Background Paper

Fiscal Rules for Suriname

Ministry of Finance and Planning

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Acronyms

EFF	Extended Fund Facility				
FS	Fiscal Strategy Paper				
FYP	Financial Year Plan				
FFYP	Financial Five-Year Plan				
IMF	International Monetary Fund				
MFP	Ministry of Finance and Planning				
MTFF	Medium-Term Fiscal Framework				
NRGDP	Nonresource Gross Domestic Product				
PFM	Public Financial Management				
SSFS	Stabilization and Savings Fund Suriname				
VRI	Value Recovery Instrument				

Executive Summary

1. In this Background paper, the Government of Suriname recognizes the need to strengthen the institutional framework for the conduct of fiscal policy. This is a worthwhile objective for Suriname in view both of its historical experience and the prospects for the development of new offshore mineral resources. Suriname's experience in the last two decades shows the potentially destabilizing impact of mineral resource volatility on fiscal policy. The prospects of new offshore oil represent an opportunity for prudently increasing development spending; but they also raise the possibility of large destabilizing effects if fiscal policy is not managed adequately.

2. The Government is of the view that the conduct of prudent fiscal policy needs to adhere to the following principles:

a. To prevent upfront surges in expenditure ahead of offshore oil production, which would result in more borrowing and higher debt. Expectations can soar soon; but production is several years away, and the rise in government's share in new oil income is backloaded owing to the fiscal regime.

b. To avoid procyclical fiscal policies, under which changes in revenue drive changes in spending, destabilizing the public finances and the economy.

c. Once new oil revenue begins flowing, to build up financial buffers to help manage downturns in mineral prices and mineral revenues.

d. To save part of the new resource-related income for future generations (offshore oil income is currently projected to last about 17 years).

e. To make room for prudently, gradually, and sustainably increasing development expenditure.

3. The Government believes that the introduction of fiscal rules can help ensure that these principles are embedded in the institutions that conduct fiscal policy. Moreover, the establishment of these rules would ensure the discipline of fiscal policy, an objective that it would not be appropriate to entrust the Stabilization and Savings Fund Suriname (SSFS) with. The operation of the proposed fiscal rules, to be sure, would be fully consistent with the operation of the SSFS, itself the subject of a proposed reform. The strengthening of the Medium-Term Fiscal Framework is also part of this reform effort. To be specific, a system of two inter-connected rules is discussed in this Background paper:

a. A medium-term fiscal anchor in the form of an indicative limit on government debt (net of financial assets in the SSFS) at the end of a five-year period.

b. A series of binding annual limits on primary expenditure in the budget. These limits on expenditure would be chosen so that, in combination with the expected government revenue, they can produce fiscal balances consistent with bringing government debt (net of financial assets in the SSFS) under the indicative limit adopted as medium-term fiscal anchor.

4. The system of rules should have enough flexibility to be resilient. In fact, the Government believes that any system of fiscal rules should include an escape clause so the limits under the rules can be temporarily relaxed during extraordinary emergencies requiring a government response, such as a natural disaster. Moreover, near the end of each specified five-year period, the numerical value of the two rules for the subsequent five-year period would be established, based on a thorough analysis of the current and expected economic conditions, while avoiding abrupt or economically destabilizing changes in the primary expenditure ratio. After two five-year cycles, a thorough analysis could be undertaken to see how the system of rules may be improved.

5. The Government is of the view that to succeed, fiscal rules need to be transparently managed. Compliance with the limits established under the fiscal rules should be subject to appropriate reporting and auditing procedures, as the law currently requires for the execution of the budget.

6. The system of rules being proposed would also need to have self-correcting features. If there is an unjustified deviation from the annual primary expenditure limits, there would be an obligation to correct the deviation within a reasonable time. Similarly, the use of the escape clause should be followed by a plan to bring the government finances back into line with the fiscal rules as soon as practicable and without causing undue strain on the public.

Introduction

1. In this Background paper, the Government of Suriname argues in favor of the introduction of fiscal rules for the operation of its fiscal policy. Fiscal rules impose long-lasting constraints on fiscal policy through numerical limits or targets on broad budgetary aggregates. The main objective is to create a process that sets such limits or targets for a prespecified, multi-year period. Observance of these limits and targets will ensure that year after year the budget contributes to maintaining economic stability and increasing the resilience of the economy in the face of economic volatility and uncertainty—including uncertainty stemming from the oil industry, which appears poised to play a larger role in the Surinamese economy in the medium and long term.

2. Moreover, the last two decades have shown the importance of prudence in fiscal policy management and the risks of putting too much trust in volatile sources of government revenue. This has been true in Suriname as well as in other countries with abundant natural resources. Suriname lived through a commodity price cycle that saw government spending and debt surge from the early 2010's, riding a wave of optimism, followed by a painful process of fiscal adjustment when international resource prices fell.

3. In the last few years, the Government has been making strides in restoring fiscal sustainability through improved fiscal policy and discipline. Also, its efforts to negotiate a debt restructuring agreement have borne fruit. But the experience of the last few decades and prospective future challenges suggest that there is a strong case for reinforcing the institutional framework for fiscal policy. The lessons of the past point to the need for ensuring that fiscal policy remains well anchored and sustainable. Moreover, the prospect of offshore oil reinforces the case to improve the underpinnings of fiscal policy at the earliest opportunity.

4. This reform is being considered now because of the urgency of strengthening fiscal policy institutions ahead of the possible start of new oil-related government revenue, expected before the end of this decade. Although that is still years away, the expectation of new revenue may fuel early calls for higher public expenditure and new subsidies. The Government understands that the experience of other countries shows the need to avoid excessive and premature surges in spending. While future revenues offer an opportunity for well-chosen additional development spending, it is essential to forestall the risk of wasteful expenditure associated with ramping up spending too quickly and too steeply.

5. The fiscal rule system presented in this Background paper is built on the principles of simplicity, flexibility, and transparency. Every five years, the Government will set

specific numbers for two numerical fiscal rules, which will guide fiscal policy and the annual budget process during the upcoming five-year period. These numerical rules are (i) an indicative limit on net government debt by the end of the five-year period and (ii) annual mandatory limits on government non-interest expenditure. Together, these rules will help build up resilience and promote economic stability, while allowing the judicious use of a part of any new resource revenues to help increase productive development spending, subject to the economy's ability to absorb increased levels of spending productively and without causing undesirable side-effects such as inflation and currency appreciation.

6. The system of fiscal rules proposed will have sufficient in-built flexibility to respond to unanticipated economic shocks and to gradual changes in the economy. First, every five years the Government will be allowed to consider the possible revision of the numerical settings for the two fiscal rules, in light of how the economy has performed and changed since the rules were last set, while avoiding changes to the numerical rules that might be destabilizing. Second, the rules will also be flexible in the face of unexpected and severe temporary adversity, including unusually deep recessions, natural disasters, and other calamities, through the inclusion of a well-specified escape clause. And third, the Government anticipates the possibility of conducting or commissioning a thorough review of the system of fiscal rules after sufficient experience has been gained in its use, so that it can be improved as needed.

7. The system of fiscal rules presented in this document is designed to operate seamlessly in conjunction with the Saving and Stabilization Fund of Suriname (SSFS), itself the subject of reform as part of a coordinated Government initiative. Together, the system of fiscal rules and the SSFS will enable Suriname to make good use of its natural resource wealth for the benefit of its citizens, now and in the future.

8. The proposed system of fiscal rules will be supported by strong fiscal transparency and communication of plans, implementation, and compliance. The National Assembly, Surinamese citizens, and financial markets need to be provided with accurate and reliable information on fiscal developments under the fiscal rules. This requires, inter alia, reporting on the fiscal rules and on compliance with the targets in budget documentation and fiscal reports.

9. This Background paper is meant to provide a thorough discussion of the economic rationale for the reforms under consideration, and to explain in detail the rules being proposed.

10. The timeline for the introduction of this reform is presently envisaged as follows. In the second half of 2024, the Government aims to submit to the National Assembly draft legislation setting up this framework through amendments to the Public Financial

Management Act. Later, a Presidential Decree would establish operational aspects of the rules that go beyond the more general scope of a law. Both the general and the main operational aspects of the functioning of the rules are covered in this background paper. In the early months of 2025, under the mandate of the amended Public Financial Management (PFM) Act, the government would prepare the first Fiscal Strategy Paper already under the new fiscal rules.

Why Consider Fiscal Rules for Suriname

11. All countries can benefit from consistent and prudent fiscal policies, and fiscal rules can be of great help in securing high quality fiscal policymaking. Academic research has found evidence that, in general, the adoption of fiscal rules can enhance fiscal discipline and signal fiscal prudence, resulting in improved credit ratings and lower borrowing costs for countries adopting and observing their fiscal rules.¹ Indeed, over a hundred countries today have a fiscal rule or system of rules.² Moreover, fiscal rules can be especially useful in countries where fiscal revenues depend on natural resources, as is the case in Suriname. Countries with abundant endowments of natural resources, especially oil and other nonrenewable exportable commodities, stand to reap substantial benefits from their exploitation, but they also face significant economic challenges. These challenges include the need to plan and execute fiscal policy in a highly uncertain environment and amid large variations in revenues. Moreover, in many of these countries fiscal policy is the channel through which the resource sector, export oriented by its own nature, transmits a large part of its effects to the domestic economy. Thus, fiscal policy plays a key role in securing broad economic stability in these countries. In the following sections specific arguments in favor of strengthening the framework for fiscal policy are presented.

Avoiding a premature surge in expenditure

12. With the prospects of new oil production offshore, growing calls for additional public spending and subsidies could arise. Even though offshore oil production is still several years away, the expectation of such revenue may feed spending pressures, and these could grow as the perspective of future increases in oil revenue gains hold.

13. There is great risk associated with surging expenditures, as the international experience shows. Two cases that illustrate this risk are Mexico in the second half of the 1970s and Ghana more recently (Box 1). A major lesson from these episodes is the need

¹ See for example Afonso and Tovar (2019), Islamaj, Ergys and others (2024), Johnson and Akriz (2005), Thornton and Vasilakis (2018 and 2019). Full references are found at the end of this Background paper. references

² In the Americas, over 20 countries have either fiscal rules (national and/or supranational), a fiscal council, or both. See Hamid Davoodi et al (2022).

to avoid steep increases in government expenditure in response to expectations of future resource revenues.

