MOBILIZING FINANCIAL RESOURCES:

Strategies to manage the commodity slump and attract investment

Chapter 1

Sub-Saharan Africa's oil exporters:

Decisive domestic adjustment is needed to address growing financing needs

ISSUE BRIEF FROM THE AUTHOR

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While prospects remain encouraging for many sub-Saharan African countries, how things have changed for the oil-exporting ones![1] Prior to 2014, oil exporters boasted an average current account surplus and even managed to generate a small government budget surplus (Figure 1.1). But then in 2014 oil prices fell so abruptly that by early 2016 they had breached their 10-year low. As revenues from oil exports shrunk, government revenues that largely depend on them fell, and so government financing requirements increased. Sub-Saharan African oil exporters are now faced with the "twin deficits" of their current account and government budget.

The challenge is that external financing requirements are increasing exactly at the same time as financial conditions are tightening. The United States' interest rates are increasing, which not only raises refinancing costs and the cost of new borrowing, but also dampens the search for yield and reduces the appetite for risk that had pushed investors to venture in frontier markets, including in Africa. Capital flows to oil-exporting countries may decline further or, even worse, reverse. Tighter financial conditions leave credible and decisive domestic adjustment as the main policy option to address growing financing needs. Unfortunately, oil exporters have so far been rather tentative in their adjustment efforts. In the face of depleted buffers and tighter financial conditions, they have been slow and at times even reluctant to implement much-needed macroeconomic adjustments.

[1] We use the IMF definition of oil-exporting countries: "countries where net oil exports make up 30 percent or more of total exports. Except for Angola, Nigeria, and South Sudan, they belong to the Central African Economic and Monetary Community (CEMAC)." See IMF (2016).

2017, then, is the time to use the oil shocks to not only implement the right macroeconomic policy mix but also to put oil-dependent economies on a better footing so they can make significant progress towards the sustainable development goals (SDGs). There is really no other choice as oil prices are expected to remain low for long (even though they have been rising of late). Short-term adjustment will only be a "pain medicine" and sectoral policies, including in agriculture, will be needed to diversify oil-rich economies and strengthen their structural transformation. Financing will only be one part of the equation and raising more revenues from the non-oil economy is an option that should be exercised. But now that oil rents have shrunk, it is the time to accelerate the pace of reforms that do not require much funding such as improving the efficiency of spending. Policymakers will need the right combination of political will, effective communication, and private sector and other stakeholders' involvement. The social contract in place during the boom years should be revisited.

Oil-exporters are facing larger financing needs

Unfortunately, and although oil prices have somewhat recovered, prospects do not look good and external financing will be difficult to obtain next year.

The boom and bust cycle of oil prices is leading to macroeconomic imbalances that will need to be financed. Fluctuations in the price of oil give a sense of how brutal the shock has been for oil exporters. The price of the commodity fell from $112 per barrel in mid-2014 to less than $39 in early January 2016. Falling oil prices have led to lower export revenues, deteriorated current account balances, and put pressure on currencies. Figure 1.1 shows how the current account deficit for oil exporters moved from positive to negative territory from 2013 to 2014. Such countries managed to generate a current account surplus of 3.8 percent of GDP in 2013, which fell to a deficit of 0.6 percent in 2014 and worsened to 4.7 percent of GDP in 2015. Figure 1.1 also shows how fiscal balances have worsened over time.

