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Strengthening Guyana's Fiscal Framework in Anticipation of an Oil Boom

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Abstract

This paper examines the effectiveness of Guyana's fiscal framework as the country prepares to usher in an era of oil wealth. The paper draws on a large body of literature to determine the key elements of an effective fiscal framework for resource-dependent economies. In summary, the literature argues for resource-dependent countries to have: appropriate levels of stabilization savings, a strong institutional framework, effective spending policies, and effective use of taxation to reduce revenue volatility. It then examines how Guyana's fiscal framework stacks up against those requirements and what lessons the country can learn from other hydrocarbon-dependent economies. Although Guyana has commenced preparations, a great deal of work remains to be done in all the above mentioned areas. The paper argues that Guyana should place stronger emphasis on strengthening fiscal institutions with regard to expenditure policies, budget implementation, and governance in the short to medium term as fiscal policy is more likely to focus on public investment and social spending. These improvements could potentially increase the productivity of public investment, reduce wastage of public funds, and increase transparency in the decision-making process.

JEL: E62, Q02, H5

Keywords: fiscal policy, fiscal framework, oil dependent countries, resource dependence, commodity price, institutions

1. Introduction

Guyana is poised to become a major player in the oil sector in the Caribbean. For this reason, it has attracted the attention of policymakers, academics, international investors, and economic pundits from around the world. The narrative thus far has been one of optimism wrapped with a fair amount of caution about the prospective benefits and potential risks for Guyana's economy over the long term. Indeed, even before Guyana exports its first barrel of oil, academics and researchers within the wider Caribbean have already issued warnings that if Guyana does not learn from the lessons of other countries, it could fall victim to the classic resource curse and Dutch disease (see, for example, Hosein et al., 2018). At any rate, the policy advice and cautions need to go deeper and account for the nuances of the Guyanese economy, its societal uniqueness, and how important economic institutions need to change in anticipation of a hydrocarbon boom. This paper does not attempt to close such a large gap of knowledge, but rather to contribute to the policy debate on a specific issue, that is, fiscal policy.

When one thinks of the incentives, signals, and outcomes of hydrocarbon-dependent economies, it is almost always related to the functioning and effectiveness of the fiscal framework and related institutions. The revenue garnered from the hydrocarbon sector is typically so large that it allows rent-based fiscal revenues to dominate the intentions of public policy: intentions that are generally benevolent but can have undesirable consequences if not managed and executed effectively. Moreover, other structural constraints can emerge along the lines of the classic Dutch disease hypothesis whereby, if government spending is not contained during booms periods, one can expect an increase in domestic prices (inflation) which manifests itself as an appreciation of the real exchange rate. This can potentially erode the competitiveness of other non-tradable sectors, resulting in de-agriculturalization and de-industrialization. From the political economy perspective, if institutions are weak, the pool of "rents" from hydrocarbons can create incentives for state capture by elites in the society and may also motivate politicians to use rents to woo and/or play to their electoral base (Arezki and Bruckner, 2011). Thus, establishing a strong fiscal framework is one of the most important institutional mechanisms to ensure sustainable growth and development.

In this paper, we tackle three questions that should be of importance to policymakers: (1) what the key elements of an effective fiscal framework for resource dependent economies are; (2) how Guyana stacks up against those requirements; and (3) what lessons can be learnt from other countries that have or have not adopted "best practice" fiscal frameworks. The next section reviews the literature to determine the essential elements of a robust fiscal framework for a

resource-dependent country. Next, we look at the current state of Guyana's fiscal framework and seek to identify the main gaps that exist. The fourth section provides a brief case study of two hydrocarbon-dependent economies (Nigeria and Norway) to examine their fiscal frameworks and economic performance. The latter allows us to connect the literature with the country experiences. Lastly, we summarize the way forward with regard to fiscal policy in Guyana.

2. Fiscal Frameworks in Resource-dependent Countries

The International Monetary Fund (IMF) (2015) has identified four key elements that fiscal frameworks in resource-rich countries should incorporate given their vulnerability to large and persistent commodity price shocks: (1) appropriate levels of stabilization savings, (2) a strong institutional framework, (3) effective spending policies, and (4) effective use of taxation to reduce revenue volatility. In the rest of this section we draw on the wider literature to explain why these elements are considered important for resource dependent economies and their shortcomings, in some cases.

I. Stabilization Savings and Fiscal Buffers

Sovereign wealth funds (SWF) are now considered an essential element of the fiscal framework in commodity-dependent countries. The main advantages that SWFs provide is that they help to mitigate risks associated with volatility in revenue flows, smooth consumption, increase savings, and reduce the effect of revenue volatility on a country's fiscal accounts. Nonetheless, SWFs have drawn criticisms, with several studies citing their ineffectiveness in smoothing out government expenditures, consumption, and liquidity between periods of strong and weak commodity prices (Balin, 2009). Indeed, the IMF found an inverse relationship between the effectiveness of SWFs and the degree of commodity dependence: the more dependent a country is on one commodity, the less effective the SWF (Balin, 2009). The argument that SWFs can provide the financial base to respond to shocks to a country's comparative advantage has also been challenged on the grounds that it is better to invest now in economic diversification than to build up an endowment for when a shock occurs (Balin, 2009). More recent research has shown that the effectiveness of stabilization funds depends on the quality of institutions and may not itself contribute to greater fiscal discipline (Asik 2013; Frankel, Vegh, and Vuletin 2012). Nevertheless, the savings accumulated in a SWF do provide a buffer for governments to draw on when faced with a sharp unexpected decline in commodity-related revenues.