Box 1. Spending Too Much, Too Early: The Cases of Mexico and Ghana Mexico

The finding of abundant new oil deposits in the Gulf of Mexico in 1977 gave rise to optimism and a sense on the part of the Government that it could use oil related revenue to lead the development process in the country. Consequently, government current and capital spending rose at a fast pace and public employment surged,

revenue to lead the development process in the country. Consequently, government current and capital spending rose at a fast pace and public employment surged, while public revenues declined reflecting the decision to increase the subsidies embedded in publicly provided goods and services. As a result of difficulties in ensuring the quality of spending amid such a rapid surge, much of the resources spent had a limited impact on development. Governance issues also arose in a context of high and inadequately controlled public spending. Public sector deficits and debt grew rapidly, the national currency suffered a large real appreciation that contributed to a surge in imports, and the country became increasingly vulnerable by the early 1980s. At that point, large adverse external shocks (a rise in international interest rates and a decline in oil prices), combined with this vulnerable state, led to a government debt default by 1982. The "lost decade" had thus started in Mexico.

Ghana

In the expectation of future oil revenues, Ghana started to increase its spending since 2006, thus raising its fiscal deficit from 3 percent of GDP in 2005 to 10 percent of GDP in 2010, and its government debt rose from 26 to 46 percent of GDP in the same period. Oil revenue did start in 2011, but it never exceeded 2.5 percent of GDP, whereas the spending momentum could not be moderated. This way, public debt kept on rising, reaching 73 percent of GDP by 2016. Meanwhile, the effect of unbridled spending was to increase inflation. Eventually, fiscal adjustment efforts were needed to bring down the fiscal deficit.

Managing resource revenue volatility and avoiding "procyclical" fiscal policy

14. Commodity prices move constantly—a characteristic often called "volatility"—and these movements are very hard to predict. Future values of these prices are the subject of forecasting, but even the "best" forecasts invariably err, and the resulting prediction errors can be very large.

15. The international price of oil, most relevant for the discussion of these matters in Suriname, reflects countless pressures and factors. Because every activity uses energy,

the price of oil –the most universally traded source of energy—can be affected by anything that impacts economic activity anywhere. This is a major reason why the price of oil can vary so much, sometimes very quickly too, and why predicting the future price of oil is so difficult.

16. The prices of oil and other commodities often show some seasonal variations, which can be roughly anticipated and prepared for. But, more importantly, commodity prices are subject to wide swings that can last for several years. Unlike seasonal movements, these so-called commodity price super-cycles are of uncertain duration and amplitude. And during different phases of those cycles, prices can reach extremely low or extremely high values.

17. Government resource revenues, heavily affected by the international prices of commodities, also move around considerably and are hard to predict with confidence. This poses challenges to the government agencies in charge of economic policy, which must design and execute expenditure policies and government programs in a context affected by highly volatile, sometimes unreliable, resource revenues.

18. The experience of many countries shows that during the rising phase of a commodity price cycle, governments can run the risk of becoming confident that the associated high level of government resource revenue will last a long time. Therefore, they increase government expenditures to match the high level of their resource revenue. Furthermore, governments have sometimes increased expenditure faster than the growth in revenues, giving rise to increasing deficits and debt, in the expectation that resource revenues will grow further in the future.

19. Often, the new spending is in programs that structurally raise those governments' permanent commitments and/or in projects that have low rates of return, which in normal times would not receive consideration but which, in a context of perceived abundance of fiscal resources, may appear feasible. This way, permanent spending pressures and wasteful spending grow. While the resource revenue remains high, these problems may unfortunately receive insufficient notice. At the same time, the high level of spending will tend to boost activity and eventually inflation in the domestic economy, amplifying the upward cyclical pressures caused by the resource price boom itself.

20. Sooner or later, however, the super-cycle moves into a downward phase. Prices go into decline, and with them resource revenue weakens. At the same time, the value of the national currency in terms of hard currency may decline (depreciation), which will increase the cost of servicing external debt and paying for imports. The inertia in public expenditure, matched with falling government revenue, increases the deficit and the need to borrow on commercial terms. And just at that time, commodity exporters, facing adverse changes in the price of their exports, are likely to find lenders more reticent to provide financing, which, if it can be found, will be now more expensive. The abrupt fall in

revenue combined with difficulties borrowing will eventually force the government to cut public expenditure abruptly. Often public investment is among the first spending categories to suffer cuts. Projects may be paused, and sometimes entirely abandoned. Then, other spending cuts will follow, affecting the population more broadly. The cut in public spending will reverberate in the domestic economy, affecting economic activity—transmitting and even magnifying the effects of the price downturn itself.

21. Fiscal policy is said to be "procyclical" when government spending follows the movements of revenues, especially resource revenues—that is, when spending moves as if tracking the movement of commodity prices. Growing when commodity prices (and thus mineral revenues) increase, and contracting when they fall. This type of policy amplifies volatility and the economic shocks the economy suffers because of its resource dependence. Instead of managing the economy to promote stability, this kind of policy intensifies the risks associated with exposure to volatile export prices.

22. Suriname itself offers an example of such phenomena in recent decades.³ As the charts below show, fiscal revenues, boosted by resource prices, rose rapidly well into the second decade of this century, almost doubling in real terms in less than ten years. Government spending followed suit, and by the end of the decade it was significantly higher than revenue.

23. The resulting deficits continued to grow even as revenues started to decline. This is an example of the bias observed in many resource-abundant countries mentioned above: the tendency to treat resource revenue increases as permanent and revenue declines as temporary. But after three years of some revenue decline, a precipitous fall took place in 2015, as resource prices fell further. It became imperative to drastically reduce spending to contain government deficits and borrowing. The high spending levels of the early years of the second decade proved unsustainable, and spending in real terms had to be cut almost in half between 2013 and 2015. Then, when resource revenues increased somewhat, spending rose step by step once again, illustrating how difficult it had been to cut spending back when resource revenues fell precipitously.

³ A more detailed recounting of this experience can be found in T. Ter Minassian (2021). R. Ossowski (2021) notes especially the remarkable volatility of government revenue and GDP that has characterized Suriname, which has been higher than those of its Caribbean neighbors.



Suriname: Revenue and Expenditure in Real Terms 2003-2021 (2003=100)

Source: IMF World Economic Outlook database



Suriname: Resource Revenue and Fiscal Balances 2010-2021 (in percent of GDP)

Source: IMF World Economic Outlook database.

24. The Government is of the view that it is appropriate to draw lessons from that experience, and similar ones in many other countries. First, that a downswing will always follow an upswing, even though it cannot be accurately predicted when. And second, that prudent policymaking should include measures to prepare for downturns to avoid forced contractions in expenditure. Fiscal spending should be maintained at levels that can be sustained even if the commodity price cycle turns, so that the substantive government functions and policies that are carried out through that spending (in areas such as health, education, security and so on) can continue to be implemented smoothly, without interruption, even in the face of a decline in resource revenue. The Government holds the view that appropriately designed fiscal rules can be used to ensure fiscal policy does not fall into the trap of procyclicality and remains sustainable in the face of the ups and downs of commodity prices and resource revenues.

Avoiding negative effects on competitiveness

25. Besides amplifying the cyclical movements of the economy, procyclical fiscal policy can have deleterious effects on the external competitiveness of the economy—a situation sometimes called "Dutch disease."

26. Competitiveness can be impacted when large proceeds from oil (or other resource) exports are channeled into the domestic economy through increased levels of government spending. As the government buys more domestic items and increases its footprint, it tends to drive up the prices of production factors, such as labor, which are used throughout the economy. Such factor price increases may be passed on to final consumers of goods and services that face no foreign competition, known as *non-traded* goods and services. In contrast, producers of *traded* goods and services, which face competition from foreign firms both in domestic and export markets, are limited in their ability to pass on cost increases to their clients because those clients can always find an alternative, competitively priced, product from another country.

27. The combination of the rise of non-traded goods prices with a relative stability of traded goods prices translates into an appreciation of the currency in real terms, and it puts pressure on exporters and on those producers competing with imported goods (or competing in export markets) because their costs rise, and their profits fall as they are not able to pass on their higher costs to their clients. Over time, this can stunt the development of these sectors, reducing the external competitiveness of the economy as a whole.

28. In Suriname, the oil industry has limited linkages to other industries in the country, and so it is unlikely to channel a large volume of resources to the domestic economy on its own. In countries like Suriname, it is the government through its spending that channels resource revenues into the domestic economy. A procyclical fiscal policy that raises spending when resource revenues rise is likely to promote the increase in the prices of

nontraded goods and labor, promoting the appreciation of the currency in real terms and thus reducing the competitiveness of traded goods producers. The need to avoid this undesirable effect is one more reason for fiscal spending to remain restrained, under the limit of what the domestic economy can safely absorb without triggering inflation and real appreciation of the currency, even when resource revenues increase rapidly.

Saving for a rainy day and for future generations

29. The fact that resource revenues may fall as prices move into a downward phase of their cycles offers an important, precautionary reason for governments to save money during the upward phase of a cycle. Accumulating a sufficient stock of liquid assets that may allow the government to see through periods when the level of natural resource revenue falls is important to strengthen the sustainability of fiscal policies. Some rules of thumb have been proposed in that regard, such as ensuring that government builds up a reserve worth a multiple of the normal annual contribution of natural resources to the budget. How large a buffer to build is a question that requires a determination of what is the "normal" or expected level of resource revenues, the estimation of the risk that resource prices will suffer a protracted slump, and a decision on the degree of coverage desired against these risks. In any case, a direct implication of this approach is that for a number of years a significant fraction of the annual flow of resource revenue may need to be dedicated to constituting such a reserve.

30. More important for Suriname, poised on the brink of developing new offshore oil, the finite nature of nonrenewable resources provides a second motivation for saving part of ongoing resource revenues: to make the wealth represented by the stream of these resources last longer. From today's vantage point, the finiteness of natural resources refers not just to their exhaustible nature, but also to the probability that these resources may become obsolete even before they are physically exhausted, as the world moves to embrace cleaner technologies for the generation of energy. Saving to extend the benefits of a resource which will be available only for a limited time over a longer, possibly much longer, period is often couched in terms of ensuring that future generations can share in the benefits from the finite resource being extracted now.