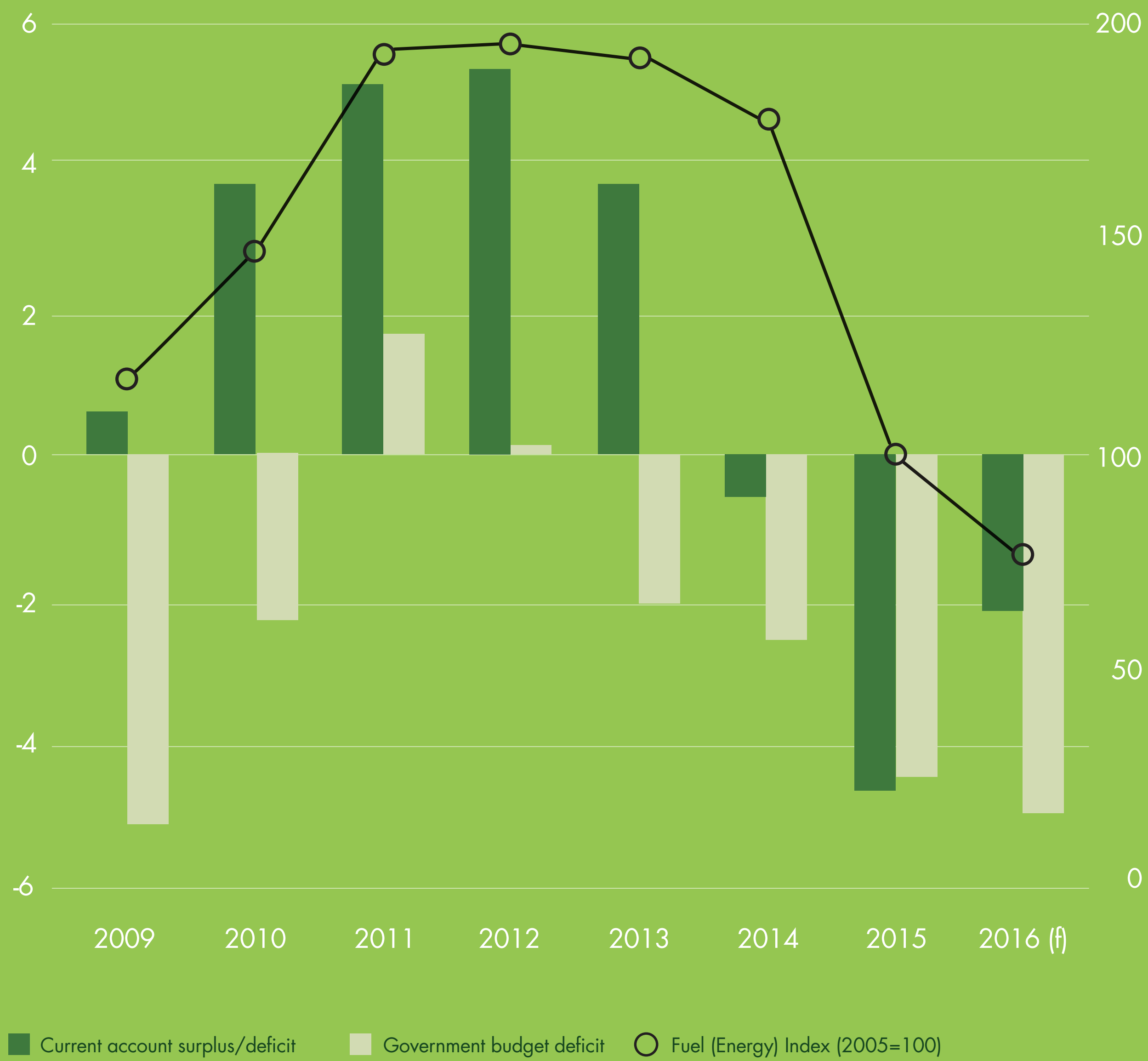
The large oil shock led to increased financing, and now a crucial question is to what extent external financing will be available in 2017. Unfortunately, and although oil prices have somewhat recovered, prospects do not look good and external financing will be difficult to obtain next year.

FIGURE 1.1.

SUB-SAHARAN AFRICA'S OIL-EXPORTING COUNTRIES:

TWIN DEFICIT FIGURES (IN PERCENT OF GDP)

Unsurprisingly, sub-Saharan oil-exporting countries face a twin deficit due to still-low commodity prices. In fact, current account deficits, which had moved from positive to negative between 2013 and 2014 have continued to remain negative over the past two years. At the same time, the government budget deficit has been expanding since 2013. In 2017 policymakers will continue to face gloomy prospects.



Sources: IMF Regional Economic Outlook (October 2016), IMF Primary Commodity Price System. Available at: https://www.imf.org/external/pubs/ft/reo/2016/afr/eng/sreo1016.htm.

