Discussion of Vitor Gaspar and Paulo Medas: Fiscal management of non-renewable natural resources

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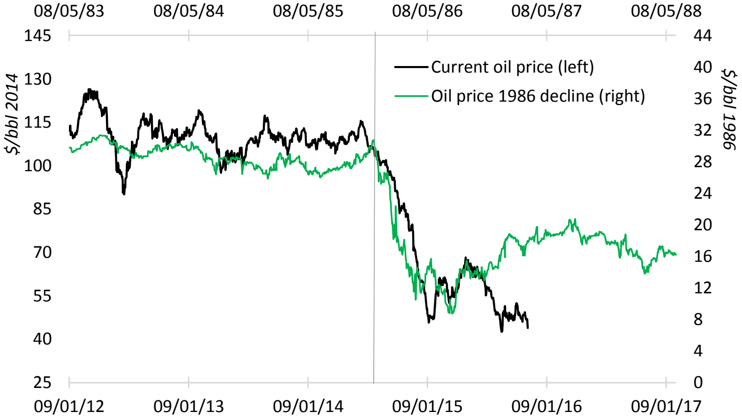
Key question

- How should resource-rich countries manage commodity price uncertainty?
  - huge costs associated with the large and unpredictable swings in commodity prices
  - if not well managed, the volatility can destabilize the domestic economy and undermine long-term growth.
- Recent fall in commodity prices is an opportune moment to review how fiscal policy can be strengthened to manage resource wealth.

Long way to recovery! The current oil price decline versus the decline in the 1980s. Brent blend.



Long term perspective

- Sound resource allocation is crucial
  - Policy need to take into account that resources will eventually be exhausted. If not invested, country will be poorer as it consumes the natural wealth
- Management of natural resource wealth should be seen as part of a strategy for sustainable, inclusive and broad based growth
- Fiscal framework should lead to efficient and effective allocation of resources
  - Allocation between competing ends. I.e., accumulate financial assets, scale up public infrastructure, or invest in people through education and health

Volatile and uncertain world

- Challenges by high volatility and uncertainty associated with commodity prices
- Fiscal policy has been procyclical, exacerbating economic volatility
- Large volatility and uncertainty argues in favour of prudence today ... to avoid regret later: the case for precautionary savings
  - Some degree of procyclicality is difficult to avoid, important benefits to ensure fiscal policy plays a more stabilising role.
  - Stabilising buffers

Key element of fiscal framework

- Broad-based taxation, backed by strong compliance
- Improve efficiency of spending
- Manage volatility
- Quality of institutions

Evaluate fiscal policy

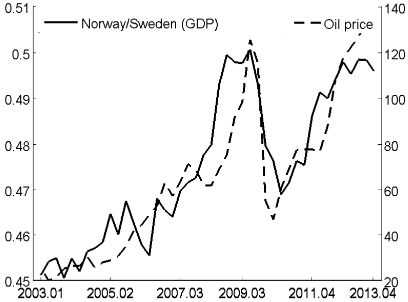
- The adoption of a fiscal framework is no proof in itself that fiscal policy works to insulate the economy from commodity price fluctuations
- What works in theory may not always work in practice
- Rule can be too lax, or rule is not followed
- Need to evaluate how fiscal policy has evolved over time in response to changing economic conditions that affects the commodity price

Prime example - Norway

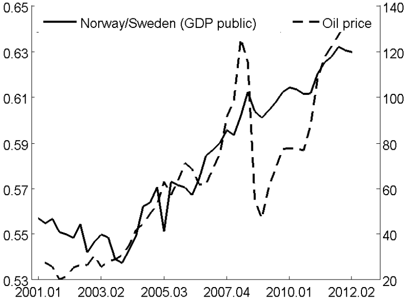
- Sovereign wealth fund established in the mid 1990s - all windfall gains saved in the fund
- Fiscal rule established 2001 - government can on average spend 4 % of the fund (the expected real return) every year:
  1. Smooth spending from the oil wealth. A gradual phase in should stabilise economic developments over time, thereby insulating the economy from Dutch disease
  2. Stabilises the fiscal impulse over and above longer term smoothing by allowing deviations from the 4 percent rule to counteract large cyclical variations in economic activity or sharp swings in the value of the fund - i.e., operate counter-cyclical
     - Explicitly defined in terms of the structural non-oil balance, allowing full effect of the automatic fiscal stabilisers

Norway: An oil driven economy?

Figure. Reduced form evidence: Norway, Sweden and the price of oil



Relative growth in GDP



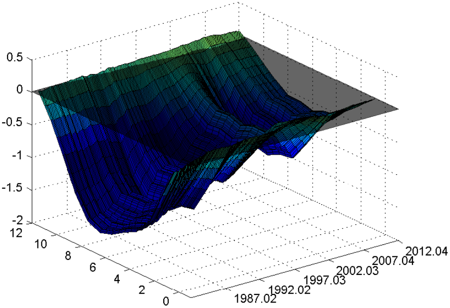
Relative growth in GDP public

Prime example - Norway - reconsidered

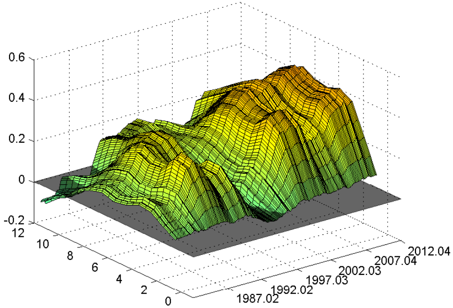
Bjørnland and Thorsrud (2015) find that for Norway:

- Following an oil price shock, fiscal policy has become more (not less), pro-cyclical after the implementation of the fiscal rule
- Further, fiscal policy has not effectively insulated the economy from an oil price shock. Has in periods exacerbated the effects.
- Following a global activity shock, the picture is somewhat more nuanced, with some components of public spending being counter-cyclical or a-cyclical the last decade.

Relative impulse responses



World activity shock



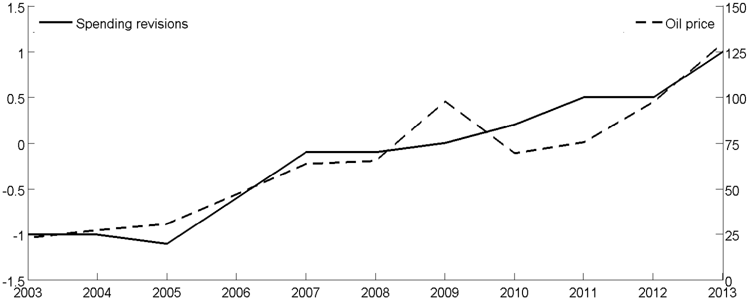
Oil price shock

Note: The figure reports the response, across time and horizons, of value added in the public sector relative to the response in the mainland economy (non-oil, non-public). A value above zero indicates that the public sector responds more positively to the given shock than the mainland economy as a whole.

What is going on?
4% of a big Fund is a lot of money.

- The Fund has been highly correlated with the oil price since 2001 (Norges Bank 2012)

Figure. The price of oil and spending revisions



Note: Spending rule in the National Budget 2013 - spending rule in the National budget from 2001

References I

Bjørnland, H. C. and L. A. Thorsrud (2015, June). Commodity prices and fiscal policy design: Procyclical despite a rule. Working Papers 0033, Centre for Applied Macro- and Petroleum economics (CAMP), BI Norwegian Business School.