FISCAL POLICY IN OIL EXPORTING COUNTRIES

**AND THE ROLE OF STABILIZATION FUNDS**

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## (2) Fiscal policy in all countries needs to be cast in a medium-term framework

- Are government spending levels sustainable?
- How quickly to adjust to short-term changes in revenue and their future path?
- Strong macroeconomic case for smoothing fiscal expenditure

## (3) Revenue stream from oil

- Is finite
- Is uncertain and volatile → difficulty in determining a long-run equilibrium oil price and predicting whether price swings are temporary or permanent

## (4) Sustainable Level of Spending (non-oil fiscal balance): Permanent Income

- The present value of expected future government revenue from oil + the existing amount of net financial assets owned by the government
- The notional income stream on this combined stock of wealth is the permanent income that can be consumed indefinitely.
- Calculations of permanent income are very sensitive to the assumptions made
- Countries that are heavily dependent on oil income should be running on average overall fiscal surpluses over the medium-term

## (5) The volatility of oil prices makes budgetary planning and fiscal management very difficult

- Frequent and large changes in government expenditure typically involve heavy costs
- Sharp fluctuations in government spending make it difficult for the private sector to make long-term investment plans and decisions.

## (6) Policy makers confront two major issues

- (1) How much of oil income to spend now and how much to save for the future
- (2) How expenditure can be planned and insulated from volatile oil revenue:

→need to minimize the correlation between government spending and volatile *and* uncertain oil revenue

→ need to break the procyclicality of government spending

## (7) Can oil funds be useful instruments in dealing with these issues?

## (8) No by themselves, but

- Oil funds could enhance the effectiveness of fiscal policy by:
- →providing safeguards against the volatility in oil prices by encouraging saving in boom periods.
- → smoothing out government expenditure, ensuring that they are driven by medium-term objectives rather than by short-run revenue availability.
- → investing surpluses accumulated to meet the need of future generations.

## (9) Main types of Oil Funds

- Savings Funds
- Stabilization Funds
- A combination of savings/stabilization fund

## (10) Savings Funds

- Because oil resources are finite and revenue base is not diversified → Governments set up these funds as a trust for future generations → to establish a financial investment base
- Rigid saving-spending rules → in some cases, changes require a constitutional amendment
- Transfers to the funds are made independently of oil market and/or overall fiscal developments (a given percentage of government revenue goes to the fund)

## (11) Formal Savings Funds

- State of Alaska's Permanent Fund (1976)
- Kuwait's Reserve Fund for Future Generations (1976)
- Emirate of Abu Dhabi's Investment Authority (?)
- Norway's State Petroleum Fund (1990) (?)
- Azerbaijan's fund (2001) (?)

## (12) Savings Funds – Results

- Accumulate large resources –ranging from 10 percent to 70 percent of GDP
- Channel a significant portion of oil revenue away from being spent
- Equitative share of the oil wealth (Alaska – Dividend Program (1982) → provide Alaskans a personal interest in protecting the fund).

## (13)…but savings funds contribute to a net accumulation of wealth

- Only if accumulation of resources into the fund is larger than government borrowing → government saving depends on the overall fiscal position
- Most countries that are heavily dependent on oil income should probably be running overall fiscal surpluses over the medium term → the lower the level of oil reserves in relation to current production, the higher the surplus should be

## (14) Stabilization Funds

- Governments set up these funds to smooth the path of revenue in the face of oil price volatility (operational objective)→Strong macroec. case for smoothing spending (policy objective)
- Frequent and large changes in expenditure typically involve heavy costs and hinder investment plans and decisions
- Saving-spending rules relatively more flexible →often changed, bypassed, or suspended

## (15) Formal Stabilization Funds

- Chile’s Copper Stabilization Fund (1985)
- Alaska’s Constitutional Budget Reserve Fund
- Kuwait’s General Reserve Fund (1960)
- Oman’s State General Reserve Fund (1980) (?)
- Venezuela’s Macroeconomic Stabilization Fund (1998)
- Qatar’s Oil Stabilization Fund (2000)
- Kazakhstan’s Fund (2001) (?)

## (16) Most commonly used rules in stabilization funds

- The CSF’s rules are based on an estimated long-term copper price, which is determined annually by the authorities—albeit not transparently→ the larger the positive gap between the benchmark and actual price, the more resources are deposited into the fund.
- Withdrawal rules are symmetric to saving rules, but the CSF’s resources could be depleted in a prolonged period of declining copper prices.

## (17) Most commonly used rules in stabilization funds

- In Venezuela, a reference value is determined every year based on a 5-year moving average
- In Alaska, CBR resources represent a loan to the budget that has to be repaid in years of fiscal surpluses
- In Kuwait, the GRF does not have clearly defined mechanism to accumulate saving
- In Oman, the SGRF's rules have changed frequently

## (18) Stabilization Funds -- Results

- There is no clear evidence that these funds have led to more expenditure restraint or less spending volatility→ ***Stabilization funds are not spending rules per se***
- Resources were accumulated during oil booms and paid out when oil prices declined → lower overall government debt
- In some countries, changes in expenditure have been smoother.

## (19) Summary

- Funds have been set up to ensure intergenerational equity, strengthen demand management, maintain competitiveness, and make expenditure less driven by short-term revenue availability
- The outcome of their experience has been so far mixed → in part due to lack of transparent and appropriate saving-withdrawal rules and medium-term fiscal framework
- These funds cannot be a substitute for sound fiscal management

## (20) Main Lessons

- The funds should be fully integrated with the budget and into the overall fiscal strategy→ Clear medium-term fiscal objectives should be set to provide a path for spending and non-oil revenue
- The rules and operations of the funds must be transparent and well-defined.
- Mechanisms need to be in place to ensure that those who oversee the operation of the funds are accountable
- Resources of the funds should be invested abroad to prevent the erosion of the competitiveness of the non-oil sector