FIGURE 1.2. REAL GDP GROWTH AND FORECASTS FOR SUB-SAHARAN AFRICA AND OIL-EXPORTING AFRICAN COUNTRIES

Forecasts for sub-Saharan Africa indicate that the region will experience even lower real GDP growth in 2016 than it did in the previous year—with oil-exporting countries experiencing larger declines than the regional average. In 2017, however, forecasted improvements in growth are in part predicated on policymakers' execution of sufficient policy adjustment and developmental spending on, for example, public infrastructure projects.

Source: IMF Regional Economic Outlook, October 2016.

TABLE 1.1. TOP AFRICAN ECONOMIC GROWTH PERFORMERS OF 2016-2017

While commodity exporters continue to experience economic strains in the short term, non-resource-intensive countries such as Côte d'Ivoire, Ethiopia, Senegal, and Tanzania are expected to remain within the top five African countries with the highest growth rates in 2016 and 2017, based on current estimates. Meanwhile, Ghana's growth rate is projected to rise substantially in 2017 following the opening of a new oil field, which may increase the country's output by nearly 50 percent.

Top performers based on 2016 growth estimates	
Country	**GDP growth (%) for 2016**
Côte d'Ivoire	8.0
Tanzania	7.2
Senegal	6.6
Ethiopia*	6.5
Rwanda	6.0
Kenya	6.0
Mali	5.3
Togo	5.3
Niger	5.2
Burkina Faso	5.2

Note: The highlighted countries will exit the top 10 in 2017.
*Fiscal year data

Source: IMF Regional Economic Outlook, October 2016.

Top performers based on 2017 growth estimates	
Country	**GDP growth (%) for 2017**
Côte d'Ivoire	8.0
Ethiopia*	7.5
Ghana	7.4
Tanzania	7.2
Senegal	6.8
Kenya	6.1
Rwanda	6.0
Burkina Faso	5.9
Uganda	5.5
Mozambique	5.5

Note: The highlighted countries will enter the top 10 in 2017.
*Fiscal year data

Source: IMF Regional Economic Outlook, October 2016.

Potential potholes to investment to watch for in 2017

Few could have predicted the confluence of factors that have shifted African markets in recent years. We've seen countries making earnest efforts to improve investment climates that have helped drive economic growth. We've seen large reductions in absolute poverty and growth in an African middle class with disposable income. We've seen the scale up of new technologies and the leapfrogging of legacy systems in areas such as banking, telecommunications, and utilities. At the same time, we've seen the devastation that a crash in commodity prices can bring to national budgets and some businesses. And, of course, little progress has been made on intractable corruption in many countries.

On balance, I remain more optimistic about the investment opportunities in Africa than I have been in the 30 years that I have been working with the continent, but I see three interrelated challenges that I believe will increasingly become gating issues that drive or inhibit investment flows over the next 12 months, depending on how they are addressed. These are: trust and trustworthiness, political will, and uncertainty.

Many social challenges that were once exclusively the domain of government budgets and aid groups can today be tackled with help from business.

First, I am concerned about persistent deep-seated public skepticism of the private sector that lies just below the surface of the welcome mat. It manifests itself in myriad overt and subtle forms in African politics and policy. Yet with aid budgets around the world flat and FDI growing, historically aid-reliant countries must adapt in order to secure the capital needed to feed, educate, and power a healthy and growing citizenry. Serious investors must be sincerely embraced and considered valued clients and partners that create jobs and generate economic growth, rather than piggy banks useful for tax revenues only.

To be sure, some of this skepticism of business is warranted. The legacy of some businesses that may have prioritized short-term profits over the health, well-being, and long-term relations with local communities has left scars. But we must not lose sight of the fact that many social challenges that were once exclusively the domain of government budgets and aid groups can today be tackled with help from business. This is because innovative models have been developed that enable these services to be delivered in a financially viable, self-sustaining manner. From electricity generation to privately operated public transportation, to private medical

Elizabeth Littlefield

President and CEO, Overseas Private Investment Corporation

clinics for low-income communities and for-profit schools that can cost as little as $6 per month, many critical development needs can be met with long-term private business models.

Second, distrust of the private sector can make ministers and civil servants reluctant to make difficult choices and decisions. When governments make bold decisions to eliminate energy subsidies or establish a cost-reflective tariff to attract investment in critical power upgrades, it's tempting to blame any accompanying energy cost increase on a predatory private sector. But that acts like a bucket of cold water on future investment. Trust and trustworthiness between investors and governments are needed to unlock critical capital flows for development.