31. A well-known point of view is that, to ensure that all future generations share in the benefits, in any given year the government should only consume the "permanent income" accruing from the "wealth" represented by the exhaustible resource. That is, consuming only the return earned on the wealth, without allowing the wealth stock to diminish.⁴ Implementing this recommendation in practice is a difficult endeavor, fraught with

⁴ Such "permanent income" is the product of a long-term real interest rate times estimated resource wealth (understood as the sum of the expected discounted value of the future sales of minerals currently in the ground, plus, possibly, the financial assets built through past sales of minerals already extracted, if any), Estimating these quantities requires making many difficult assumptions about the future.

analytical and practical complications, and in fact no country does so at present. But even if literally following this precept is not something a government may want to do, it is still important to keep in mind the responsibility the government has today to ensure that durable benefits from nonrenewable resources reach future generations—literally, our children and grandchildren—by saving, which is the way we have to transfer resources to the future.

Proposed fiscal rules for Suriname

32. The Government is of the view that fiscal rules can play an important role in fostering a fiscal policy that promotes macroeconomic stability, does not hurt the competitiveness of the country, supports development, protects the sustainability of fiscal and other policies, and spreads the benefits of nonrenewable resources over time so that future generations of Surinamese citizens can enjoy them too.

33. The Government has reviewed international evidence and the advice of multilateral institutions.⁵ It has concluded that for a system of rules to work well, it should be simple, transparent, and flexible enough that it can evolve over time with changing economic circumstances and permit adequate responses to sudden, unanticipated temporary shocks of sufficient severity. The Government believes that the system of fiscal rules outlined below would help it conduct its fiscal policy in a manner consistent with these principles.

Institutional coverage

34. The system of fiscal rules should cover as much fiscal activity as possible, consistent with the government having the ability to monitor and control such activities. At present, the proposed rules would cover the operations of the [*budgetary*] central government, as this is the institutional sector that can be effectively monitored and controlled by the MFP.

35. However, entities of the public sector outside the central government [*budget*], such as [*extrabudgetary funds and*] state-owned enterprises, may engage in activities that can pose fiscal risks to the central government. The aim should be to contain as much as possible these risks, and over time to work towards a system of institutional linkages and control that may enable Suriname to prevent such entities from undoing the benefits and discipline of the fiscal rules. Every effort should be made to prevent the activities of those entities from undermining the operation of the fiscal rules.

⁵ See in particular Ter-Minassian, op.cit., and IMF (2018a) *How to select fiscal rules: A primer.*

36. As fiscal reporting and control improves over time, the institutional coverage of the rules will be broadened.

Time frame and legal basis

37. For a system of rules to promote stability it should set numerical limits or targets for key fiscal aggregates for a period of several years. This said, the country may undergo structural changes relevant for fiscal policy over the medium to long term. Therefore, the amendments to the PFM Act (and the implementing presidential decree) enacting the fiscal rules will include provisions for the periodic reviews and, if necessary, revisions of the rules' ceilings and targets. The period should be determined in a way that the system of rules can flexibly adapt to the evolution of the economy.

- A period of four years could strike a good compromise between stability and flexibility, and dovetail with the forecast horizon of the rolling *Medium-Term Fiscal Framework*, or MTFF, an analytical document currently produced by the MFP, under the mandate of the PFM Act, that presents multi-year forecasts of the main macroeconomic variables that affect fiscal outcomes and the main fiscal variables themselves.
- A five-year period, albeit a year longer than the current MTFF, would coincide with the duration of the main national political cycle. Adopting a five-year period would provide a measure of insurance against political cycles and prevent a situation where a given government gets to determine fiscal rules for two four-year periods. Thus, the Government is of the view that the five-year period is preferable. Moreover, the process of revision of the numerical values of the fiscal rules should not take place in election years.

38.It is proposed that the new system of fiscal rules be established through amendments in the PFM Act of 2019. (Other legislation, including on the SSFS, as discussed in the corresponding Background paper, would be amended too; the rules will not clash with the ceilings in the Debt Act, so reforming that Act does not appear necessary). Chapter II of the PFM Act is concerned with establishing the basis for a prudent fiscal policy, setting down the principle that fiscal policy should be based on a budget strategy that considers the medium term, and regulating the content and structure of the state budget. Moreover, the MFP publishes every October a Financial Year Plan (FYP), which discusses fiscal policy in a medium-term perspective that covers recent years as well as projections of future years, and is a valuable companion to the budget bill sent to the National Assembly. The reform explained in this Background paper can be carried out by enhancing this Financial Year Plan, and giving a special character to the FYP prepared at the start of a specified five-year period, which will henceforth be referred to as the Financial Five-Year Plan (FFYP). The FFYP would be the main instrument for

establishing the numerical fiscal rules that will be in effect during an entire five-year period. Other parts of the Act, dealing with functions such as auditing and reporting, would be harmonized with these changes.

39. To summarize, the Government's proposal in this Background paper is to require the MFP to prepare, every five years, a FFYP setting down the numerical values of the rules for fiscal policy for the coming five-year period. This FFYP would be prepared by the Government and submitted to the National Assembly, and the rules for fiscal policy established in it would be of mandatory observance for the Government when preparing and executing its annual budgets during the five-year period covered by the FFYP. In view of the time to the initiation of production in offshore oil fields, expected to take place possibly already in 2028, the first multi-year period of effect of the rules (and *only* the first) should be only four-years long. This transitory arrangement will also help set the normal five-year cycle of review of the numerical rules farther from the national elections (more on this below).

The two numerical rules

40. The proposed system, for simplicity, should involve just a few rules. The rules should nevertheless suffice to give medium-term direction to policy and provide guidance for the setting of the main annual budgetary aggregates every year. Therefore, the Government proposes a system of two complementary rules (Annex 1 contains a numerical example of how these rules may work in practice):

A medium term fiscal anchor in the form of an indicative ceiling on net government debt (that is, government debt net of financial assets held in the SSFS) by the end of the five-year period covered in the FFYP. The indicative ceiling on net debt would be expressed as a ratio to nominal GDP initially, and of nonresource GDP when such a statistic becomes a standard variable regularly published by the Bureau of Statistics of Suriname, as it will be explained in the Transitory Provisions section of this paper. For simplicity of exposition, in the intervening sections the Paper will refer to ratios to nonresource GDP. Also, the indicative ceiling five-years out may be complemented by a series of indicative targets for the value of net debt at the end of each year covered by the FFYP. The nominal value of these intermediate ceilings would be technically adjusted each year to reflect updated projections of the change in the deflator of nonresource GDP.⁶ And,

⁶ For example, imagine that in year T nominal nonresource GDP is projected to grow by 10 percent during each subsequent year and that it is desired to keep the ratio of net debt to nonresource GDP constant. Initially then the nominal ceiling on net debt for year T+5 would be the current level of debt augmented by 10 percent a year for five years. Assume that, one year later, one finds out that nominal nonresource GDP grew by 8 percent only in year T+1 as a result of more moderate inflation, and that such conditions are expected to continue in years T+2, T+3, and so on. Then the nominal ceiling on net debt for year T+5 would be adjusted downwards, to the initial level observed in year T augmented by 8 percent for five years.

 A series of annual ceilings on noninterest expenditure of the government, also expressed as a ratio to projected nonresource GDP, for all the budget years in the period covered by the FFYP. These annual ceilings would be calculated to bring the net debt within the limit established in the FFYP by the end of the five-year period, given the levels of non-mineral revenues (under existing tax and nontax revenue policies) and of mineral revenues expected at the time when the FFYP is formulated.⁷

The indicative ceiling on government debt net of financial assets in the SSFS

41. This numerical medium term anchor is defined as *government debt net of financial assets in the SSFS (as a ratio to nonresource GDP) at the end of the five-year period.* The FFYP setting this ceiling will also include an indicative trajectory for the value of government debt net of SSFS financial assets at the end of each year before the end of the five-year period. Should the net debt deviate from the path at some point, the government will need to explain the reasons in a document submitted to the National Assembly (the regular Financial Year Plan, which contains unaudited, preliminary budget outcome figures for the previous year). The coverage of the gross debt and SSFS financial assets under the rule will be specified in detail in the proposed amendments to the PFM Act and the subsequent Presidential Decree laying out operational details.

42. The indicative ceiling on net debt is designed to help direct fiscal policy toward the reduction of public debt in a gradual and sustained manner during the five-year period in question, a major policy objective and a requirement for the government to restore the fiscal space needed to face unforeseen events. As of the end of 2023, already reflecting the benefits from the recent debt restructuring agreements, central government debt stood at an estimated 87.1 percent of GDP.⁸ This is too high by any standard, and far above the traditional statutory limit on central government debt established in the Debt Act, of 60 percent of GDP, which was suspended in 2017.

43. Under the program currently in effect with the International Monetary Fund (IMF), the Extended Fund Facility (EFF), one of the key objectives of the government is to restore fiscal sustainability, including by reducing government debt. Under the policies

⁷ These annual limits would be consistent with the net debt limits inclusive of the technical adjustments discussed in the previous footnote. For example, if nominal primary expenditure ceilings were initially expected to increase by 10 percent each year, as in the example of footnote 3, with updated information and projections for inflation these annual limits would be expected to increase by only 8 percent (assuming revenues are also expected to grow at the new slower rates). Note that it would not be desirable to make a similar technical adjustment if nominal nonresource GDP had been lower than expected because of a weaker than expected rate of real economic growth; in such a case, making this kind of technical adjustment would introduce procyclicality in the operation of the fiscal rule by tightening the spending ceiling when activity weakens.

⁸ IMF, Suriname: Fifth Review Under the Extended Arrangement under the Extended Fund Facility, April 2024.

explained in the Memorandum of Economic and Financial Policies (MEFP), the Government expects to bring government debt to around 71 percent of GDP by 2028.

44. Therefore, the inclusion in the FFYP of an objective to bring debt down significantly over time is fully consistent with the policy objectives of the government. Indicating an objective several years out, such as bringing government debt to 71 percent of GDP or less by 2028 (with GDP in such a statement assumed to exclude any offshore oil GDP, as explained in the IMF Staff Report⁹ for the EFF) provides a clear direction for overall fiscal policy over the medium term, and thus should be incorporated in the first FFYP.