Maintaining strong fiscal buffers is important to moderate the impact of commodity shocks on natural resource-dependent countries. Fiscal buffers are considered adequate when a country

has a low debt-to-GDP ratio and a primary fiscal surplus (Ruprah, et al., 2014). Resource-dependent countries are at a greater risk of undertaking sharp fiscal adjustments to weather large and persistent disruptive price and supply shocks to the resource sector. When these shocks occur, difficult policy decisions on fiscal retrenchment are almost always inevitable for countries with insufficient buffers, limited access to capital markets, and high and rapidly rising debt levels. Indeed, such countries may have to undertake a frontloaded adjustment strategy where the pain is endured upfront. On the other hand, countries with stronger fiscal buffers and adequate savings may be able to undertake a smoother, pro-growth adjustment process at a slower pace, which has the advantage of protecting expenditure on priority areas and giving the authorities more room to implement higher-quality reforms (IMF, 2016). Gradual approaches to adjustment are also considered to be more politically and socially desirable (Baldacci, et al., 2004).

II. Effective Use of Taxation

Government revenues in resource-rich countries depend largely on rents generated from natural resources. As rents are rewards in excess of effort and productivity, governments in commodity-dependent countries are not sufficiently incentivised to design and maintain efficient tax systems (Eklou, 2016). Indeed, the IMF (2015) has found that while resource-rich countries collect relatively more revenue (as a percent of GDP) when compared to non-resource-rich countries, they collect less from the non-resource sector. Non-resource sector revenues are particularly important as they can help to insulate expenditure plans from revenue volatility and promote good governance, as taxpayers would be more incentivised to scrutinize fiscal policies (IMF, 2015).

The Organisation for Economic Co-operation and Development (OECD) (2011) identified three principal taxation challenges in developing countries. These are: (i) weak tax administrations; (ii) low taxpayer morale, corruption, and poor governance; and (iii) dealing with 'hard-to-tax' sectors. Weak tax administrations in developing countries is related to understaffing of tax offices, inadequately trained and underpaid tax officials, and inappropriate structures which do not promote an integrated approach to different taxes. The OECD also found that weak governance and corruption are generally associated with low tax collection. Moreover, the high levels of informality in developing countries, coupled with weak administrative capacity and compliance incentives, contribute to high levels of noncompliance: estimates indicate that value-added tax (VAT) 'gaps' are roughly 50–60 percent in developing countries, compared to 7–13 percent in developed countries. Weak non-resource revenue collection can hamper government's ability to adequately respond to unexpected commodity price shocks.

III. Effective Spending Policies

Two important issues related to expenditure polices are public investment management and the profile of public expenditure. Public investment management is important for the productivity and efficiency of public investment. Public investment refers to government spending on physical assets or economic infrastructure, such as airports, road networks, ports, bridges, utilities, water and sewage systems and social infrastructure, which has a relatively long productive life. Recently, policy advisors have called on governments to increase public investment due to its growth-enhancing attributes. Some studies have stressed the positive relationship between public capital investment and economic growth and the important role of public investment as a countercyclical policy tool (Gupta et al., 2011; United Nations, 2009). Other studies, however, have highlighted that public investment tends to result in wastage of public funds (Miller and Mustapha, 2016; Pritchett, 2000). Tanzi and Davoodi (1998), for example, noted that corruption distorts decision making on public investment projects. The degree of distortion tends to be higher for countries with weak audit institutions, which reduces the productivity of public investment. In a study by the IMF (2015), it was also found that in countries where investments were needed the most, the institutions required to oversee and manage public investments tend to be the weakest.[1] The IMF (2015) concluded that improving the quality of public investment management institutions—that is, how governments select, implement, and manage their public investments and assets—could potentially reduce the public investment efficiency gap by up to two-thirds.

The profile of government spending is another important aspect of spending policy. In the literature, the relationship between public expenditures and economic growth is interpreted in different ways, expressed in two opposing hypotheses: the Wagner hypothesis, which argues that public expenditure is an endogenous factor that is positively influenced by economic growth, and the Keynes hypothesis, which suggests that public expenditure is an exogenous instrument that can be used to stimulate economic growth through its multiplier effect on aggregate demand (Tang, 2008). Other studies have shown that different components of government expenditure and their relative importance as a share of total government spending have varying effects on economic growth. In a study covering both developed and developing countries, Baum and Lin (1993) found that welfare expenditures, while serving an important function, have a negative effect on economic growth, while expenditure on education and defense have a positive growth effect. In OECD countries, Devarajan et al. (1996) found that expenditures on healthcare, transportation,

[1] For example, Dabla-Norris et al. (2011) found that public investment management in oil-exporting economies tends to be lower compared to others. Albino-War et al. (2014) found similar evidence for oil exporters in the Middle East and North Africa region.

and communication had a positive effect on growth, while education and defense spending had a negative impact. In the case of Barbados, Belgrave and Craigwell (1995) found that capital expenditure is growth-positive while current expenditure is growth-negative. These findings are particularly important, as during commodity booms, natural resource-dependent countries tend to disproportionately increase expenditure on subsidies (fuel and utilities) and transfers to households, which are generally not well targeted and result in vertical inefficiencies that can have growth-reducing effects, in addition to other environmental and health costs (Clements and others 2013).

IV. Strong Institutional Framework

The key elements of a strong institutional fiscal framework embody a medium-term fiscal framework, enhanced management of fiscal risks, and transparency (IMF, 2015). Other elements include numerical fiscal rules, a fiscal council, and robust and transparent budgetary processes (see IMF, 2015 for further details). In general, a medium-term fiscal framework is beneficial for countries in three main ways: (i) it strengthens fiscal discipline, (ii) it allows for a more efficient and strategic allocation of public expenditure, and (iii) it encourages inter-temporal planning and execution of resources (Allen, Chaponda, Fisher, and Ray, 2017; Brumby and Hemming, 2013; Harris, et. al., 2013). Medium-term fiscal frameworks also facilitate a close linkage between medium-term policy objectives and short-term annual budgets, which is important for setting targets and fiscal rules to maintain macroeconomic stability.

