 (23.3% of GDP) and 2016 (25.6% of GDP). ¹⁴²	Escape clause ¹⁴³
Not met, subsequently modified	Deficit was 0.9% (met) in 2015 but 2.4% (missed) in 2016. ¹⁴⁴	From 2017 onwards, government set a target of 3%.
Suspended	Rule was suspended in 2015. ¹⁴⁵	New rule introduced in 2017. ¹⁴⁶
New rule	Rule was only adopted in 2015, not effective. ¹⁴⁷	Not modified
New rule	Rule was only adopted in 2015, not effective. ¹⁴⁸	Not modified
Not met	Debt target missed in 2016. ¹⁴⁹	Not modified
Modified to meet target	Complied with modified targets. ¹⁵⁰	The Bipartisan Act of 2015 canceled the discretionary reductions for 2016 and set new caps for those years. The debt ceiling was suspended and raised until 2017.
Suspended	17 modifications since created FRL in 2000 (latest modification 30 December 2015). ¹⁵¹	Decree 6.210 President can decide on the amount, distribution and disposal of natural resources over any legislation. ¹⁵²

144 IMF, *Philippines: 2017 Article IV Consultation-Press Release; Staff Report* (2017), 4.

145 IMF, *Russian Federation: Staff report for the 2016 Article IV consultation – press release; and staff report* (2016), 8.

146 Sanghi, Apurva and Naoko Kojo, "Will Russia's new fiscal rule end its oil and gas dependence?" [brookings.edu](https://www.brookings.edu/blog/future-development/2017/12/06/will-russias-new-fiscal-rule-end-its-oil-and-gas-dependence/). <https://www.brookings.edu/blog/future-development/2017/12/06/will-russias-new-fiscal-rule-end-its-oil-and-gas-dependence/>

147 IMF, *United Republic of Tanzania, selected issues*. IMF Country Report N. 16/254 (2016), 48.

148 Ministry of Finance, Planning and Economic Development, Charter for Fiscal Responsibility (2016), 1.

149 U.K. Office for Budget Responsibility, *Economic and Fiscal Outlook* (2016), 6.

150 Congressional Budget Office, *Federal Debt and the statutory Limit* (2017), 1.

151 Transparencia Venezuela, "Ejecutivo adeuda estimaciones para el presupuesto 2017." transparencia.org.ve/otra-mas-para-la-cuenta-el-ejecutivo-adeuda-estimaciones-para-el-presupuesto-2017/.

152 Decree 6.210. Gaceta Oficial. wbod.com.ve/media/97487/GACETA-OFICIAL-EXTRAORDINARIA-6210.pdf

Appendix 2. Oversight organizations in Resource Governance Index countries

Country	Fiscal council	Year created	Type	Report on fiscal rule compliance in 2015/2016
Argentina	Federal council for fiscal responsibility	2004	Government body	No
Brazil	Federal Court of Accounts (TCU)	1981	Parliamentary Budget Office	No
CEMAC members	CEMAC commission	2002	Supranational body	IMF regional report ¹⁵³
Chile	Chile's Advisory Fiscal Council	2013	Fiscal Council	Yes ¹⁵⁴
Colombia	Comité Consultivo para la regla Fiscal	2011	Fiscal Council	Yes ¹⁵⁵
India	Comptroller and Auditor-General	1971	Audit Office	Yes ¹⁵⁶
Indonesia	The Audit Board of Indonesia	1946	Audit Office	Yes ¹⁵⁷
Malaysia	Malaysia's Fiscal Policy Committee (FPC)	2013	Government body	No ¹⁵⁸
Mexico	Center for Public Finance Studies (CEFP)	1997	Parliamentary Budget Office	Yes ¹⁵⁹
Nigeria	Fiscal Responsibility Commission	2007	Fiscal Council	No
Peru	Consejo Fiscal del Perú	2013	Fiscal Council	Yes ¹⁶⁰
U.K.	Office for Budget Responsibility	2010	Fiscal Council	Yes ¹⁶¹
United States	Congressional Budget Office	1974	Parliamentary Budget Office	Yes ¹⁶²
WAEMU members	WAEMU commission	2000	Supranational body	Yes ¹⁶³

153 Central African Economic and Monetary Community (CEMAC), IMF, 2016.

154 Public Finance Evaluation Report, Chile 2015 and 2016. *Evaluación de la Gestión Financiera del Sector Público*

155 Report on Compliance of the Fiscal Rule, Colombia 2015 and 2016. *Informe de cumplimiento de Regla Fiscal*

156 Report on Compliance of the Fiscal Rule and Budget Management Act, 2003. 2015-2016.

157 Financial report of the Government of Indonesia for the years 2015 and 2016. *Laporan Keuangan pemerintah pusat tahun*

158 They issued press statements in the past: 2013

159 Quarterly reports on public finances since 2016

160 Report on Compliance of the Fiscal Rule, Peru 2015 and 2016. *Análisis de la Declaración de Cumplimiento de la Responsabilidad Fiscal al 31 de diciembre de 2015 and 2016.*

161 Economic and Fiscal Outlook, United Kingdom. 2015 and 2016

162 Updated Budget Projection 2016-2026. United States.

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