45. But debt will need to continue declining further, as a safe level of public debt, low enough to create new capacity to borrow in the face of an emergency, would be much lower than 71 percent of GDP. For this reason, debt reduction needs to remain an objective in the specification of this numerical rule in the subsequent FFYP.

46. In fact, a proper objective is to ensure that debt levels are brought over time into compliance with the requirements in the Debt Act. The indicative ceiling on government debt net of financial assets in the SSFS at the end of a five-year period should be set in such a way to (i) avoid conflict with the permanent ceilings on government debt mandated in the Debt Act, and (ii) help move government debt below 60 percent of GDP in a sustained and continuous way. In practice this means that, while generally speaking different combinations of debt and SSFS financial assets can result in a given value for debt net of such assets, the government will have to aim for a combination that satisfies both the Debt Act ceiling and the numerical fiscal rule.¹⁰

47. There are two main arguments for having a fiscal rule on the net financial assets of the government instead of simply on government debt, as in the Debt Act. First, over time, as the offshore oil production begins and then rises, the possibility and the need to accumulate financial assets in the SSFS will emerge. New resources will become available, and some of them can be used to reduce debt further; also, some of these resources can be used to raise development spending, within the capacity of the economy to absorb such spending while maintaining macroeconomic stability and ensuring the quality of the spending. But these new resource revenues are likely to exceed at some point the amounts that can be used reasonably for those two purposes, and thus a part

⁹ Same reference as in footnote 8.

¹⁰ For example, suppose that the old 60 percent of GDP limit on debt is reestablished in the future under the Debt Act, and that later a future FFYP proposes a ceiling of 55 percent of GDP for government debt net of financial SSFS assets five years out. While in theory this could be achieved with a debt of 65 percent of GDP and assets of 10 percent of GDP, this combination would be incompatible with the Debt Act, and therefore the government would have to strive to observe both limits by accumulating no more than 5 percent of GDP worth of financial assets in the SSFS so that, other things equal, debt can be kept below 60 percent of GDP.

will remain available to save in the SSFS once debt has been brought to a safe level.¹¹. Once Suriname finds itself in this context, some years from now, the government can indeed face a choice at the margin between reducing debt a little more or investing in the SSFS a little more. The indicative ceiling proposed here would not prejudge between those two options, as the ceiling is on government debt net of financial assets in the SSFS. The government would have the ability to make the best choice under the financial conditions prevailing then, subject to complying with the Debt Act.

48. Second, a precautionary argument also motivates the need to save. Suriname should build up buffers to face sudden declines in resource revenues that will inevitably happen at some point. So, resources of adequate size should be set aside each year to ensure that the value of the assets in the SSFS can grow over time till it reaches a level that can offer confidence that, even if the world oil industry fell into a protracted slump, with the consequent drop in resource revenues for the Government, it would not be necessary to abruptly reduce expenditure. That is, building up this liquidity buffer is necessary to ensure the sustainability of the broad range of public policy programs carried out by the government.¹²

49. So, in the first few FFYPs, the goal of restoring and enhancing sustainability should be reflected in appropriately reducing the level of government debt and increasing the volume of financial assets in the SSFS. These two processes can be summarized in a reduction in the ceiling for government debt net of SSFS financial assets (as a ratio to nonresource GDP), hence the definition of this numerical rule.

50. The last point concerns the characterization of the ceiling on net debt as "indicative." What this means is that failure to observe this ceiling, all by itself, will not be considered a sufficient reason to adopt corrective fiscal measures. The motive for this provision is that even if the government follows the fiscal policies envisaged in the FFYP, including by observing strictly the annual primary expenditure ceilings (as discussed more fully in the next section), net debt could end up being different than anticipated owing to reasons beyond the control of the government. For example, an unexpected change in the exchange rate of the national currency could increase the value of government debt net of financial assets in the SSFS above its prescribed ceiling. Similarly, even if all fiscal policies are implemented as planned, oil and gold prices could be unexpected outcomes for government debt net of financial assets in the SSFS. Because these factors are beyond the control of government, it would be inappropriate to hold government

¹¹ Indeed, it will always be useful to maintain a minimum level of government debt in circulation so that the financial system may have a benchmark asset of sufficient liquidity.

¹² See Eyraud, Gbohoi and Medas (2023) for a discussion of how one may calibrate a ceiling on debt net of financial assets with the objective of creating buffers that can protect against resource price risks with a sufficiently large probability.

accountable for them. This does not mean the ceiling on debt net of financial assets in the SSFS is irrelevant. Its importance stems from its role as fiscal anchor emphasized at the start of this section—it is from this ceiling that the mandatory annual limits on primary expenditure and therefore the annual budget amounts for the five budget years covered by the FFYP will be derived.

The primary expenditure rule

51. Ceilings on the net debt anchor fiscal policy over the medium term. However, they need to be complemented by a rule that can orient the annual budget process every single year. Thus, the second numerical rule proposed is a ceiling on annual government non-interest, or "primary," spending (also as a ratio to nonresource GDP).¹³ This is a simple and transparent way to set annual limits that are stable over time and consistent with bringing government debt net of SSFS financial assets to its desired level by the end of the FFYP period, conditional on the path of revenues anticipated in the MTFF (which is based on existing tax policies and projected mineral revenues). The annual guidance provided by the expenditure rule is necessary to ensure the broad stability of expenditure from year to year. It is also necessary to prevent situations where needed fiscal adjustment measures are postponed, which could force a large fiscal effort near the end of the period covered by the FFYP. The rule, therefore, prevents a pattern of volatile levels of spending, which would be to the detriment of economic stability.

52. A key reason to implement a rule for annual primary expenditure is to avoid procyclicality in fiscal policy. A pre-determined and smooth path of government primary spending set at the start of the FFYP period will largely delink spending policy from the ups and downs of government revenue. This is important for any country where government revenue is highly dependent on macroeconomic variables subject to variation and cycles. And it is particularly important in Suriname where resource revenues are a substantial component of public revenues, given their volatility and unpredictability. Adopting a primary spending rule is, therefore, an approach that promotes economically "neutral" fiscal policy—that is, "automatic stabilizers" will be built in the design of the fiscal rules.

53. The path for primary spending in the FFYP will be subject to adjustment if there are discretionary changes in nonresource tax policy. This is needed to avoid providing incentives to the government to use tax exemptions or other preferential tax treatments as a substitute for transfers or subsidies. It will also ensure that the level of spending remains consistent with the attainment of the debt reduction objective under the new tax policy. In a deep economic sense, requiring adjustments in the ceiling on primary

¹³ As explained earlier, the nominal ceiling will be derived from the ceiling on the ratio to nonresource GDP and the projection for nonresource GDP. The Planning Bureau has the capacity to make such projections, although it has not been making them regularly.

expenditure for deliberate changes in fiscal policy makes the primary expenditure rule similar to a rule on structural primary balances or primary balances adjusted for cyclical variations in the level of revenues. It is, however, simpler to administer because there is no need to constantly calculate structural or cyclically adjusted balances, a task of technical complexity.

54. The proposed rule refers to primary spending, that is, spending excluding the interest bill. Expenditure excluding interest payments under the rule is more directly under the control of policymakers. The exclusion of interest also prevents the transmission of interest bill shocks to the rest of spending and to the economy. Moreover, it avoids distorting debt funding choices between domestic and external debt.

55. Because primary expenditure is under the control of the government, the observance of this annual ceiling will be mandatory (binding). That means that failure to comply with the ceiling on primary expenditure would trigger the obligation for the government to implement corrective fiscal policy actions in the next budget. Mandatory corrections will be discussed in more detail later in this document.

How do the two numerical rules interact?

56. At least in the first FFYP, there should be a clear hierarchy where the annual primary spending limits are chosen with the goal of ensuring the attainment of the net debt rule. The first FFYP should, for reasons indicated earlier, set limits on primary expenditure consistent with bringing debt down to 71 percent of GDP by 2028, given current tax and nontax policy settings and current expectations for growth of the economy and mineral revenues, which are laid down in the MTFF as already required by the PFM Act.

57. The work underlying the preparation of the FFYPs will include economic analysis to produce the actual ceilings for expenditure that would be set at the start of the period covered by the FFYP. A main input for this work will be the medium-term macroeconomic and fiscal projections included in the MTFF and regularly published in the Financial Year Plan. These projections will allow determining the expenditure level which, in combination with projections of government revenues, can produce a smooth path for public debt net of financial assets in the SSFS consistent with the objective for that variable by the end of the FFYP period and the indicative targets. The methodology, underlying data, and assumptions for making these projections will be transparent and based on internationally accepted sources, including the IMF's World Economic Outlook (the WEO). As part of the MTFF, such projections will need to be accompanied by a discussion of relevant risks.

58. In subsequent FFYP, as success in the implementation of the rules reinforces the sustainability of fiscal policy, the two numerical rules will influence each other on a more reciprocal basis. On the one hand, the selection of spending limits will take into account

the desirability of making room for development spending funded with the new resources without creating excessive inflationary and real appreciation pressures in the Surinamese economy. If the analysis shows that some gradual increase in spending ratios appears feasible and desirable, this information can be used to help determine how much can be spent and how much can be saved, that is, how much should government debt net of SSFS financial assets be required to decline during the period covered by the FFYP. On the other hand, it will be important to consider the need to save toward the constitution of a reserve against potential protracted declines in resource revenue prices, as discussed earlier, and this may restrict the scope for raising spending. By taking into account these various objectives and how they affect each other it will be possible to arrive at prudent and balanced numerical values for the system of rules.

59. In any case, it is necessary to avoid the risk of a disruptive change in fiscal policy between two consecutive FFYP periods. For that reason, the change in the average ratio of primary spending to nonmineral GDP mandated by one FFYP and the average of the annual limits established in the subsequent FFYP shall not exceed four percentage points.