In the next section, we examine each of these elements in relation to Guyana's current fiscal framework.

3. Guyana's Fiscal Framework: Is It Ready for an Oil Boom?

Guyana is expected to become a major oil producer within the next decade with recent discoveries of oil, currently estimated at 3.2 billion barrels of oil equivalent with several unexplored blocks expected to yield additional reserves.[2] This is expected to bring a windfall of revenues, pushing GDP growth to 38.5 percent in 2020.[3] The magnitude of oil revenues is not to be underestimated, and preparations need to commence to establish a comprehensive framework for managing oil wealth, along with a transparent and rules-based fiscal framework.

[2] On February 27, 2018, the government announced another discovery of oil by Exxon Mobile in the Pacora well, taking the potential daily production for Guyana to 500,000 barrels per day.

[3] IMF Article IV 2017- Assuming a 60 percent value-added of gross oil production, GDP growth will be 38.5 percent in 2020 and 28.5 percent in 2021.

In this regard, the country has already taken steps to prepare for its transformation toward an oil-dependent economy with its membership in the Extractive Industries Transparency Initiative (EITI) confirmed in 2017, and the legislation to manage the petroleum industry currently being drafted. The government has committed to establishing the legislative and regulatory framework for the new oil sector: The Petroleum Commission Bill and a draft Local Content Policy for Guyana's emerging oil and gas sector have been sent to a Parliamentary Committee for discussion. The government has also committed to releasing a green paper (green state development strategy) which includes a proposal for the SWF in 2018. Considering the abovementioned initiatives, below we examine Guyana's fiscal framework looking at four issues related to effective fiscal frameworks:

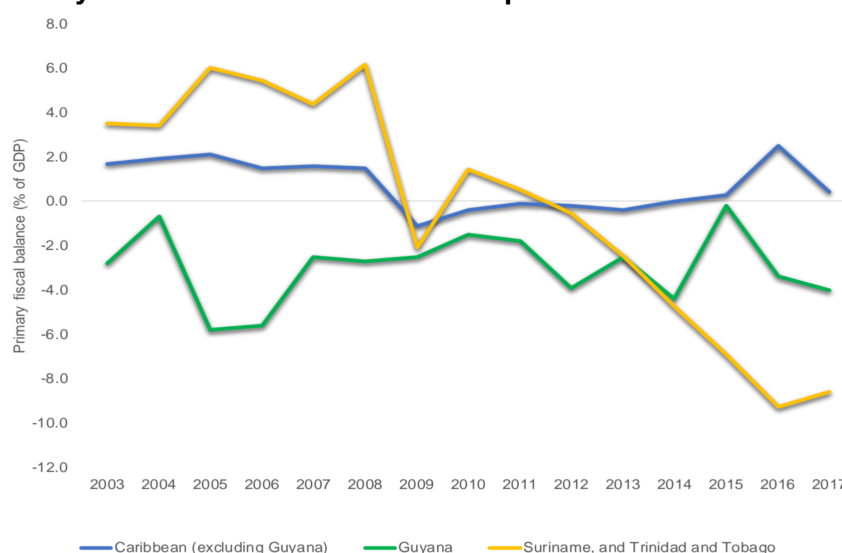
- Fiscal buffers and stabilization savings
- Effective use of taxation
- Effective spending policies
- Strong institutional framework

i. Fiscal Buffers and Stabilization Savings

Fiscal performance in the absence of stabilization savings and fiscal buffers

For any commodity-dependent country, maintaining adequate fiscal buffers to guard against adverse commodity price shocks is essential to maintaining a stable macroeconomic framework. In the past, Guyana had generally reported larger primary fiscal deficits than the Caribbean (on average) with a trend reflective of volatility in international commodity prices. For example, over the period 2003–2017, Guyana's primary fiscal balance as a percent of GDP averaged -3.0 percent while the average for the rest of the Caribbean was 0.3 percent. Moreover, the average primary balance of the other two other commodity-dependent countries in the Caribbean, Suriname and Trinidad and Tobago, were also better than Guyana's, at least up to 2014. These comparisons largely reflect the vulnerability of Guyana's fiscal performance to fluctuation in commodity prices and fiscal policy decisions that the government must contend with in the absence of stabilization savings and adequate fiscal buffers.

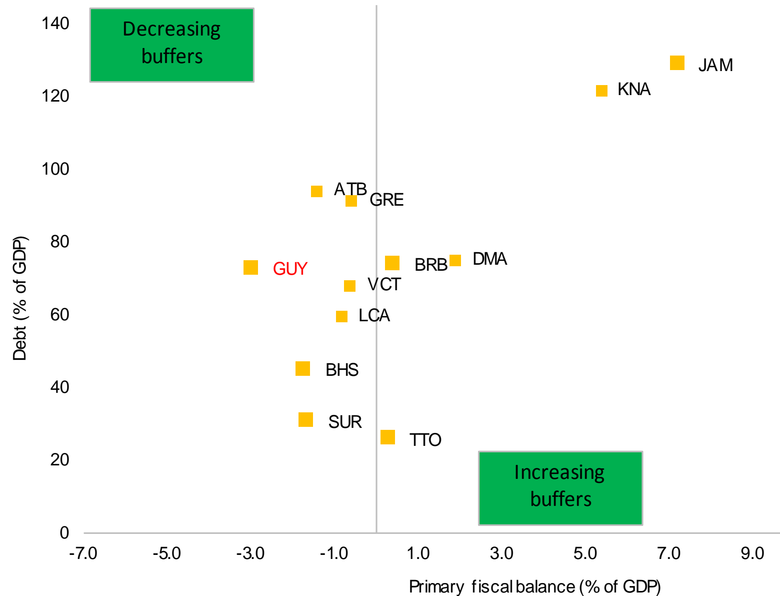
Figure 1. Guyana: Fiscal Performance Compared to the Caribbean Average



Source: World Economic Outlook (2017).