My final concern is around uncertainty. It is investors' worst enemy. From energy tariffs to taxation to tendering processes to land and regulatory policies, predictability is what investors crave. Yet, we are seeing many instances of governments re-negotiating the agreements struck with early pioneering investors when their countries become more popular and less risky as an investment destination. Worse, we're seeing a retreat in short-term FDI in some markets because of the chilling effect of punitive policy changes. Nothing stymies prospective investors more than seeing existing investors having to deal with retroactive taxes, renegotiated concessions, or other painful and unforeseen policy changes. The experience of investors already in a country is the best advertisement for future investors—and it can be either a positive one or a very negative one.

The experience of investors already in a country is the best advertisement for future investors.

In many cases, a suboptimal but stable policy is preferable to a more attractive policy that might change. By sticking with a proven system with which investors and governments have practice, investors have a reliable foundation for business plans, project development timeframes shrink, and investment will flow.

Africa needs foreign investment to create jobs and opportunities, boost economic growth, drive innovation and build stable markets. It is my fervent hope, as president of the U.S. government's development finance institution, that governments and investors will grow to understand each other's needs and perspectives and see each other as partners in Africa's growth. When both can trust and be trusted to carry out their roles with fairness, pragmatism, and a sense of urgency, we will see progress in meeting the enormous needs and capitalizing on the historic opportunities that Africa richly merits.

International reserves have been depleted and additional foreign financing is less available

One buffer against falling oil prices is the level of international reserves, but such a buffer is limited. Oil-exporting countries in the region have been depleting their international reserves and, as noted by World Bank (2016), the cumulative decline in international reserves in oil-exporting countries in the region was more than 30 percent between end-June 2014 and March 2016. IMF (2016) also remarks that these countries have financed about two-thirds of their current account deficit by drawing on international reserves to the tune of 1.5 percent of GDP each year since 2014.

Foreign borrowing can also help finance the widening current account of oil exporters. But, as noted above, accessing the international debt market is becoming increasingly difficult and costly. In 2016, only South Africa and Ghana tapped international bond markets, the latter raising $750 million at yield of 9.25 percent after having delayed the issuance because of the higher price demanded by investors.[2] It is useful to note that unlike oil-exporting countries like Nigeria and Angola, Ghana was already under an IMF program and had already started its domestic macroeconomic adjustment.