60. In future FFYPs, when at least the uncertainty surrounding the date of the start of offshore oil production has been resolved, another important issue can be brought naturally into the determination of the two numerical rules: how much of the resource revenues should be set aside for the benefit of future generations? This is a question often presented in terms of the permanent income hypothesis: what share of resource income can be consumed each year so that the value of resource wealth, scaled by some metric such as projected population, price level, or GDP, is preserved indefinitely? This is a challenging analytical question. In the early stages of the system of fiscal rules, even before major new offshore oil has been developed, this question is clearly premature. But once there is more certainty about future oil production, it would be a useful and appropriate question to ask, and the proper context for addressing it would be during the preparation of a FFYP. Then, the answers could be relevant for the quantification of the two numerical fiscal rules from that point forward. As a minimum, following the IMF's Fiscal Transparency standards, a range of estimates of resource wealth will be prepared by the MFP and published.

Why express debt and primary spending as ratios to nonresource GDP?

61. It is customary to express goals as ratios to GDP to make these quantities comparable across time and robust to economic change, including in the price level. However, the ability of total nominal GDP to play a proper role as a scaling variable may decline substantially as new offshore oil fields go into production. In fact, Suriname's nominal and real GDP are likely to experience fast and significant growth once offshore

oil goes into production. This will reduce all calculated ratios to GDP and also make these ratios less meaningful. This is explained with some hypothetical examples below.

62. In the case of spending, if large offshore oil production were, for example, to cause GDP to rise by 30 percent in real terms over a few years, keeping the ratio of spending to GDP constant would allow increasing spending by 30 percent in real terms as well. A constant ratio of spending to GDP would be recorded; but this constant ratio would be concealing a massive increase in public spending, enlarging dramatically the footprint of the government in the onshore economy, involving the risk of waste and almost certainly creating severe inflationary and real currency appreciation pressures. If (nominal and real) spending surge would be taking place, with adverse economic consequences, even though the ratio of spending to GDP would be declining, a situation that could be confusing and complicate policy analysis and policymaking. In other words, in a scenario with a large increase in the contribution to GDP from the offshore oil sector, the meaning of the ratio of spending to GDP is distorted.

63. Similarly, it would be inappropriate to conclude that there should be less concern about the debt if the ratio of debt to GDP falls simply because oil production increases abruptly. The reason is that the resources which the government has at its disposal to service its debt will not grow as fast as overall GDP. The bases of the VAT and other taxes, for example, are related to national income and consumption; but these two aggregates will grow more slowly than GDP. The reason is that a large part of the new resource component of GDP will not constitute Surinamese income. It will be profit for foreign investors, as specified in the fiscal regime for offshore oil production. Even government resource revenue may initially grow less than overall resource GDP because of the cost recovery mechanisms recognized in the fiscal regime for offshore oil. In fact, as in other countries, the fiscal regime for the offshore oil industry in Suriname exhibits some backloading of government shares in total resource income over time.

64. In contrast, expressing the debt net of financial assets in the SSFS and the expenditure ceilings as ratios to nonresource GDP would preserve the stability and comparability across time of these ratios, and would ensure they remain economically meaningful. However, the National Bureau of Statistics does not currently publish statistics on nonresource (or nonmineral) GDP. Because the start of production of oil in Block 58 is not expected until late 2028, on an interim basis it would be possible to start working with the fiscal rules with a 2028 horizon using nominal GDP as a denominator for the relevant ratios. This strategy would give time for the official macroeconomic statistics and estimates to begin including nonresource GDP, nominal and real, and for the public to gain confidence and familiarity with it. Then, nominal nonresource GDP could be used to express the ratios for primary spending and government debt net of SSFS financial assets beginning in the FFYP 2029-2033.

Alternative rules: nonresource primary balance instead of spending, or rates of real growth instead of ratios to nonresource GDP?

65. The Government also considered a possible fiscal rule on the nonresource primary balance—the government primary balance excluding resource revenues. But it came to the view that the primary expenditure rule proposed above is preferable.

66. The nonresource primary balance concept could serve well as an instrument to operationalize the annual steps toward the achievement of the medium-term objective for reduction in net government debt. An advantage it may have over a primary expenditure rule is that it is not necessary to calculate expenditure ceiling adjustments to offset discretionary changes in nonresource tax rates and exemptions (see paragraph [53]): the focus on the *balance* would automatically take care of this.

67. However, a disadvantage is that any cyclical decline of revenues levied on nonresource activities (for example, VAT revenue declining during a recession) would force a commensurate reduction in spending to keep the nonresource primary balance on target. That is, a rule based on the nonresource primary deficit would tend to generate procyclical behavior in relation to the fluctuations of nonresource economic activity, even if it succeeds in insulating fiscal policy from the fluctuations in resource revenue. In that sense, a primary expenditure ceiling is preferable because it is neutral to the fluctuations in both the resource and nonresource activity.

68. While in principle it might be possible to make adjustments for nonresource cyclical factors, they would involve significant additional complications. This is because a rule for the cyclically adjusted nonresource primary deficit would have to be set. This, in turn, would require the estimation of potential nonresource output, a difficult task that becomes even more challenging during periods of structural change, such as those that may be in the offing for Suriname.

69. The case against choosing the primary balance is even stronger, as it would induce procyclical behavior also with respect to resource revenue cycles, which is one of the problems that the Government seeks to avoid by the introduction of fiscal rules. As explained in previous sections, Suriname is used to working with primary balances, but this is one of the factors that have facilitated procyclical behavior. When mineral revenues rise owing to temporary international price increases for minerals, it is possible to increase spending and still "respect" the primary balance commitments; and when international prices fall, dragging down revenue, respecting those primary balances would demnd drastic expenditure cuts. Eliminating this kind of procyclicality is one of the objectives the Government aims for when proposing to implement fiscal rules. For these reasons, the rule proposed in this Background paper refers to primary expenditure and not to the nonresource primary balance nor the primary balance.

70. A different kind of alternative is to think of the fiscal rules as controlling the real rates of growth of the stock of debt net of SSFS assets and of primary expenditure. In fact, given the technical adjustment for inflation discussed previously in paragraph 40 (with its explanatory footnotes), an equivalency can be established between setting the ceilings under the rule in term of rates of real growth or in terms of ratios to nonresource GDP. The equivalency occurs if one chooses the maximum rate of real growth of net debt and spending by reference to the expected real rate of growth of nonresource GDP. For example, if the rules prescribed that primary spending should be kept constant as a ratio to nonresource GDP for the next five years, while allowing technical adjustments for inflation surprises, that requirement could be equally well expressed by saying that over the next five years primary spending should grow in real terms at the same rate as real nonresource GDP is *expected* to do. The choice between these alternatives can thus be viewed as a choice between two ways to present the commitment undertaken by the government under the fiscal rules.

Escape clauses

71. The recent pandemic illustrated the importance of governments having the flexibility to act in support of people and businesses in the face of extreme adverse events. Therefore, fiscal rules should have flexibility to permit adequate government policy reactions to severe unanticipated but temporary events. Well-designed fiscal rules feature escape clauses for such events. An escape clause temporarily relaxes or suspends the requirement to comply with the existing fiscal rules, to enable the government to mount effective responses to natural disasters and other severe unanticipated shocks.

72. The Government proposes that the system of fiscal rules include an escape clause for well-defined classes of temporary adverse events. The escape clauses will be clearly specified and will be verifiable based on measurable variables outside the Government's control. The types of exogenous shocks and their minimum degree of severity (taking into account the historical record) that would allow a request to activate escape clauses will be specified in the amendments to the PFM Act and the implementing Presidential Decree. They will include major natural disasters, severe recessions of the nonresource economy, and major pandemics. The activation of the escape clause, if warranted, will be proposed by the MFP to the National Assembly, providing explanations, quantification, and a plan to return to the fiscal rule. The use of the escape clause would need to be approved by the National Assembly.

73. Procedurally, the Government considers that the activation of the escape clause should require a well-justified motivation by the MFP, indicating why a relaxation or suspension of one or more of the fiscal rules in effect is needed for the government to mount an adequate response to the shock or emergency at hand, and the corresponding approval of the National Assembly. The approval granted should be limited to one fiscal

year at a time, although it may be possible to extend its duration incrementally if the underlying events required a response beyond the initial fiscal year. The approval of the escape clause would nevertheless maintain the obligation of the MFP to provide regular monitoring reports on the evolution of the public finances and of the events motivating the use of the escape clause.

74. If an escape clause is activated, the government will be responsible for preparing a fiscal recovery plan to be put in place once the emergency is over, as early as the following budget year or, if the emergency ends early in a calendar year, through a supplementary budget. Such a plan would aim to bring the public finances back onto the path envisaged in the FFYP, as rapidly as it may be done without causing undue stress on the economy. Given that a FFYP will cover a period of a few years, it may be necessary to accept some shortfalls in the observance of the net debt objectives for the period, while the government implements an expedited and feasible return to annual ceilings on primary expenditure. The acceptance of such shortfalls would require approval by the National Assembly.

75. Finding the right balance will depend on issues such as the timing and duration of the shock and the state of the economy as it returns to normality. That is why a detailed and well-reasoned fiscal recovery plan should be prepared by the government, justifying, if appropriate, amendments to the specific numerical targets in the FFYP. This would necessitate the support of an updated MTFF. Only in the case of shocks requiring the invocation of the escape clause would changes to the FFYP be permitted.

Revision and review clauses

76. As discussed above, fiscal rules should apply for extended periods of time to provide effective guidance, help ensure fiscal discipline, and signal a sustained commitment to the proposed conduct of fiscal policy. Over a longer time period, however, economic circumstances may change and the country may undergo structural changes relevant for fiscal policy over the medium to long term, such as the discovery of additional resource reserves, large migration into the country, or beneficial structural reforms with short-term fiscal costs.

77. Therefore, the proposed legislation for fiscal rules will include provisions and procedures for revision and review. These mechanisms aim at providing additional flexibility in case of large, long-lasting events and improving the system of fiscal rules if needed, and provide a reasonable balance between discipline and flexibility. The timing of the revisions and reviews proposed below will be kept distant from the electoral cycle.

