Briefing

Impact of falling natural resource prices on the poorest countries

2016
February

Development Initiatives exists to end extreme poverty by 2030

Development Initiatives

www.devinit.org

The International Monetary Fund (IMF)'s latest World Economic Outlook (WEO) database and report, released in October 2015 and January 2016, have brought into sharp focus falling economic growth in low income countries (LICs). Growth in LICs globally is estimated to have decreased from 6% in 2014 to 4.6% in 2015 and in sub-Saharan Africa from 5% to 3.5%.[1] This lower growth is principally due to the continued decline in energy and mineral prices, impacting countries that rely on exports of these commodities. Falls in these commodity prices have also not been reflected in fuel prices in many LICs who are net oil importers, stifling potential growth and impacting on household incomes. For those countries that are net exporters of energy and mineral commodities, the sustained nature of this fall in prices is causing knock-on effects for a broad set of other macro-economic performance indicators like balance of payments[2] and is impacting on potential government revenue raising. This is a key concern, as resource revenue is often a crucial source of finance for reducing poverty.

This briefing draws on the latest IMF data to assess the economic growth projections in countries with the highest depth of extreme poverty globally, before examining how government revenue is being impacted in developing countries that are defined as 'resource rich' and the responses they have pursued.

Growth projections have declined sharply in countries with the highest poverty

While many factors contribute to poverty reduction, strong economic growth is an important component, particularly where it directly benefits people in poverty: stimulating job creation, incomes and government revenues that can then finance specific poverty-reducing interventions. So any significant falls in growth can impact on the poorest people through consequent falls in economic activity, in employment opportunities and in the government revenue allocated to human development spending.

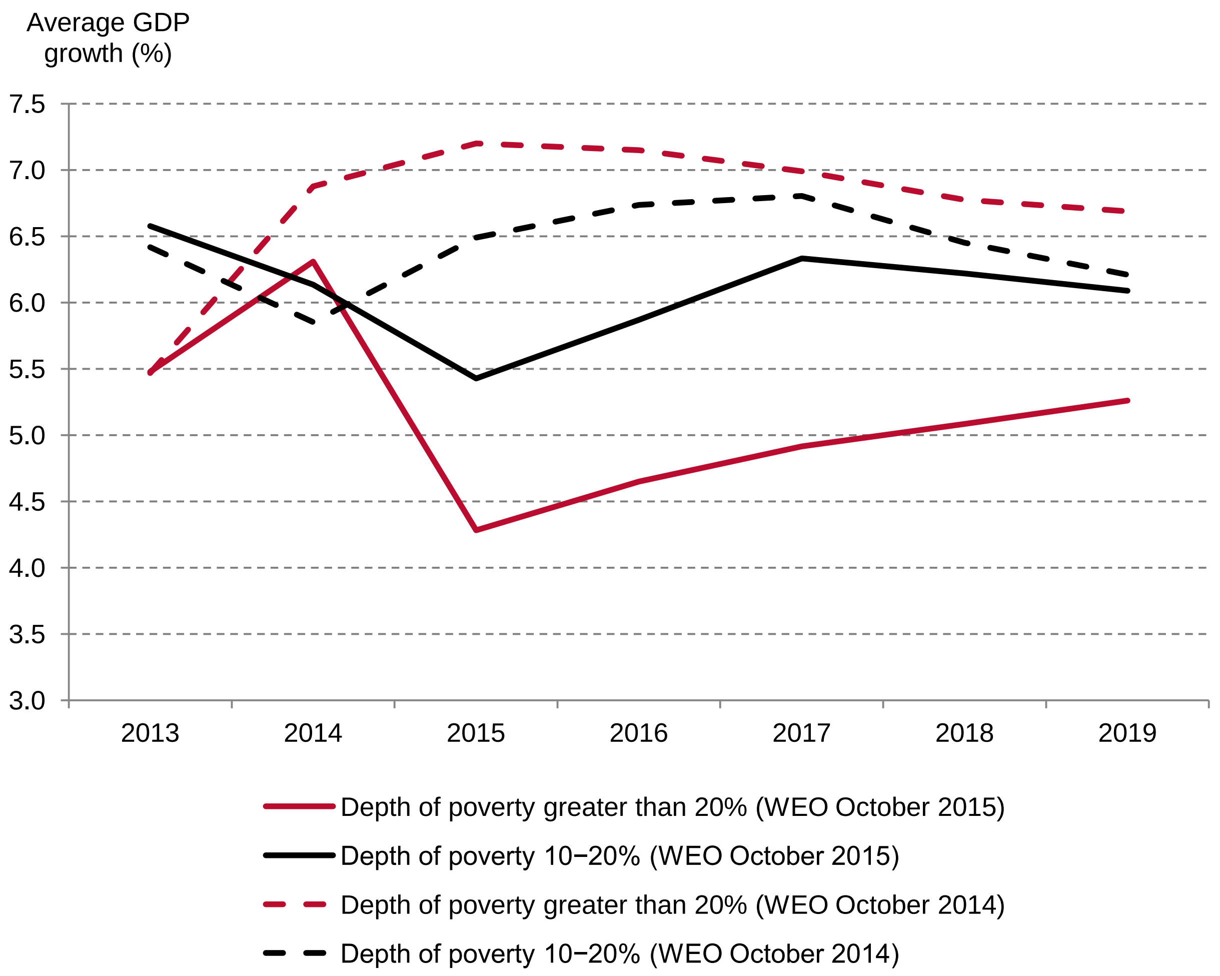
In 2015, it is estimated that countries with the highest depth of extreme poverty globally[3] have seen significant reductions in predicted economic growth compared with a year earlier (Figure 1). For example, in developing countries where depth of extreme poverty is greater than 20%, WEO data in October 2014 projected growth in 2015 and 2016 to be 7%. This has subsequently been revised down in the latest WEO to just over 4%, a considerable and sharp decline. The