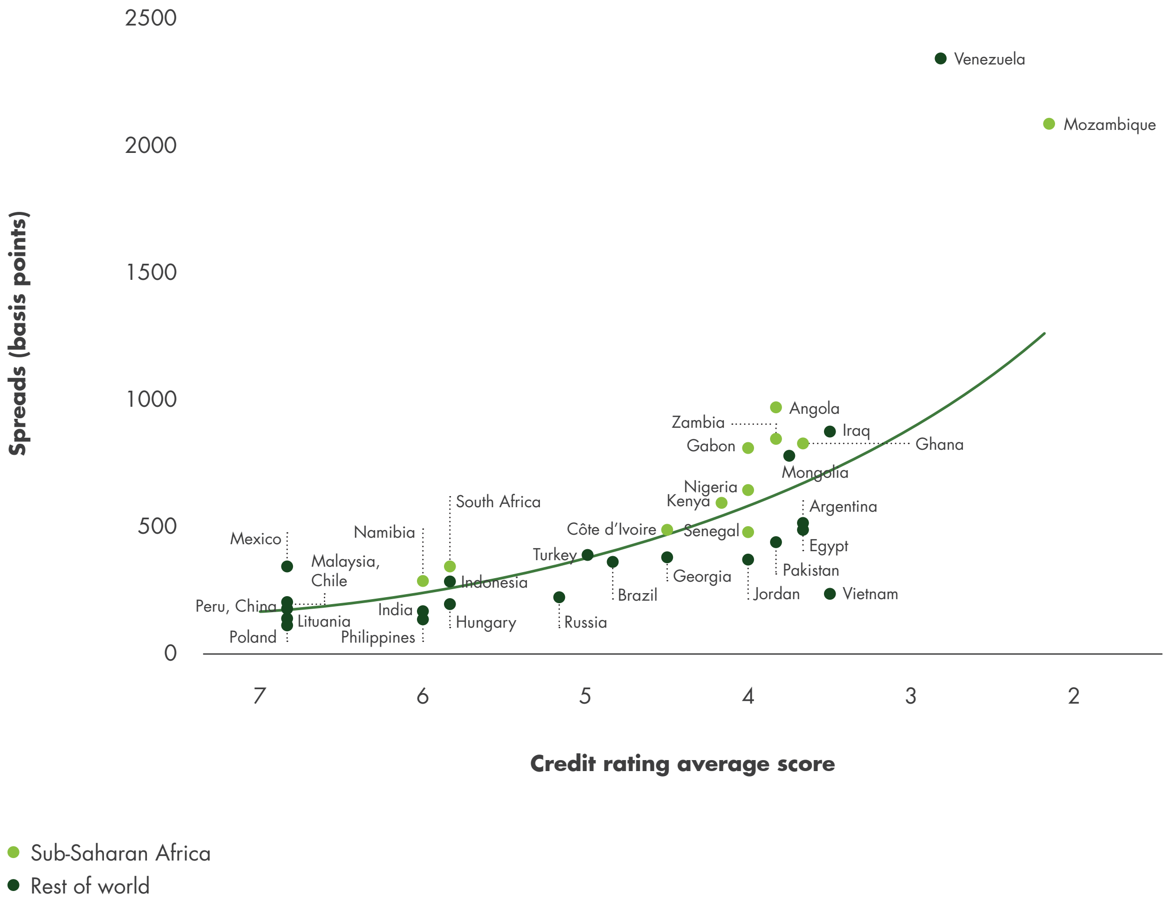
In the first half of 2016 alone, a number of oil-exporting countries, such as Angola, Gabon, and the Republic of the Congo, saw credit rating downgrades.

As noted by World Bank (2016), the pace of credit rating downgrades has accelerated over the past year. In the first half of 2016 alone, a number of oil-exporting countries, such as Angola, Gabon, and the Republic of the Congo, saw credit rating downgrades. Higher interest rates and lower ratings are complicating these countries' efforts to access international markets. Figure 1.3, which shows sovereign bond spreads and ratings as of November 15, 2016 (before Mozambique's downgrade to "restrictive default" from CC by Fitch Ratings) indicates that oil- (and commodity-) exporting countries pay a relatively higher cost to issue debt. Nigeria's planned international bond issuance, its first since 2013, will provide a litmus test for other African oil-exporting countries seeking to finance themselves externally.

[2] Bloomberg, September 8, 2016. Available at: https://www.bloomberg.com/news/articles/2016-09-08/ghana-selling-benchmark-size eurobond-in-fourth-issue-since-2013.

FIGURE 1.3. SOVEREIGN SPREADS V. CREDIT RATING SCORES

African commodity-exporting countries tend to pay a higher cost to issue debt. The graph below shows the negative relationship between credit rating scores and the sovereign bond spreads. African countries, compared to other developing and emerging nations, pay a higher spread for the same level of default risk, as measured by credit ratings.



Note: Spreads are as of November 15, 2016. Credit rating average scores refer to the average ratings of Fitch, Moody's, and S&P ratings. Numerical values correspond to the following credit rating categories: 7=A, 6=BBB/Baa, 5= BB/Ba, 4=B, 3=CCC/Caa, and 2=CC/Ca.