• A revision clause will allow a formal, periodic reconsideration (every five years) of the ceilings and targets under the fiscal rules based on medium- and long-term reassessments. The preparation of each new FFYP will be the natural opportunity to revise the setting of the numerical fiscal rules, providing the flexibility needed to modify the rules as structural changes in the economy unfold over time. Any changes proposed based on such analyses will be submitted to the National Assembly for approval and clearly communicated to the public to foster credibility. As indicated earlier, to avoid the risk of destabilizing, abrupt changes in fiscal policy, the average ratio of primary spending to nonmineral GDP during the period covered by an FFYP cannot change by more than four percentage points between two consecutive FFYPs.

• A review clause will allow a broader assessment from time to time of how the entire framework of fiscal rules is functioning. Such an analysis may suggest potential improvements to the existing system of fiscal rules. In fact, given the magnitude of the change in the public finances expected to follow the start of offshore oil production, a thorough study of the experience under the system of fiscal rules should be completed before the start of work on the FFYP for 2034-2038.

Correction for missed ceilings

78. As noted, the numerical rules set forth in the FFYP should not be amended except in cases of temporary and large exogenous shocks (when the escape clause can justify relaxing or suspending the rules) or as part of periodic revisions and reviews.¹⁴

79. If the government breaches the ceiling on primary expenditure under the numerical rules established in the FFYP, the MFP would promptly formulate and publish the fiscal (spending or revenue) measures necessary to correct those deviations as soon as it can reasonably be done, giving due consideration to the effect of corrective measures on the economy. The updated MTFF would reflect these corrective actions. Deviations that can be considered *de minimis* would not require a correction but would still require an explanation. The adoption of corrective measures would not be required for missing the ceiling on net debt when the ceiling on primary expenditure has been respected, because that would indicate that missing the net debt ceiling was the result of factors beyond the control of the government.

Transition issues

80. As noted earlier, an important transitory arrangement concerns the duration of the first multi-annual period of effect of the fiscal rules. In view of the time to the initiation of production in offshore oil fields, expected to take place in late 2028, the first multi-year period of effect of the rules (and only the first) should be shorter, covering the period through 2028. This will also postpone the need eventually to add one year to the horizon

¹⁴ As noted earlier, the nominal value of the numerical ceilings at the end of a given year may need to be adjusted if nominal non-resource GDP projections change in response to changes in inflation forecasts. But the rules themselves, expressed as limits on the ratios to nonresource GDP of net debt and primary spending, would be kept unchanged, as indicated in the main text.

of the MTFF, which currently spans four years, allowing technical staff to make this change with due care. This transitory arrangement will, in addition, have the advantage of setting the normal five-year cycle of review of the numerical rules farther from the national elections, starting with the five-year period of 2029-2033, helping strengthen the purpose of insulating these rules from the political cycle.

81.A second transitory arrangement is the expression of all ceilings in the first FFYP as ratios to nominal GDP. This will help ensure a smooth introduction of the rules, given that the general public, markets, and technical staff in the public sector are familiar already with ratios to GDP. At the same time, the Government intends to start publishing statistics on nominal and real (constant price basis) nonresource GDP, and to publish also projections for these variables in its MTFF, so that all interested parties can gain familiarity with them. The fiscal rules will be presented as ratios to nonresource GDP starting in the FFYP 2029-2033.

82.As for content and orientation, the Government considers that the first FFYP should be fully consistent with the policies and objectives that are being pursued at present and are currently endorsed by the IMF and incorporated in the program with that institution. The MEFP for the program provides clear insight on how to set the numerical rules that should guide fiscal policy for the next several years.¹⁵

83. This decision is prudent in light of the large uncertainties concerning future offshore oil revenue, and it is appropriate in view of the potential increase in spending pressures in the coming years. In line with best international practice, the MEFP and the corresponding medium-term financial targets and forecasts under the EFF supported by the IMF have not incorporated any revenues from potential offshore oil production so far. As of the writing of this Background paper, the final investment decision on whether to develop those oil fields is still pending. Moreover, even after such a decision is announced, there will be a years-long investment and development process before oil production can commence. As discussed above with the help of the examples of Mexico and Ghana (Box 1), during this time, it will be prudent for the government not to spend revenue that has not arrived yet, and whose eventual size is subject to large uncertainty. It would be risky to start allowing spending to rise when new government resources have not materialized.

84. These considerations confirm the need to ensure that the inaugural FFYP is based on current policies and objectives. Specifically, public debt is expected to be brought to 71 percent of GDP by 2028, on the basis of policies resulting in primary spending of 21.6

¹⁵ The EFF expires in [March 2025]. The discussion in this section refers to the continuation of the policies under the program, which are reflected in the IMF forecasts for subsequent years.

percent of GDP each year from 2025 onwards, and this should inform the setting of the numerical rules in the inaugural period under the rules.

85. A matter requiring its own transitional arrangements arises from the recent agreement with creditors to restructure the government debt. Suriname's creditors agreed that in the absence of new oil developments Suriname would need a larger amount of debt reduction; but they also foresaw that, if new oil were developed, the amount of debt reduction in the restructuring agreements would, in hindsight, turn out to have been too large. For these reasons, the agreements included a clause that allowed creditors to reverse some of the debt relief granted, should Block 58 come into production at some future moment. The mechanism created for that purpose as part of the restructuring agreement was a Value Recovery Instrument (VRI). This type of contingent mechanism has been used often in the history of debt restructuring. In the case of Suriname, it implies that, should offshore oil be developed, 30 percent of royalties on the new oil production would be earmarked for servicing this liability to creditors.¹⁶ If and when offshore oil production from Block 58 materializes, government debt would automatically rise by the total amount of the VRI (US\$275.6 million). Thus, the ceiling under the numerical rule for net debt by 2028 in the inaugural FFYP will need to include an upward adjustor for this VRI amount. This amount is not included in the government debt projections incorporated in the EFF documents published in April 2024 because these are, as explained, based on an assumption of no new offshore oil. If Block 58 starts production before the end of 2028, the ceiling would be adjusted to make room for this additional debt.

86. The second FFYP will need to be prepared nearer the end of this decade, likely just around the time of the start of offshore oil production. At that time, there will be better information on the prospects for offshore oil. New ceilings on primary spending and net debt can then be specified that, within the absorptive capacity of the economy, start to make room for gradual and prudent increases in development spending. The possibility of additional developing spending, nevertheless, will initially be constrained in part by the need to service the VRI debt, and because other royalties, which will be the main component of government mineral revenue from offshore oil in the first few years of production, need to be set aside in a special account outside the country until the restructured debt is fully repaid, which could take several years (more on this below). As discussed earlier, this is one of the clauses of the agreement the Government reached with its external creditors, which permitted a restructuring of Suriname's external debt. From the perspective of the appropriate setting of the fiscal rules and of the scope for increasing development spending in a sustainable way, this is one more reason to apply

¹⁶ More specifically, after the first \$100 million in royalties on offshore oil production has been sent to the government, 30 percent of the royalties on additional production would be earmarked for servicing VRI.

a gradual approach to raising government spending even after new offshore oil is confirmed.

87. The second FFYP should continue to require a reduction of government debt net of SSFS financial assets with the goal of building up buffers to prepare the public finances to deal with volatility in resource revenue and of saving part of the mineral revenues for future generations. As of now, in a scenario without any new offshore-oil, an appropriate ceiling on debt net of assets by 2033 consistent with the continuation of the policies and objectives in the EFF would be about [77] percent of NRGDP (55 percent of GDP), based on the extrapolation by one year of the projections contained in the debt sustainability analysis included in the EFF documents. But in a scenario with new offshore oil, as new offshore oil related revenues accrue to the government, some of which would be saved, the ceiling on debt net of financial assets in the SSFS would have to be lower than that value even when allowing for some of the oil-related revenues to be used for a gradual and judicious increase in development spending. In any case, these numbers are highly tentative and cannot be considered firm at this stage, since not enough information is available about that future. That is why the Government would conduct a thorough study of economic conditions and prospects in 2028 prior to proposing the new fiscal rule ceilings for the period 2029-2033 in the FFYP that would be submitted to Parliament in late 2028, along with the state budget for 2029, following best international practice.¹⁷

88. Lastly, also as part of the negotiations with creditors, in the event that new offshore oil goes into production, the remaining 70 percent of royalties on such oil (after the 30 percent earmarked for VRI servicing) would have to be deposited in an escrow account abroad (an "offshore payment account" from the perspective of Suriname, and a "springing security account" from the point of view of creditors). This money, constituting a government asset, would be temporarily held in guarantee of the servicing of restructured bonds. Once those bonds have been repaid, the money in escrow will be liberated, and shall be deposited in the SSFS. This means that there needs to be a corresponding downward adjustor for the ceiling on debt net of assets in the SSFS in the second FFYP (and possibly in the third one if the resources are not liberated by 2033) for the final value of this offshore payment account.

Relationship between fiscal rules and the sovereign wealth fund

89. The fiscal rule system proposed is designed to ensure consistent fiscal policy and related budgetary ceilings every year. These rules will impose discipline and limits on the

¹⁷ See in particular IMF (2018b), *How to calibrate fiscal rules: a primer.*

conduct of fiscal policy. Therefore, it is not necessary for the operational inflow-andoutflow rules of the SSFS, a wealth fund, to impose additional constraints on fiscal policy through complicated and rigid deposit and withdrawal conditions. In fact, it might be counter-productive to set complex inflow-and-outflow rules for the SSFS, which could end up in conflict with the fiscal rules themselves and overdetermining fiscal policy choices.

90. The proposed approach in this Background paper and the background paper on the reform of the SSFS is consistent with the well-known principle of assigning an instrument to each objective. The proposed reform assigns to the fiscal rules the job of ensuring discipline in the conduct of fiscal policy and assigns to the SSFS the role of custodian and administrator of the financial assets that are expected to be accumulated as a result of the growth of the country's mineral resource revenues. This assignment of roles is a departure from the existing framework implicit in the 2017 SSFS Act. That act assigns both functions to the SSFS by creating a set of rules that limit the ability of the government to withdraw money from the SSFS. The theory in that framework is that, by mandating certain deposits and limiting withdrawals, fiscal policy will end up being more prudent. That is, prudence is expected to be forced indirectly, by limiting withdrawals from the SSFS. However, this indirect approach is imprecise, and can be partially or fully circumvented by issuing new debt to increase spending. In the new framework proposed here, in contrast, fiscal rules directly limit policy choices on expenditure and debt so that the trajectory of fiscal policy remains prudent. This more direct approach can be more precise for that reason. Moreover, the proposed approach can be put in place already now, before the SSFS becomes active and any rules on deposits and withdrawals can become operational, which will not happen for many years.

