

Managing Volatility: Fiscal Policy, Debt Management and Oil Revenues in the Republic of Congo

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A “resource curse” may sound like a contradiction in terms, but resource-rich countries have witnessed stagnating growth, de-industrialization, low savings, lagging human and physical capital accumulation, and stagnating or declining productivity. Yet recent turmoil in commodity markets has highlighted a possibly even more important problem: the volatility of what for most resource-rich countries is the dominant source of export earnings. Managing that volatility may well be the prime challenge facing resource-rich countries, superseding traditional concerns about competitiveness of non-resource sectors. “Debt overhang” (when arrears on old debt deter new lenders, thereby blocking the country’s new access to capital markets) has been cited in the literature as a potential explanation for the negative macroeconomic experiences of many resource-rich countries – in Nigeria, for instance, debt overhang problems have magnified expenditure volatility, contributing to a hostile climate for private sector development

A large number of resource-rich countries remain classified by the World Bank as severely indebted, with high levels of external debt making them vulnerable to resource-wealth volatility. Several commodity exporters have gone through external debt crises and long periods of depression (Mexico and Nigeria are well known examples). Public indebtedness also tends to be high in oil-exporting countries, and a substantial number of them have run into debt problems (for example, Angola, Chad, Ecuador, Iraq, Mexico, Nigeria, the Russian Federation, Sudan, the Republic of Yemen, and República Bolivariana de Venezuela), mostly when oil prices were in decline but some even in boom periods. This evidence suggests that the design of fiscal policy should pay special attention to downside risk in international capital markets: debt overhang problems imply that world capital markets become inaccessible at precisely the moment they are needed most.

This paper therefore focuses on the role of fiscal and debt management policies in managing resource-wealth volatility and its implications for debt and development. The case study selected for our assessment is the oil-rich country of Congo (but other natural resources, like copper, would present similar problems). The paper applies a new framework for assessing fiscal sustainability and vulnerability to debt overhang problems applicable to special features of oil-rich countries.

The framework uses simulation methods to forecast the distribution and evolution of net public debt and assets, taking into account various rules governing oil fund allocations, the non-oil primary deficit, and foreign debt accumulation. It consolidates the government’s fiscal accounts with an Oil Stabilization Fund – like, for example, Norway’s Oil Fund – and the central bank’s foreign-currency reserves. Fiscal policy is captured by restrictions on the size of the non-oil primary deficit (NOPD) of the public sector, plus the rule for allocating current oil revenues from the Oil Stabilization Fund to the budget. We focus in particular on how expenditure volatility can be reduced through, for example, permanent-income-type rules for contributions to or withdrawals from the OSF. (Permanent-income-type rules base consumption of the proceeds of an asset not on the current return from it, but on a constant and sustainable proportion of its total estimated value.) Fiscal sustainability analysis then means examining the impact of the non-oil primary fiscal deficit and OSF allocation rules on net debt levels, including monies saved in the OSF under various scenarios for the oil price. We explicitly analyze the effects of uncertainty, not just through scenario analysis but also through full stochastic analysis, allowing Value-at-Risk-like assessments (which measure the potential loss in value of a risky asset over a defined period for a given confidence level). In

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particular we analyze how debt management policies and fiscal feedback rules can contribute to reducing volatility and thereby bring down the risk of getting caught in debt overhang crises.

The paper applies this framework to assessing fiscal sustainability and vulnerability to debt-overhang problems in Congo. Congo is rapidly building up its production and export capacity, and can expect to be a substantial energy producer for several decades to come. But Congo's oil reserves are smaller than those of countries that, for all practical purposes, have oil for the foreseeable future: the post-oil economy is nearer for Congo. The country's major challenge, if its oil wealth is to prove a resource blessing rather than a resource curse, is how to manage an oil windfall that will be short-lived, and how to ensure fiscal sustainability when that windfall is gone.