Indeed, Guyana will soon become even more vulnerable to the vagaries of commodity price shocks. As it stands, the country does not have adequate institutional mechanisms and has generally maintained inadequate fiscal buffers (compared to the Caribbean, especially commodity-dependent countries) to guard against unexpected commodity price shocks (see Figure 2). While the country has yet to establish an SWF, forthcoming legislation in 2018 will seek to establish one. The proposed fund will be used as a savings fund for future generations, financed by a percentage of the oil revenues. The IMF advised that while some frontloading of consumption may be desirable given pressing development needs, a high proportion of resource revenue should go to savings and domestic investment to generate lasting development gains. Not to dampen the importance of an SWF, it is important to note that simply establishing one is not a guarantee for fiscal stability (see for example, Frankel, Vegh, and Vuletin, 2012). In the first instance, the appropriate mechanisms to manage the fund, clear and simple rules for withdrawals and deposits, and issues related to governance and transparency will be of paramount importance to ensure that the SWF achieves its objectives. In this regard, the Santiago Principles, a list of 24 generally accepted principles and practices voluntarily endorsed by the International Forum of Sovereign Wealth Funds provides some general guidance for countries (see IWG, 2008). More substantially, an SWF must be supported by a strong fiscal framework. We will return to this issue later.

Figure 2: Fiscal Buffers (average 2013–2017)



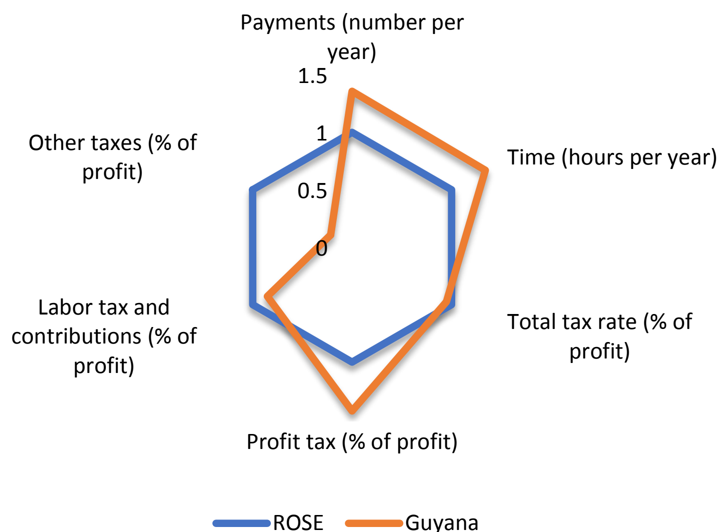
Source: World Economic Outlook (2017).

ii. Effective Use of Taxation

As is, there is room for Guyana's tax system to become less cumbersome, less complex, and more efficient along with improvements in tax administration that can reduce noncompliance (IDB, 2016). Tax administration is currently hampered by relatively low capacity of the Guyana Revenue Administration (GRA), with inadequately skilled human resources,[4] limited use of information and communication technology (ICT), and inadequate use of technology to capture common and relevant information.[5] Moreover, tax administration shows up as a major constraint for Guyanese firms: to pay taxes firms must spend 256 hours and make 35 payments annually compared to 195 hours and 25 payments annually by firms in the rest of small economies (ROSE).[6] In addition, the Ease of Doing Business index shows that profit tax (percent) in Guyana is much higher than the average for the ROSE: 21.3 percent compared to 14.3 percent (Figure 3). Nonetheless, Guyana has a better ranking than ROSE in labour tax and contribution, other taxes, and total tax rate (percent of profit).

[4] GRA has a population/staff ratio of approximately 726; while the C6 average is 1171 (IMF, 2017)
[5] Guyana National Tax Reform Committee Final Report, 2016.
[6] ROSE refer to a group of countries with a population size under 3 million (see Ruprah and Sierra, 2014)

Figure 3. Paying Taxes in Guyana



Source: Ease of Doing Business Report (2016).

Notwithstanding these challenges, the country has benefitted from advisory services from the Caribbean Regional Technical Assistance Centre (CARTAC) and has seen vast improvements post-global financial crisis (GFC). The semi-autonomous organization, Guyana Revenue Authority (GRA), has benefitted from successive reforms and training to strengthen its organization, functionality, and efficiency. However, despite years of reform, tax compliance is still relatively low. For example, the on-time VAT filing rate is 43 percent compared to the regional average of 62 percent and below international standards of between 70–90 percent (IMF, 2017).

On a positive note, Guyana is adopting policies to broaden its tax base and reduce noncompliance. The introduction of the VAT in 2007 greatly widened the tax base and increased revenues, capturing businesses that previously were noncompliant or were in the informal sector. The mandatory use of the Taxpayer Identification Number (TIN) has increased the number of taxpayers and encouraged people previously in the informal sector to come under the tax authority. The reforms undertaken in 2017 are expected to strengthen VAT tax compliance with a reduction in the tax rate.

iii. Effective Spending Policies

Commodity dependence makes fiscal management difficult due to its unpredictability. A resource-dependent country like Guyana should ideally smooth expenditures over time based on average revenues. Available evidence suggests that government spending tends to be more procyclical

for commodity-exporting countries than for other emerging markets and developing countries (IMF, 2015). Moreover, fiscal policy in countries with weaker institutions tends to be relatively more procyclical and controlling procyclical policies are associated with improved macroeconomic outcomes (IMF, 2012). Also, countries with weak political institutions are more prone to inefficient expenditures, including rent-seeking, in the face of commodity windfalls. In this regard, we look at two issues related to spending policies in Guyana: (i) public investment management and (ii) profile of government spending.