[1] Based on January WEO update.
[2] The difference in total value between payments in and out of a country. Falling prices for resource exports has caused foreign exchange earnings to fall significantly, which in turn has impacted on private sector investment.
[3] Based on data from World Bank PovcalNet – average gap for the whole population of each country, with those above the extreme poverty line counted as having a zero gap.

picture is similar, although not as sharp, for countries with a depth of extreme poverty between 10 and 20%.

While longer-term projections to 2019 also show a closing gap in economic growth between the 2014 and 2015 WEO data in countries with a depth of extreme poverty between 10 and 20%, for countries where that depth is above 20%, a pronounced drop in growth is predicted compared with a year ago. This continued fall in projected growth has clear implications for economic poverty reduction methods, such as domestic resource mobilisation.

Figure 1: Economic growth in the poorest countries declined significantly in 2015

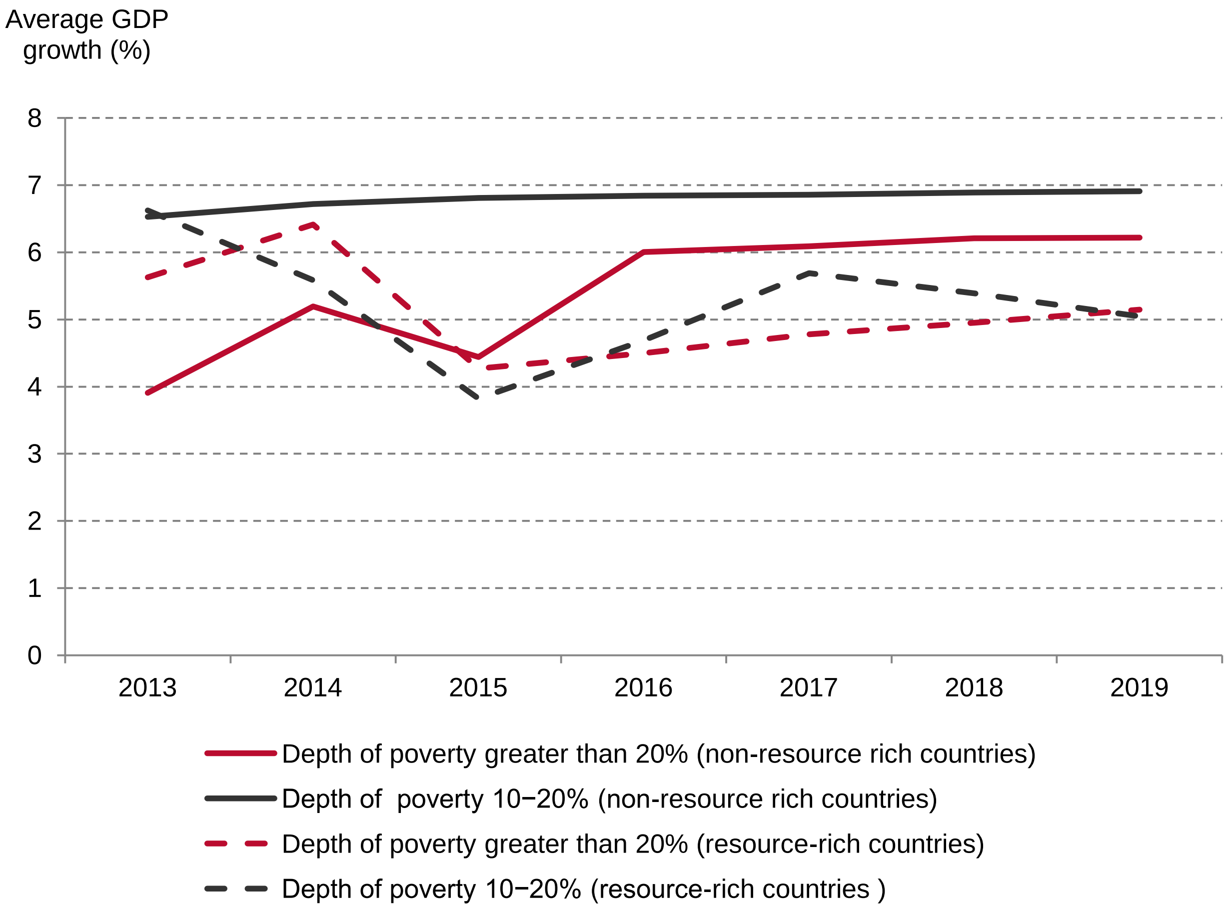


Source: Development Initiatives based on IMF World Economic Outlook database (October 2014 and 2015)
Notes: The average is a weighted, based on IMF WEO 2015 report methodology.

This sharp fall in growth is principally due to reduced global demand for and over-supply of oil, which has seen prices drop from US$110 a barrel in June 2014 to under US$30 now. This has particularly impacted economic growth in countries with the highest depth of extreme poverty that are 'resource rich'[4] (see Figure 2). While growth in 'non-resource rich' countries is projected to remain strong at fairly constant levels of above 6%,[5] levels of growth in resource-rich countries are projected to fall heavily in 2015, with levels of yearly growth to remain lower than 2014 for the foreseeable future.

[4] We define 'resource rich' as those countries where mining and quarrying makes up over 5% of total economic output. Note that forestry is not included.
[5] The decline in economic growth in 2013 and 2015 of the solid red line is a result of political instability in Central African Republic (2013) and Burundi (2015), which if excluded would result in a much greater linear growth projection.

Figure 2: Resource-rich countries' growth has dropped significantly more than others



Source: Development Initiatives based on IMF World Economic Outlook Database (October 2015).
Notes: The average is weighted, based on IMF WEO 2015 report methodology. GDP: gross domestic product.

