The Role of Fiscal Institutions in Managing the Oil Revenue Boom

CEPAL XIX Regional Seminar on Fiscal Policy
January 2007

Rolando Ossowski
Fiscal Affairs Department
International Monetary Fund

The views expressed herein are those of the author and should not be attributed to the IMF, its Executive Board, or its management.
Outline of the Presentation

- Fiscal responses to the recent oil boom in oil-producing countries (OPCs)
- Challenges to fiscal management in OPCs
- Use of special fiscal institutions
  - Oil funds
  - Fiscal rules and fiscal responsibility legislation
- Qualitative and quantitative assessment of special fiscal institutions
- Some lessons from experience
- Suggestions for strengthening fiscal management in OPCs
Fiscal Responses to the Recent Oil Boom

- On average, during 2000-05 countries spent about half of the additional fiscal oil revenue.
  - Higher non-oil primary spending; non-oil primary revenue rose somewhat.
  - Correlation between oil revenue and spending remained high.
  - Average non-oil primary deficit increased from 26 percent of non-oil GDP in 1999 to 38 percent in 2005.
  - Average overall fiscal balance changed from a deficit of 3 percent of GDP to a surplus of 12 percent.
  - Significant variation across countries.

Figure 1. Cumulative Change in the Non-Oil Primary Deficit Relative to Additional Oil Revenue, 2000-05 1/

-50 0 50 100 150 200
-20 0 20 40 60 80 100 120
Cumulative change in the non-oil primary deficit (in percent of additional oil revenue)
Change in oil revenue (in percent of non-oil GDP)

Source: Fund staff estimates.
1/ Equatorial Guinea and Libya are not shown because of their very large changes in oil revenue as a ratio to non-oil GDP.
Government Effectiveness, Fiscal Sustainability, and Vulnerability

- Higher oil revenues have provided OPCs an opportunity to raise public spending on priority economic and social goals.

- The quality of public financial management and fiscal institutions is critical for the effective use of the additional resources.

- Long-term fiscal sustainability
  - A number of countries recorded substantial improvements.
  - But in others, there was limited improvement or deterioration—mainly due to larger non-oil primary deficits.

- Vulnerability
  - Some countries remain vulnerable to oil shocks and the possible need for adjustments.
Challenges to Fiscal Management in Oil-Producing Countries and the Use of Special Fiscal Institutions

- Many OPCs have had difficulties in addressing the challenges posed by dependence on oil revenues.
  - Oil revenue volatility and uncertainty
  - Oil is an exhaustible source of revenue—intergenerational issues
  - Oil revenue largely originates from abroad
- In response, a number of OPCs have established special fiscal institutions (SFIs) to help manage fiscal policy.
  - Oil funds
  - Fiscal rules and fiscal responsibility legislation
Oil Funds

• Proliferation of oil funds in recent years

• Policy objectives
  • Stabilization
  • Financial savings
  • Fiscal transparency
  • Asset management

• Operational objectives
  • Smoothing budget oil revenue
  • Putting away a share of oil revenue
  • Providing information on oil revenue and the oil fund’s financial assets
Oil Funds—Operational Issues

- Integration with overall fiscal management
- Rigid versus flexible operational rules
  - Rationale for choosing rigid rules
  - Channeling money into a fund does not of itself control spending
  - Rigid rules have been difficult to design and implement
    - Consistency with overall fiscal policy
    - Rules have often been changed, bypassed, or eliminated
  - Flexible rules: financing funds
- Extrabudgetary spending and earmarking
- Cash management
- Transparency, governance, and accountability
- Growing efforts to better integrate oil funds with budget systems
Fiscal Rules and Fiscal Responsibility Legislation

- Fiscal rules are less common than oil funds but could have a larger impact on fiscal outcomes.

- The design of numerical fiscal rules is very challenging in OPCs.
  - High oil revenue uncertainty and volatility

- Experience has often shown difficulties in abiding by the rules.
  - Design issues
  - Political economy factors

- Fiscal responsibility legislation
  - Few cases in OPCs
  - FRL can contribute to transparency and accountability improvements important for good fiscal management
  - Success depends on design, political commitment to fiscal discipline, and overall institutions.
Quantitative Assessment of Special Fiscal Institutions

- To what extent can SFIs explain differences in fiscal responses (across countries and over time), controlling for key factors?
  - Non-oil primary balance
  - Expenditure dynamics
  - Controlling for government net wealth and degree of dependence on oil revenue

- Econometric results suggest that:
  - SFIs have no significant impact on the non-oil balance or expenditure dynamics.
  - Liquidity considerations are a key factor for fiscal policy in OPCs.
  - Some evidence that broader governance institutions have an impact on fiscal outcomes.
Some Lessons from Past Experience

- OPCs face a difficult task in designing and implementing sound fiscal policies.

- Often, SFIs by themselves have not been able to overcome these constraints and achieve sustainable improvements in fiscal management.

- SFIs have been more successful where there was broad political consensus about fiscal objectives.

- There is a need in many OPCs for greater focus on:
  - The quality of spending
  - Longer-term perspectives in fiscal planning
  - Risk analysis
Some Suggestions for Strengthening Fiscal Management in OPCs

- Enhance public financial management systems where needed

- Implement Medium-Term Frameworks for fiscal policy
  - MTFs can help connect the annual budget to longer-term objectives, policies, and plans, and can help assess fiscal risks.

- Well-designed SFIs can complement—but not substitute—improvements in overall institutional frameworks.
  - Successful SFIs require political commitment.
  - Sound operational design is critical.