(i) Public Investment Management

Public investment in Guyana is relatively high but is perceived to be insufficient and ineffective (IDB, 2016a). There is room for improvement throughout the cycle of public investment management, particularly in the areas of planning and execution. Multiple capital projects are delayed, overbudgeted, and of sub-standard quality once completed, shortening useful life spans (IDB 2016a). For example, delays in capital expenditure continued from 2015 with Public Sector Investment Programme (PSIP) implementation less than 30 percent by mid-2017.[7] In addition, commentators have attributed implementation delays to shortages of skilled staff and the need to improve transparency. Further, the selection of public investment projects could be better linked to the objectives and goals of the medium-term plan, coupled with enhanced transparency on details of investment projects (IDB 2016a).

(ii) Profile of Government Spending

Public expenditures in Guyana are high relative to revenues and concentrated mostly on wages and salaries, transfer payments, and capital expenditures. On average, capital expenditure accounts for 9 percent of GDP, followed by transfer payments (9 percent of GDP), wages and salaries (12 percent of GDP), other goods and services (7 percent of GDP), and interest payments (1 percent of GDP). This composition of public expenditure has not changed significantly over the past six years. Current expenditures are highly skewed toward transfer payments to unproductive and inefficient public enterprises, while capital expenditures seem to be inefficient. These observations are supported by econometric evidence from IDB (2016b), which suggests that public expenditure in Guyana has low efficiency and contributes to a dampening effect on economic growth.

[7] Ministry of Finance, Mid-Year Report 2017 https://finance.gov.gy/wp-content/uploads/2017/08/MID-YEAR-2017.pdf

iv. Strong Institutional Framework

Strong institutions, particularly transparency and governance, are essential for ensuring that countries can transform their natural resource wealth toward achieving stable long-term growth. Resource-rich countries depend on strong macroeconomic institutions to manage revenues and expenditures over the commodity price cycle. Containing excesses during booms and managing fiscal adjustments during downturns require strong fiscal institutions.

With respect to fiscal institutions in Guyana, the existing medium-term fiscal framework is considered weak and is not correlated to strategic goals with expenditure items and debt management (IDB 2016; IMF, 2010). Likewise, limited monitoring of budget execution occurs, evaluations of impacts are rare, and contingent liabilities are not explicitly accounted. The annual budget process involves negotiation between stakeholders with limited private sector consultation. Parliamentary oversight is also limited to general debates without significant scope for amendment once the budget is presented (IDB 2016).

Guyana's budget framework is governed by the Fiscal Management and Accountability Act (FMAA) of 2003 (FMAA, 2003). The credibility of the budgetary process is difficult to assess as the country is not included in the Open Budget Index, which measures government budget transparency. Nevertheless, Guyana's budget process has limited public engagement, insufficient budget transparency, and weak budgetary oversight. Recent figures show a variance greater than the internationally accepted benchmark of 5 percent,[8] which is an indication of underlying issues with forecasting and/or execution capacity.

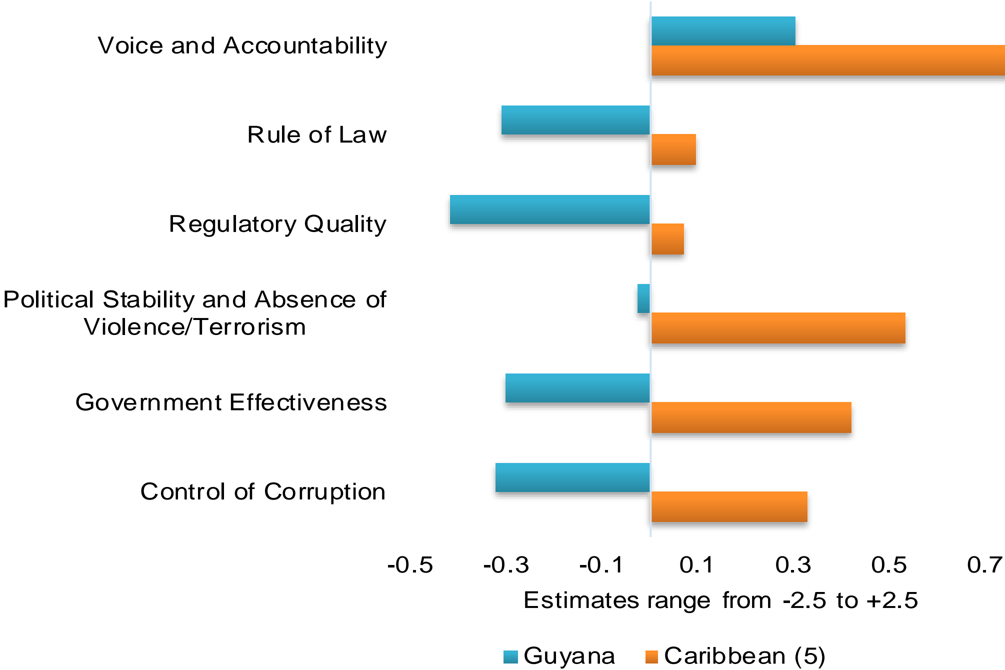
Presently, Guyana does not have explicitly stated fiscal rules[9] nor does it have a fiscal council. Also, Guyana's budget implementation could be improved, as capital expenditure has consistently performed below expectations; in 2016, for example, the public-sector investment program was 23 percent lower than budgeted. While current expenditure continues to increase, actual capital expenditure has consistently been below budget for three years. The prevailing poor budgetary performance is ascribed to weak institutional capacity in government ministries, lack of adequately skilled staff, and the need for improvements in transparency and procurement. It should be noted, though, that efforts are ongoing to improve disbursements of capital expenditure. In this regard, better procurement plans implemented in 2017 for 2018 along with other measures

[8] The IDB (2016 b) noted that in the case of current revenue there is little variation, but in the case of capital expenditure the deviations can be more than 20 percent. In the case of revenue, there was undershooting between 2011–2014, but collections have more closely coincided in 2015 and 2016.