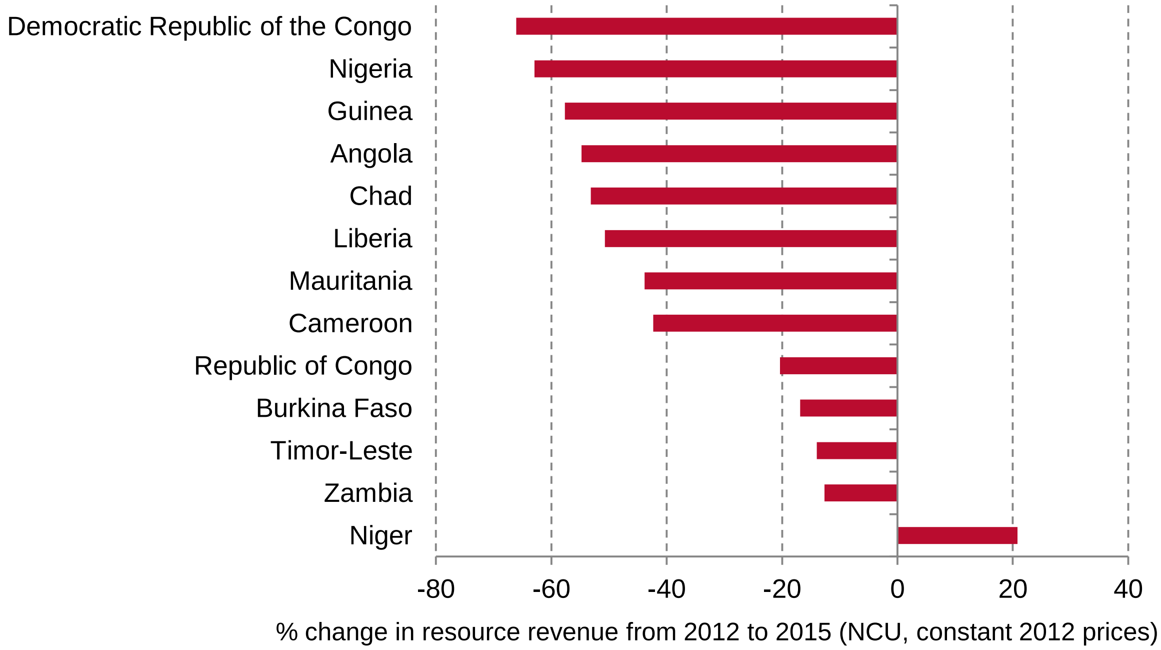
While a challenge to exporters of energy and minerals, the impact of predicted prolonged lower energy and mineral prices should in principle benefit countries that import these goods. However, although growth is still predicted to be strong in non-resource rich countries, there was no appreciable increase in growth in 2015 and none are predicted in the medium term. As the IMF suggests,[6] this highlights that global price falls are not being reflected at the local level in these countries. Potentially lower growth in the 'resource rich' countries could also be impacting on levels of regional trade and investment.

Reduced government resource revenue in many of the poorest countries depends mineral and energy exports

Decreased economic growth through falling prices for mineral and energy commodities has negatively affected many governments' resource revenue collection. From 2012 to 2015, almost all 'resource rich' countries[7] with the highest depth of poverty globally have seen government revenue collection through mineral and energy extraction fall in real terms (Figure 3). Nigeria, for example, has seen revenue decrease by 62% and Democratic Republic of Congo (DRC) by 66% between 2012 and 2015, with only Niger seeing an increase, as a result of increased production of oil.

[6] www.imf.org/external/pubs/ft/weo/2016/update/01/pdf/0116.pdf
[7] Country selection based on availability of resource revenue data through mineral and energy extraction sectors.

Figure 3: Resource revenue has decreased in the majority of resource-rich countries



Source: Development Initiatives based on latest IMF article IV reports.
Notes: Resource-rich countries are those for which mining and quarrying as % of GDP is over 5%. The above graph includes countries with available data from IMF reports.

This fall in resource revenue has undoubtedly caused reductions in potential revenue collection overall. However, as the following section shows, the impact on government revenue and expenditure overall has differed depending on the country's context.

The impact of, and governments' responses to, reduced revenue through lower mineral and energy commodity prices has been varied

While most 'resource rich' country governments have faced reduced revenue receipts through falling mineral and energy commodity prices, their responses have varied. Some countries like Nigeria, Angola and Chad have experienced falls in both expenditure and revenue, principally as a result of resource revenue making up a significant proportion of total revenue. However, the falls in expenditure are lower than revenue, as countries have used financing mechanisms, both domestic (e.g. debt securities) and international (concessional and non-concessional lending) to bridge the gap made by revenue shortfalls. While this prevents drastic spending cuts to key sectors in the short term, care needs to be taken to ensure debt levels are sustainable and future poverty focused expenditure is not constrained by increased principal debt servicing. These countries also need to focus on broadening their tax base, to move progressively away from a high dependency on resource revenue.

An alternative to the situation Nigeria currently faces can be seen in the case of Timor-Leste (see Table 1), where despite seeing falls in revenue, expenditure has significantly increased. This has been achieved through accessing finance from the stabilisation fund that manages its resources wealth. This enables the government to buffer against shocks such as the fall in resource revenue and also provides a sustainable future finance source.[8] Although this is a model example, increases in expenditure in countries like Timor –Leste should be tempered

[8] For more information see www.resourcegovernance.org/sites/default/files/NRF_Timor-Leste_Aug2013.pdf

against the need for these stabilisation funds to continue to provide sustainable finance to fund development and poverty reduction.