91. The government will be constrained to conduct fiscal policy in compliance with the numerical rules in the FFYP. Therefore, no further constraints are needed. The deficit in the nonresource balance resulting from the application of the fiscal rules will be consistent with the principles of good fiscal policy incorporated in the design of such rules. Indeed, the experience of a number of other resource-producing countries shows that rigid and complicated inflow/outflow rules for the SSFS can hamper sound fiscal and asset/liability management. Therefore, under the Government-proposed integrated budget-SSFS system, the Government will be able to request financing from the SSFS for the nonresource deficit, as explained in the Background paper for the reform of the SSFS Act that is being circulated in parallel to this Background paper.

92. The government may also request financing from the SSFS for the repayment of debt falling due. Together with the nonresource overall balance, this is the nonresource gross financing need. This will be consistent with the fiscal rules, because they impose a ceiling on government debt net of financial assets in the SSFS, so that using the latter to reduce the former is neutral from the point of view of the net financial asset position. Covering these two types of financing need (the nonresource deficit and debt maturities

falling due) means that the resource revenues channeled through the SSFS will enable the government to operate smoothly within the fiscal discipline premised by the fiscal rule system, making room for development spending at a pace that allows maintaining macroeconomic stability, and simultaneously continuing gradually to reduce public indebtedness and create new liquid buffers.

93. The maximum total annual withdrawal from the SSFS to finance the budget will be proposed in the annual budget together with an explanation and analysis, and will need to be approved by the National Assembly as part of the budget. (This issue is also discussed in the Background paper on the proposed reforms to the SSFS Act.)

94. Where will the SSFS get its own funding? Under the Government's proposed reform of the SSFS, the fund will receive all resource revenues which the government is entitled to collect under the existing fiscal regime for extractive industries, taking into proper consideration the commitments undertaken by the government as part of the debt restructuring agreements.¹⁸

95. The flexible nature of the financing from the SSFS to the budget is designed, inter alia, to allow the Government to implement a highly desirable integrated sovereign asset and liability management. As recommended by the IMF, the SSFS should be considered within the context of the overall sovereign balance sheet of the government. In deciding the withdrawal from the SSFS to finance the budget in a particular year, given a projected nonresource deficit and gross financing needs, the MFP will take into account factors such as the size of the debt and its composition, interest rates, yields on assets, risks, and liquidity. For example, in some situations the MFP may prefer to repay expensive government debt rather than accumulating lower-yield assets in the SSFS, which would result in a larger withdrawal from the SSFS, other things being equal. Or there may be a preference for building up liquid assets in the SSFS for self-insurance purposes against revenue volatility, with the cost of this liquidity being measured by the differential between the interest costs of the debt that will not be repaid and the returns on the new SSFS assets. That would result, other things equal, in a lower withdrawal from the SSFS.

96. During an initial period, as the SSFS begins to receive resource revenues, it may be necessary for the government to exercise some restraint in determining how much to withdraw from the SSFS for financing in the budget year, complementing with new borrowing the financing needed to cover the gross financing needs. This could happen if

¹⁸ This means, as noted earlier, that the SSFS would not receive the part of resource revenues that must be dedicated to service the creditors' VRI. It also means that resources due to the government which, by virtue of those agreements, must temporarily flow into an escrow account maintained by the designated third party, will upon their release from the escrow account flow into the SSFS. All resource revenues not subject to the conditions agreed in the debt restructuring agreements will flow directly to the SSFS.

the nonresource deficit for an upcoming year is larger than the stock of resources in the SSFS at the end of the previous year. This kind of situation is expected to be short-lived.

97. As explained in the Background paper on the amendments to the SSFS Act, the SSFS would be activated at the time of the start of offshore oil production in Suriname. Therefore, it is not expected to have SSFS operations during most of the period covered by the first FFYP (2025-2028).

Supporting fiscal management functions

Public Financial Management: forecasting

98. The operation of the fiscal rules proposed in this Background paper, and more generally good fiscal and budgetary planning, requires the ability to produce unbiased fiscal and macroeconomic forecasts over annual and multiannual horizons. The production and publication, as part of the MTFF, of rolling medium-term forecasts (for the upcoming year and an additional 3-4 years¹⁹) is needed to determine the nominal limits on primary expenditure for the coming years, including in particular the budget for the next year. To counter any incentives to manipulate these forecasts, and as part of the adoption of the system of fiscal rules, the Government will commit to publishing the methodology (including underlying data and assumptions) employed to make macroeconomic and fiscal forecasts in the MTFF and all Financial Year Plans, including most especially the FFYP. The Government will also publish a table comparing its own macroeconomic forecasts with the most recent forecasts published by international organizations, including the IMF, the World Bank and the IADB, and with a simple 3-year trend of the macroeconomic variables. The Government will need to explain its reasons when its forecasts differ from these international comparators and statistical trends. Concerning the forecasting of resource prices, these will be based on the most recent WEO and World Bank commodity price forecasts.²⁰ In many countries, a Fiscal Council audits macroeconomic and fiscal forecasts; as part of the reform discussed in this Background paper, we are proposing at this stage to enable the public and the markets to judge the Government's forecasts by publishing the methodology and the comparisons mentioned in this paragraph.

99. Every year, as an initial step in the budgetary process, the expenditure limit for the upcoming year, which was set in percent of nonresource GDP in the FFYP, will be translated into a specific limit in national currency units for the upcoming fiscal year on

¹⁹ The PFM Act at present requires forecast for 3 years in addition to the upcoming budget year. Adopting a fiscal rule with a period of five years as proposed in this Background paper will require extending the projection horizon by one year.

²⁰ In fact, while the EFF is in effect, the relevant forecasts need to be with the same as the EFF forecasts.

the basis of the updated forecast for the nominal nonresource GDP for that year. The same updated rolling forecast for nominal nonresource GDP will help produce updated figures for the nominal expenditure limits expected for the years beyond the upcoming year.

100. The close monitoring of the stock of government debt will permit the MFP to produce forecasts of the government's interest bill and its upcoming debt repayments. Together with the updated primary expenditure limit, the updated projection for the interest bill will yield updated projections for total government expenditure consistent with the fiscal rules.

101. With the support of its development partners, the Government is making efforts to improve macroeconomic and fiscal forecasts. This includes forecasts for resource and nonresource revenues for the upcoming year and for the subsequent years covered in the rolling MTFF. The nonresource revenue forecasts should reflect updated macroeconomic forecasts, as macroeconomic aggregates such as consumption or GDP have predictive value for anticipating the growth in tax bases. The resource revenue forecasts should be based on the commodity price forecasts published by the IMF and the World Bank. The Government commits to ensure the adequate staffing of the teams in charge of the forecasting function in the MFP.

102. Forecasts are also a key input for the formulation of the MFP's request for financing from the SSFS. In the architecture of the reform described in this paper and in the Background paper on the reform of the SSFS law, the SSFS will be responsible for the custody of the part of the resource revenue that is not used to finance nonresource deficits or pay down the debt. The fund will finance the nonresource related operations of the Government, which are subject to the discipline of the fiscal rules. Thus, the updated nominal expenditure and nominal nonresource revenue projections will yield updated nonresource fiscal deficit projections. Adding to those the debt maturities falling due, the Government can estimate its nominal nonresource gross financing needs. As explained above, the latter constitute the basis upon which the MFP can, as part of its budgetary process, determine how much financing to request from the SSFS in the coming year, as well as any supplementary financing in the form of new debt that might be deemed appropriate and consistent with the numerical fiscal rules. In addition, the forecasts of resource revenues will help produce projections of the evolution stock of resources in the SSFS.

103. The assessment of economic risks that is part of the MTFF will help the Government evaluate the risks to the public finances, including the risk of deviations from the ceilings under the fiscal rules for reasons beyond the control of the Government. Such a discussion should be included in the FFYP and in the annual FYP and MTFF.

PFM: monitoring and reporting

104. Monitoring and reporting fiscal developments over the course of the year and fiscal outcomes after the end of the year is necessary for the successful application of the fiscal rules proposed in this Background paper. The need for adequate fiscal reporting and audit arises from two factors: the need for government to follow developments closely to comply with the fiscal rules, and the need to inform the National Assembly, the public, and markets about fiscal developments and compliance with the fiscal rules.

- Ongoing reporting during the year allows the MFP to monitor whether it is on track to comply with the annual budgetary limits approved as part of the implementation of the multiannual fiscal policy, especially the primary expenditure limits defined in the FFYP.
- The reporting of final outcomes after the end of the budget execution permits the government to determine whether any deviation relative to those limits took place. This helps the government manage its fiscal policies under the rules, and when a deviation occurs, it also helps put in place corrective measures—that is, measures to correct the underlying causes of the observed deviation from an annual expenditure limit, as well as remedial measures to make sure any adverse impact of this deviation on the trajectory of public debt is subsequently offset. This full-year report should be part of the following year's MTFF and included in the corresponding FYP, as is currently the practice. Reporting on compliance with the fiscal rules should also be discussed in the final budget execution reports the government is required to submit for their definite auditing to the Court of Accounts by the end of July of the year following the budget year in question.
- A comprehensive, clear, reliable and timely reporting of public finances and of performance against the fiscal rules is an essential requirement for effective oversight, including by the National Assembly, financial markets, and the public. Reporting helps raise the reputational costs of noncompliance, making the system of rules more effective.

105. The initial framework for monitoring and reporting fiscal performance against the rules will be based on the framework already in place for the monitoring of fiscal outcomes under the EFF supported by the IMF. This framework would continue to be used after the EFF ends, as currently expected, in early 2025.

106. The Government recognizes the need to extend the institutional coverage of fiscal reporting to have a more comprehensive view of fiscal policy and allow broadening the coverage of the fiscal rules beyond the budgetary central government over time. As a first step, the MFP will carry out the preparatory work (including fiscal reporting) necessary for the inclusion of nonmarket extrabudgetary units at the central level in the coverage of the expenditure rule.