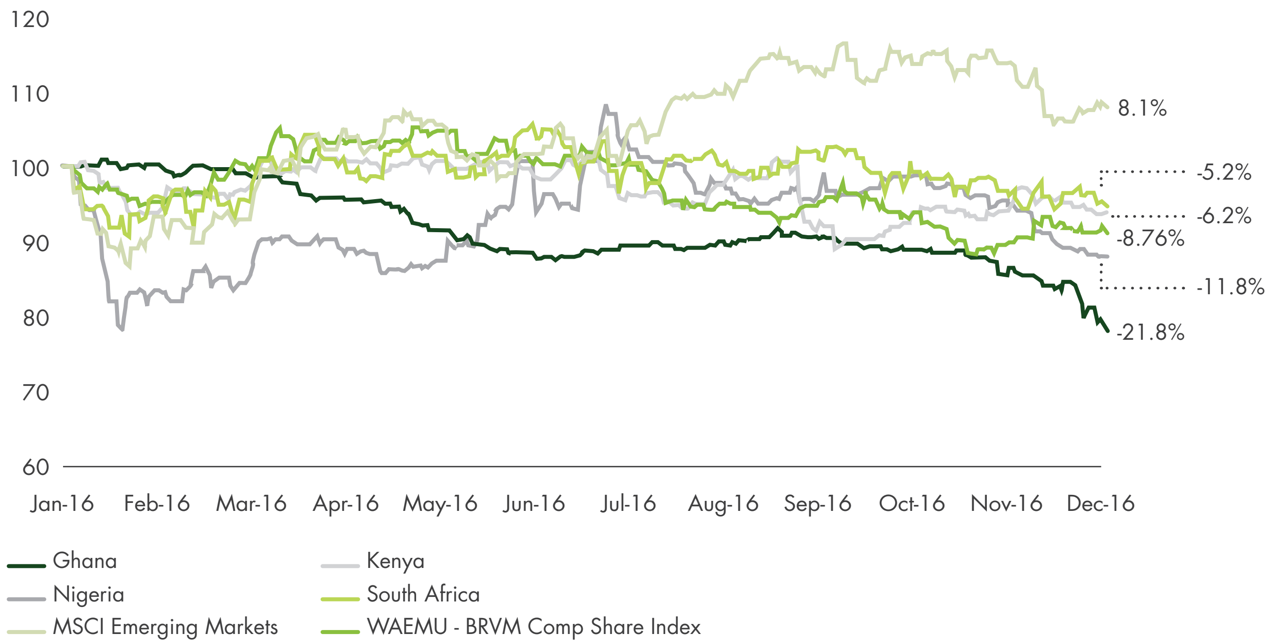
Source: Bloomberg L.P., J.P. Morgan EMBI Global.

Capital inflows (foreign direct investment (FDI) and portfolio inflows) are typically sought to finance current account deficits (with a preference for the former as it is more stable), but there are indications that investors are not as eager to invest in many oil-exporting countries as in other African countries. Indeed, World Bank (2016) notes that capital inflows in the region have slowed. In the case of Nigeria, capital inflows fell by 55 percent in the first quarter of 2016 while outflows more than doubled.

Against this background of tight foreign financing, what policy options are left for African oil exporters?

FIGURE 1.4. RETURNS FOR SELECT EQUITY MARKET INDICES (JANUARY 1 TO DECEMBER 1, 2016)

African equity indices fell below the emerging markets benchmark index (MSCI EM) registering negative returns in 2016. Ghana's decline not only reflects difficult macroeconomic conditions and power outages, but also investors' preference for the fixed-income market.