[9] The FMAA Act 2003 currently governs all budgetary processes in the country but remains inadequate to fully address fiscal short comings. The FMAA does not provide a comprehensive approach to procurement nor adequate guidelines; in addition, it does not provide for adequate monitoring and oversight of the budget.

announced in Guyana's 2018 budget could help to improve the execution of budgeted capital expenditure. Indeed, the PSIP improved in the latter part of the 2017, exceeding 75 percent,[10] and the domestically financed PSIP was 10 percent above its year-end estimate. Weak fiscal institutions are not isolated and are a reflection of the overall quality of institutions in Guyana. Indeed, the quality of the country's institutions and governance framework can be described as weak, as Guyana underperforms on many indices related to the quality of its institutions. On the World Bank's Government Effectiveness ranking, Guyana places in the 42nd percentile, compared to 58th for the Latin America and the Caribbean (LAC) region. Guyana underperforms across all indicators compared to the C5 countries.[11] On voice and accountability, Guyana scores 0.3 compared to 0.75 for C5; political stability and absence of violence/terrorism -0.03 compared to 0.53; government effectiveness -0.3 compared to 0.42; regulatory quality -0.42 compared to -0.07, rule of law -0.31 compared to 0.10; and control of corruption -0.32 compared to 0.33 (Figure 4).

Figure 4: Quality of Governance (2016)



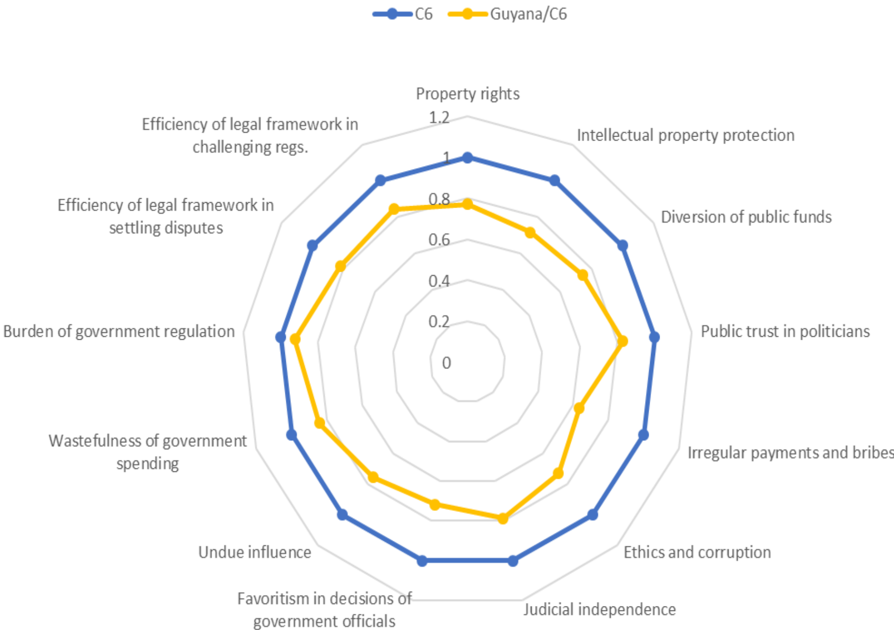
Source: Worldwide Governance Indicators (2018).

[10] The Guyana Chronicle http://guyanachronicle.com/2018/02/09/greater-output

[11] World Bank Governance Score 2016 has a range from -2.5 to +2.5, where higher values indicate a better performance (see Kaufmann, Kraay, and Mastruzzi, 2010). The C5 countries include The Bahamas, Barbados, Jamaica, Suriname and Trinidad and Tobago.

On the Global Competitiveness Index (GCI), Guyana underperforms in most categories compared with a group of Caribbean countries. Public trust in politicians is low (score 3.1/7 on GCI), and there is a perception of favoritism in decisions made by the government (2.7 out of 7), usually perceived as favoring well-connected firms and individuals who wield substantial influence (undue influence score 3/7). There continues to be a negative perception on corruption and ethics (3.7 out of 7) and irregular payments and bribes (2.9 out of 7), along with the occurrence of diversion of public funds (3.1 out of 7). This also holds for property rights, judicial independence, transparency of government policy making, and the strength of auditing and reporting standards, all scoring no higher than 3.6 out of 7 on the GCI (Figure 5).

Figure 5: Quality of Institutions



Source: GCI (2018).

Moreover, Guyana's Corruption Perception Index score in 2017 was 38 out of 100 (where 100 is a score reflecting clean of corruption), the lowest among Caribbean countries. These perceptions may reflect gaps in transparency related to public procurement, particularly with regard to competitive bidding, contract award, and project implementation. Using the methodology for Assessing Procurement Systems, in institutional framework and management capacity, the country scored 0.67 out of 3; for market practices 0.60 out of 3; and for integrity and transparency 1 out of 3. There are also major gaps in the areas of institutional framework and management capacity, market practices, and transparency of the system.

The country-specific PRODEV analysis for Guyana notes that its institutions lack the ability to conduct long-term operational planning, that is, the ability to define programmes and targets and establish roles and responsibilities (IDB, 2015). The weakest pillar on PRODEV continues to be monitoring and evaluation systems.[12]

The conversion of future oil wealth into long-term growth and development depends on the ability of government institutions to support productivity-enhancing reforms. Evidence shows that natural resource wealth has the potential to become a real development asset when coupled with strong institutions (both public and private), smart investments in skills and technological capacities, and solid macroeconomic fundamentals (IDB 2017). Strong institutions are essential to managing better natural resources by adopting fiscal rules and enacting a stabilization fund. In Guyana, the authorities need to enact reforms to strengthen its existing institutions to create a strong fiscal framework to manage the expected oil revenues. They need to revamp the fiscal and public procurement institutions and implement reforms to increase transparency and promote good governance.