107. The Government is of the view that transparency is a key underpinning of the fiscal rules framework. The dissemination to the public of the information from the reports on observance of the fiscal rule after each fiscal year has an important role in bolstering the credibility of the fiscal rules. The proposed legislation will mandate the provision of complete, accurate, detailed and timely reports to the National Assembly on the execution of fiscal policy and compliance with the fiscal rules, which can be done through the Financial Year Plan, featuring the MTFF numbers. These documents should also include clear and detailed explanations of any deviation from the limits established under the fiscal rules, as well as the steps to correct such deviations.

108. Compliance with the fiscal rules will be subject to the external audit of government financial statements and fiscal accounts by the Court of Accounts. This institution will be required to undertake analysis of the reliability of accounting information and provide formal opinions on the compliance with the relevant accounting and reporting instructions of annual reports required by the fiscal rules system. The Court of Accounts will assess the government's compliance with the fiscal rules on an annual basis, and issue an opinion on whether the rules were observed.

109. The Government will also publish a digest of the key pieces of information the citizenry needs to assess the government's compliance with the fiscal rules. This digest can be published at the same time as the Government submits its accounts to the Court of Accounts.

Avoiding circumvention of the fiscal rules

110. Governments can come under pressure to deviate from fiscal discipline or may be tempted to spend more than allowed by the fiscal rules. Experience around the world suggests that such pressures, coupled with the desire to maintain the appearance of fiscal discipline, can result in attempts to circumvent the fiscal rules while trying, on the surface, to adhere to them. That is, to observe the rules in the letter, not the spirit. Such conduct weakens the fiscal rules' institutional standing, and thwarts the ability of the rules to improve economic stability and fiscal sustainability.

111. Governments around the world have at times resorted to various means to circumvent fiscal limits.

• A common way to do this is to create extrabudgetary funds. Such funds, by their very nature, are meant to avoid the discipline associated with the budget and its limits.

- Another unwelcome, though common, practice is known as quasi-fiscal activity, consisting in tasking state owned enterprises or other public entities outside the perimeter subject to fiscal rules with the conduct of activities which would not be part of their normal responsibilities, but which would be carried out nonetheless to advance certain governmental objectives.
- Also, so-called creative accounting can be used to disguise or hide fiscal activities which are beyond the publicly avowed objectives of government, as would happen when certain items of financing are misrepresented as revenue to flatter fiscal balances, or when items that should properly be considered consumption or current spending are passed for investment outlays.

112. For fiscal rules to be effective it is necessary to close the door to the types of practices described in the preceding paragraph. Therefore, the Government intends to ban the creation of new extrabudgetary funds and the delegation of fiscal or government policy objectives to entities outside the budgetary central government.

113. Government guarantees may also be used to facilitate the circumvention of the restrictions provided by the fiscal rules. To deal with this eventuality, government guarantees will be considered as part of public debt for the purpose of the application of the fiscal rules. The same will apply to any fiscal commitments undertaken through the creation and operation of public private partnerships (PPPs). The Government will ensure proper accounting and auditing to make sure that government debt, expenditure, revenue, and deficits are accurately measured and reported.

Improving the public investment management system

114. Although not immediately related to the system of fiscal rules proposed in this Background paper, the Government thinks it is appropriate to say a word about public investment. The increased availability of fiscal resources when offshore oil is developed will open an opportunity to increase public investment. At the same time, the need to comply with the ceilings under the fiscal rules will mean that it will not be possible to undertake all public investment ideas that may seem potentially interesting or attractive. To make the best of this opportunity and avoid waste, while remaining within the budgetary envelope determined by the fiscal rules, it is essential to strengthen the public investment management system.

115. The Government is working with the support of its development partners on an effort to strengthen the public investment management system in the MFP. This effort will result in stronger processes for the selection of potential investment projects, assessing their merit and their expected socioeconomic and environmental impact before they are approved. The system will also ensure that selected projects are executed efficiently, and their impact evaluated *ex post*.

Conclusion

The Government considers it essential to strengthen fiscal institutions ahead of the development of offshore oil. This new source of natural resources brings an important promise of new opportunities for development in Suriname. But it also demands that the Government improve the budgetary processes and institutions to make the best of this opportunity and avoid the errors that many other countries, in similar circumstances, have made in the past.

To this end, the Government intends to propose a set of reforms including the amendment of the PFM Act to introduce numerical fiscal rules as described in this Background paper, the amendment of the SSFS Act as discussed in the Background paper on this subject that is also being put forward, and the strengthening of the MTFF with the cooperation of Suriname's development partners.

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Annex 1: Illustrative Example

The table below uses some made-up simple numbers to explain how the fiscal rule numbers would be calculated and updated over time to inform annual budgets during the five-year period in response to various surprises. The numbers are given in simple "units" and are just for illustration.

Panel A shows the relevant projections for the entire period (years 1 through 5) made in Year 0, which would be published in the FFYP for years 1-5 around October of Year 0. With net debt standing 56.4 percent of GDP, the goal is to bring it down to 40 percent of GDP by the end of year 5. Under the projections for the growth in nominal GDP, this can be achieved basically by keeping nominal debt constant. In turn, it is calculated that given expected revenues and interest costs, a primary spending level of 22 percent of GDP each year will result in zero overall balances on average and therefore on a constant level of nominal debt. For year 1, under the assumptions about GDP growth, the level of primary expenditure that should be embedded in the Government's budget for Year 1 is 235.7 units, which is shown in a box.

Panel B advances time by one year. Then we learn that Year 0 GDP was a little lower than originally estimated; we also learn that the government estimates to have complied exactly with the Year 1 ceiling on primary spending. However, we learn that inflation in Year 1 is now expected to be 6 percent instead of 4 percent as originally anticipated. As explained in the text, this means that an inflation adjustment must be made to both the nominal ceiling on net debt in Year 5 and to the series of subsequent nominal ceilings on primary expenditure. Thus, the ceiling on primary expenditure is now 257.2 units, shown in a box. One can immediately see that this is higher in nominal terms than the 252.4 units anticipated in the original FFYP, as it appears in Panel A. However, since the adjustment only has to do with an inflation surprise, the ratio of primary spending to GDP is still 22 percent, as originally expected.

Panel C advances time another year. We learn then that in Year 2 the government again complied with its target on spending, and inflation is estimated to have been as projected. However, growth in real GDP appears to have been weaker. As explained in the main text of the paper, in this case the ceilings for subsequent years will not be changed to avoid procyclicality in spending. thus, the nominal ceiling for primary s[ending in Year 3, shown in a box, will still be 275.6 units, as in Panel B, which will represent a slightly higher ratio to GDP in Year 3 than anticipated a year earlier. This is the implication of avoiding procyclicality and is a feature of the system.

Illustrative Example of the Operation of the Fiscal Rules

Year	0	1	2	3	4	5			
A-Figures in FFYP for years 1-5, published in Year 0: Estimate for Year 0, Projections for years 1-5 in italics									
Nominal GDP	1,000.0	1,071.2	1,147.5	1,229.2	1,316.7	1,410.4			
Percent change in GDP deflator		4.0	4.0	4.0	4.0	4.0			
Percent change in real GDP		3.0	3.0	3.0	3.0	3.0			
Government Debt net of financial assets in the	SSFS								
Nominal	564.0								
In percent of GDP	56.4								
Indicative ceiling on net debt									
In percent of GDP						40			
innominalternis						304.2			
Ceiling on Primary Spending									
In percent of GDP	F	22.0	22.0	22.0	22.0	22.0			
innominalternis	L	233.7	202.4	270.4	209.7	310.3			
B-Figures in FYP published in Year 1: Final figure Year 0, Estimates for Year 1, Projections for years 2-5 initalics									
Nominal GDP	995.0	1,086.3	1,169.3	1,252.5	1,341.7	1,437.2			
Percent change in GDP deflator		6	4.5	4	4	4			
Percent change in real GDP		3	3	3	3	3			
Government Debt net of financial assets in the	SSFS								
Nominal	564.0								
in percent of GDr	50.7								
Indicative ceiling on net debt									
In percent of GDP						40 574 9			
						014.0			
Ceilingon Primary Spending			00.0		00.0				
in percent of GDP		235.7	22.0 257.2	22.0 275.6	22.0 295.2	316.2			
CFigures in FYP published in Year 2: Final fig	gures Year (and 1, Estin	nates for Year	2, Projection	sfor years 3-5	initalics			
Nominal GDP	995.0	1,086.3	1,146.6	1,228.2	1,315.7	1,409.3			
Percent change in GDP denator		3	4.5 1	4	4	4			
Government Debt net of financial assets in the SSFS									
Nominal	564.0								
In percent of GDP	56.7								
Indicative ceiling on net debt									
In percent of GDP						40.8			
in nominal terms						5/4.9			
Ceiling on Primary Spending									
In percent of GDP		22.0	22.0	22.4	22.4	22.4			
în nominai terms		235.7	257.2	273.0	295.2	310.2			
D-Figures in FYP published in Year 3: Final figures Year 0 to 2, Estimates for Year 3, Projections for years 4-5 initalics									
Nominal GDP	995.0	1,086.3	1,146.6	1,228.2	1,315.7	1,409.3			
Percent change in GDP deflator		6	4.5	4	4	4			
r er cent change inn ear ODP		3	1	3	3	3			
Government Debt net of financial assets in the	SSFS								
Nominal In percent of GDP	564.0 56 7								
Indicative ceiling on net debt						40.0			
in percent of GDP in nominal terms						40.8 574.9			
Ceilingon Primary Spending		22.0	22.0	00 G	24.0	24.0			
in nominal terms		22.0 235.7	257.2	23.0 290.0	21.9 288.0	∠1.9 309.0			
						,			

Panel D advances time one more year. We learn that although real and nominal GDP came in as expected, the government exceeded the ceiling on primary spending for Year 3 by 14.4 units. The rules demand that corrective measures de adopted to offset this breach and to prevent it from occurring again. In this example all measures deployed to make the correction are on the expenditure side so we can show them in the table. The adjustment to prevent the repetition of the problem is immediate, but the offset of the excess incurred in Year 3 is spread in this example over years 4 and 5, to moderate the adjustment. Thus, we see that the ceiling on primary expenditure for Year 4 is now 288 units, shown in a box, which is equivalent to 21.9 percent of GDP.