Table 1: Changes in total revenue and expenditure have been varied in resource-rich countries

	Falling revenue and expenditure			Falling revenue only		Increased revenue and expenditure							
	Angola	Chad	Nigeria	Liberia	Timor-Leste	Burkina Faso	Cameroon	Democratic Republic of the Congo	Republic of Congo	Guinea	Mauritania	Niger	Zambia
Non-grant revenue (NCU, % change 2012–2015)	-30.8	-22.6	-39.0	-0.7	-11.4	15.1	16.6	25.2	9.8	4.4	36.1	44.0	19.1
Total expenditure (NCU, % change 2012–2015)	-13.3	-9.9	-15.5	50.5	38.2	13.2	38.6	30.1	28.1	30.6	22.7	67.6	38.3
Expenditure per person global rank (out of 188)	120	160	154	181	128	172	156	186	100	178	138	177	145

Source: Development Initiatives based on latest IMF article IV reports.
Notes: Liberia has seen strong expenditure increases as a result of increasing donor funding through the government budget.

Lastly, some countries have seen rises in total revenue and expenditure despite significant falls in resource revenue. Typically these countries had a broad revenue base before the fall in resource commodity prices and have increased collection from non-resource sources, offsetting the decline in resource revenue. A key reason for this increase in non-resource revenue has been improvements to broadening their tax base, which is encouraging. For example in DRC, the government has increased non-resource direct and indirect tax in real terms from 2012 to 2015 through eliminating tax exemptions and reducing VAT rates.[6] Mauritania, despite a decrease in resource revenue of almost 50% (Figure 3), has managed to increase its non-grant revenue. This has been achieved through progressive tax reform, like increasing the income tax rates to the wealthiest part of the population and promoting more tax exemptions for poor people.[6] While broadening the revenue base has been crucial in maintaining expenditure, attention needs to be placed on how progressive new taxes and other revenue sources are, to ensure that the poorest people are not adversely impacted by them.

However, as with all these countries, falling resource revenue has almost certainly impacted on potential government resources to channel into developmental and poverty reducing expenditure. These resources are crucial for governments, as despite being defined as ‘resource rich’, those countries are ranked among the lowest public spenders in the world in per person terms. As spending is low in relative terms, any reduction in revenue means it is highly likely to impact on developmental spending, rather than cut recurrent costs, so as to maintain basic government functions.

Conclusion

The falling price of mineral and energy commodities has had widely varying impacts on the poorest countries in the world.

Growth forecasts for developing countries that rely on imports of these goods remain strong, although the IMF has raised concern that this growth is being constrained, as global price falls are not being reflected in the cost of these goods to end users.

Developing countries that rely on exporting these goods have seen economic growth forecasts drop dramatically, causing knock on effects to other economic indicators, like government revenue, undermining poverty reduction efforts further. The reaction by governments to falling resource revenue has been varied. Typically, those that rely heavily on this revenue stream have not managed to diversify away and increase other streams, seeing revenue fall without being able to use stabilisation funds or access suitable lending to maintain levels of expenditure. Others countries who had a more diverse revenue base have broadened their tax base and seen non-resource revenue increase, ensuring government expenditure has not been cut.

We draw the following conclusions from this analysis:

1. It is essential to diversify away from resource revenue, where there is significant opportunity to do so, but in a way that ensures progressive tax regimes and does not negatively impact on the poorest people. Where diversification is difficult, robust financial mechanisms to prevent shocks should be explored.
2. With this need to diversify revenue streams, governments should define a clear strategy for resource mobilisation. A well-defined strategy can assist in guiding any potential official development assistance (ODA) allocated for domestic resource mobilisation, especially given the commitment to double ODA in this area under the Addis Ababa Tax Initiative.[9] Tools, such as the Tax Administration Diagnostic Assessment Tool (TADAT)[10], could be explored to assist governments on this.
3. While lending provides a clear avenue to maintain levels of expenditure, every attempt should be made to ensure that overall debt is sustainable, so as not to constrain future spending, particularly on development and poverty reduction.
4. To make progress and ultimately meet the Sustainable Development Goals, it is vital that governments' developmental and poverty reducing expenditure be maintained, even in cases where expenditure levels overall need to be cut. Public finance management reforms can help by improving efficiency of resource use.

Contact

Richard Watts, Senior Analyst
T: +44 (0) 1179 272 | E: richard.watts@devinit.org
www.devinit.org

[9] For more information see www.taxcompact.net/documents/Addis-Tax-Initiative_Declaration.pdf
[10] For more information see www.tadat.org