4. Case Studies: The Nigeria vs. Norway Comparison[13]

This section examines the experience of two oil-dependent economies with respect to fiscal management, fiscal institutions, and fiscal stability.

i. Nigeria

On one extreme is Nigeria, African's most populous nation, which has been embroiled in decades of ethnic and religious conflict that has contributed to a highly inequitable society segregated along tribal, religious, and state lines. Despite having the largest proven oil reserves in Africa, the unstable internal situation has negatively impacted the country's growth potential (see Meagher (2013). Nigeria has large development and social disparities ranking 152 on the HDI, poverty rates above 50 percent, high income inequality, and decaying infrastructure. A lack of transparency and heavy perception of corruption has led to tremendous loss to the citizens. The World Bank has estimated that because of corruption 80 percent of energy revenues benefit only one percent of the population (Gadzala, 2015).

Historically, Nigeria has suffered large fiscal imbalances, low growth, and high debt primarily due to its inability to effectively develop a strong macroeconomic framework to insulate

[12] The PRODEV Evaluation Tool evaluates five pillars of the public management cycle that are considered important for the implementation of Management for Development Results. See more at https://idblegacy.iadb.org/en/topics/government/management-for-development-results/diagnostic-tool,8360.html

[13] See Hosein, et al. (2018) for a detailed analysis of Trinidad and Tobago's oil experience and lessons for Guyana

its economy from commodity price volatility. Following the GFC and the controversy surrounding the mismanagement of the Excess Crude Account (ECA) to fund budget deficits, the ECA went from US$20 billion in 2008 to US$4 billion in 2010. The Nigerian SWF, Nigerian Sovereign Investment Authority (NSIA), was created in 2011 to supplement the ineffective ECA which, despite being a good fiscal instrument, was plagued with issues of transparency and accountability and is perceived to be subjected to the whims of politicians.[14] The NSIA is an independent entity entrenched in the constitution; with its adherence to the Santiago Principles the SWF scores 9 on the Linaburg-Maduell Transparency Index.[15] To complement its SWF, the country has implemented budget balance fiscal rules, which allows for an annual overall deficit ceiling of 3 percent of GDP. However, the existence of these fiscal tools, while necessary, is not sufficient for a stable economy.

Nigeria's ability to withstand a commodity price shock is severely limited due to a weak institutional and macroeconomic framework; it is ranked 143 in the institutions pillar and 71 in the macroeconomic environment sub-pillar of the GCI. A lack of political will, along with what appears to be an entrenched culture of corruption and a lack of transparency as reflected in the country's ranking on the Corruption Perception Index, are some of the reasons identified as constraining the government's ability to implement sound fiscal policies.

ii. Norway

On the other extreme is Norway. Norwegians enjoy a high standard of living, ranking number 1 on the United Nations Human Development Index. The country has a high quality of free education and health care, and long life expectancy. With a low level of inequality and historically ethnically and religiously homogenous, Norway has had little civil conflict. Highly dependent on the petroleum sector, Norway discovered oil in 1969, and the Government Pension Fund Global (GPFG) was established in 1990 to manage and invest revenues from the petroleum sector. Today the Pension Fund is the largest SWF in the world, with US$998.93 billion in assets, and investments in over 9000 companies in 78 countries.

The GCI ranks Norway as having the most stable macroeconomic environment, with a fiscal framework designed to insulate the economy from volatile oil prices. This strong economic framework helped the country to withstand the effects of the GFC as well as the commodities market collapse. With a high level of exposure in external financial markets, primarily in developed

[14] The ECA provided financial stability through the GFC, provided an economic buffer to the large budget deficits, and was used to pay off the component of Paris Club debt that made Nigeria benefit from debt cancellation.
[15] The Linaburg-Maduell Transparency Index is a method of rating the transparency of SWFs. See more at: https://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index/

countries, the GFC precipitated a fall in GDP from 2.93 percent in 2007 to -1.6 in 2009, before rebounding in 2012 to 2.7 percent. While on the path to recovery, the economy was hit by a commodity price shock in 2014 that negatively impacted real GDP growth.

The petroleum industry is one of the key drivers of Norway's economy; the relative importance of the petroleum industry to the economy increased significantly. However, the slump in oil prices from 2014 has hurt the petroleum sector, with spillover effects on supporting industries across the supply chain. The petroleum sector's share of GDP fell from 24.5 percent in 2008 to 12.2 percent in 2016. Petroleum's share of state revenues fell sharply, from 32.6 percent at the height of the commodity boom in 2012 to 10.7 percent in 2016. Similarly, the oil and gas share of exports declined from 51.6 percent in 2012 to 36.2 percent in 2016. The decline in the petroleum sector contributed to a contraction in Norway's primary surplus. The government of Norway has consistently recorded fiscal surpluses for decades, but since the commodity price slump, the surpluses have gradually declined from 17.1 percent of GDP in 2007 to 3.1 percent in 2016. However, the country's large fiscal buffers and prudent fiscal management helped to mitigate the effects of the decline in oil prices.

The response to combatting the commodity price shock has been the implementation of an expansionary fiscal policy, which seemed to be an appropriate policy response. The government targeted a fiscal stimulus by reducing personal income and corporate taxes, employment targeting tax deductions, and targeting public expenditure at increasing productive capacity and external competitiveness, particularly in the non-oil sectors.

The success of the Norwegian model is not only based on the exemplary management of its massive SWF. Without strong institutions,[16] robust regulatory practices, and effective fiscal rules in place, this success would not have been realized. The political system encourages collaboration and power sharing, with strong expectations of transparency in all aspects of government business. On the Open Budget Index, Norway scores 84/100, making 7 of the 8 key budget documents publicly available within the timeframe consistent with international standards. Ranked 6th on Transparency International's Corruption Perception Index, strong procurement and anticorruption legislation have encouraged full transparency on all deals and contracts.[17] This has in turned translated into high levels of trust among citizens and encourages active citizen participation. The government adheres to the strong fiscal rules governing its budget balance as

[16] Norway is ranked 4th out of 140 countries in the institutions pillar of the GCI with a score of 5.8 out of 7.

[17] Full transparency on contracts and deals are displayed online. In 2016 the government adopted new procurement legislation to govern public procurement. The authorities must always comply with the main principles as equal treatment of tenderers, transparency, non-discrimination, integrity, and good business practices, regardless of the threshold values.

well as withdrawal rules from the SWF. On the GCI institutions pillar, the country ranks well on all public and private institutions.

In summary, while having adequate buffers helped the economy to withstand a commodity price shock, the presence of strong institutions that facilitate transparency and good governance, adherence to international best practices, and a relatively conflict-free homogenous society are some of the main sources of Norway's strength as a successful oil-dependent economy.

5. Conclusion and Key Lessons for Guyana

This paper examined four key elements of Guyana's fiscal framework, which are important to ensure macroeconomic stability in resource-rich economies. These are: (i) appropriate levels of stabilization savings, (ii) a strong institutional framework, (iii) effective spending policies, and (iv) effective use of taxation to reduce revenue volatility. We find that Guyana has work to do in each area. Historically, Guyana exhibited problems in maintaining adequate fiscal buffers, and the country currently does not have an SWF. One step in the right direction is that authorities are in the process of establishing an SWF. However, an SWF is not a panacea. Instead, strengthening institutions, particularly fiscal institutions, supported by implementing sound tax and expenditure policies, including public investment management, strengthening the budgetary process, enhancing human capital in key institutions, improving institutional capacity within key government ministries to improve budget execution, improving procurement rules, increasing transparency, and good governance are some of the critical areas that are essential for Guyana to be able to translate the expected boom in natural resource wealth into long-term inclusive growth and prosperity.

As can be seen, itemizing reforms to Guyana's fiscal framework at a granular level can easily result in a long laundry list that may require several years, or perhaps another decade to achieve—time that policy makers do not have. Thus, some prioritization of reforms is required over the next three to five years. Since the focus of fiscal policy is more likely to emphasize public investments along with an increased level of social spending initially, strengthening expenditure polices may be a key area that can yield more desirable benefits over the medium to long term, especially as it relates to improving the productivity of public investment, reducing wastage of public funds, and reducing the perception of corruption in the decision-making process related to public investment. The experiences of the extreme cases of Norway and Nigeria provide important lessons and perspective for policy makers in Guyana to reflect on as the country ushers in an era of oil wealth.

Appendix 1: Fiscal Sustainability Benchmarks

Designing an appropriate a fiscal regime is essential to ensure proper management and long-term sustainability for a resource-rich country. Strong fiscal rules, procurement rules, anti-corruption legislation and parliamentary oversight should anchor the appropriate fiscal framework. This should be supported by strong institutional arrangements to ensure transparency and proper management of natural resource wealth, and the associated conversion of that wealth into citizen development. Resource-rich countries with stronger economic and political institutions tend to have better macroeconomic and growth performance (Arezki et al., 2011).

Guyana does not have most of the fiscal structures in place that constitute a fiscal framework for resource-rich countries. Below is a table by the IMF (2015) that explicitly sets out key elements of a desired framework. In addition, a fiscal framework needs to be supported by the appropriate fiscal institutions to manage natural resource revenues.

Of importance is the ability of fiscal policy to mitigate the volatility of commodity prices. A fiscal framework that sets fiscal rules to manage price volatility and establish medium- and long-term fiscal targets is essential for smoothing revenues and expenditures. Implementing fiscal balance targets, primary balance targets, and structural primary balance targets is useful for adjusting for volatility.

As shown in the table below, fiscal policy indicators set fiscal sustainability benchmarks that should be adopted by the government. This helps to avoid fiscal procyclicality and helps with revenue smoothing to cushion against volatility. Targeting the structural primary balance is one way to guard against the boom-bust cycle of commodity dependent countries.

	Indicator	**Definition**	**Implemented in Guyana**
Fiscal policy indicators	Overall fiscal balance	Total revenues minus total expenditures, which gives the net financial position. This indicator is useful to assess financial vulnerability.	Yes
	Non-resource primary fiscal balance	Overall fiscal balance excluding resource revenues, spending associated with the development of the resource sector, and interest payments, (i.e., total non-resource revenues minus total non-resource expenditures). Useful to measure whether fiscal policy is being procyclical or counter-cyclical.	No

Fiscal policy rule	Debt rules	Debt rules set a specific numerical target for public debt as a percentage of GDP. This rule is useful when monitoring and measuring economic performance. Debt rules are capable of directly tackling debt sustainability, can be transparent and simple, and can accommodate large shocks if debt is well below a defined ceiling.	No
	Expenditure growth rule	Sets a limit on the growth of government spending. Useful to limit the procyclicality of fiscal spending, especially in cases of absorptive capacity constraints and where the volatility of resource windfalls requires precautionary savings.	No
	Revenue rule	Revenue rules impose limits on revenues with a view to containing the size of the public sector/tax burden and allocating ex-ante revenue windfalls (e.g., due to surprisingly high growth). This rule is useful as it can reduce procyclicality in good times.	No
	Budget balance rule	Budget balance rules focus on an overall budget balance, structural or cyclically adjusted balances, or an average balance over the cycle of the economy. This rule helps reduce the budget deficit and supports the convergence of the debt-to-GDP ratio to a desired level.	No
Fiscal sustainability	Fiscal sustainability framework (modified DSA)	Based on a debt sustainability framework. Aims to stabilize net resource wealth (over the longer term), while allowing scaling up of expenditures. Considers the growth impact and the replacement and recurrent costs associated with additional investment.	Yes

Adopted and modified based on IMF (2015) and Wright et al. (2017).

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