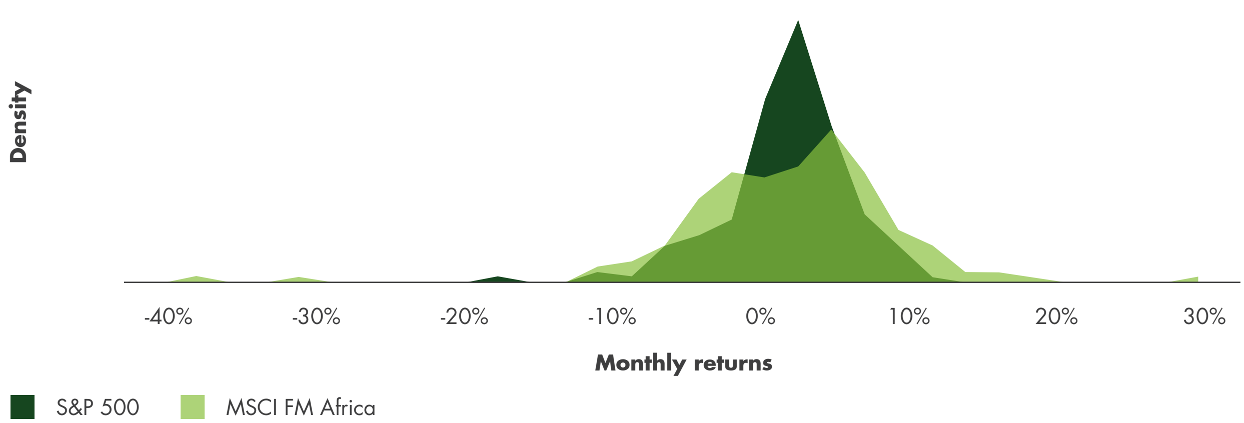


Note: Index (January 1, 2016 = 100). Equity indices are denoted in local currency terms, except for the MSCI Emerging Markets Index which is denoted in U.S. dollars. Percentages listed are total returns calculated using only price change for the period.

Source: Bloomberg L.P.

FIGURE 1.5. PROBABILITY DENSITY FUNCTION OF MONTHLY RETURNS: S&P 500 AND MSCI FM AFRICA

The graph below represents a probability density function comparing the monthly returns of the S&P 500 index with that of the MSCI FM Africa between May 2002 and April 2016. In that period, the lowest possible return for the MSCI FM Africa and the S&P 500 were -39 percent and -19 percent, respectively; while the highest monthly returns were 30 percent and 10 percent respectively. The MSCI FM Africa index is reportedly riskier than the S&P 500, given the larger distribution in the graph.



Source: Bloomberg L.P., MSCI.

The year of Africa

Makhtar Diop
Vice President for Africa, World Bank

As we begin a new year, calls for forecasts on what's at stake for Africa in 2017 keep pouring in. Predicting the near future for a continent as diverse as Africa is a perilous endeavor; one I usually stay away from. This year is no exception. With economic growth in sub-Saharan Africa falling in 2016 to 1.5 percent—its lowest level in over two decades—pundits have been quick to point out that Africa is no longer rising.

Times remain tough for sub-Saharan Africa with risks to the economic outlook remaining tilted towards the downside. But in a world full of uncertainty, African countries are faced with a unique opportunity to implement policies that matter.

For the region's largest economies and other commodity exporters came the realization that we can no longer depend on commodities. In fact, we never should. The reason is simple: Ample financing in times of high commodity prices have often delayed structural reforms. While commodity exporters have begun to address fiscal vulnerabilities and rebuild policy buffers, their efforts will take time.

For the economic juggernauts of sub-Saharan Africa, economic diversification is no longer an option, improving the non-resource tax systems is a must, and enhancing agricultural productivity is not an outdated concept.[1] Consider this: Higher productivity would not only raise the incomes of farmers, it would also free up resources, such as labor, for other economic sectors.

The big lesson from the downturn is that good policies make a difference. Which brings me to an important point: Sub-Saharan Africa is growing at diverging speeds. While some countries are struggling, over a quarter of the countries in the region continue to experience solid growth. But here comes the catch: As noted in this year's Africa's Pulse, our latest analysis of issues shaping Africa's economic future, countries that are showing signs of resilience tend to have stronger fiscal and monetary policies, better business regulatory environments, more effective public institutions, more diversified export structures, and not much oil.

For African countries, the time has never been better to move beyond business as usual and invest in the future. But I remain optimistic about prospects for a new model of high and inclusive growth. With the right policies, its ability to leapfrog development hurdles, and the ingenuity of its people, Africa can defy the odds.

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World Bank. 2016. Africa's Pulse, No. 14, October 2016. Washington, D.C.: World Bank Group. Available at: https://openknowledge.worldbank.org/handle/10986/25097.

[1]See: Diop, M. 2016. Foresight Africa 2016: Banking on agriculture for Africa's future, Africa in Focus, Brookings Institution, January 22. Available at: https://www.brookings.edu/blog/africa-in-focus/2016/01/22/foresight-africa-2016-banking-on-agriculture-for-africas-future/.

Unlocking infrastructure investment across Africa

Enoh T. Ebong
Deputy Director, U.S. Trade and Development Agency

Modern, efficient infrastructure is the key to economic growth. Unfortunately, energy, transportation, and internet costs in Africa are among the highest in the world. This lack of infrastructure makes it difficult for African markets to grow sustainably. It also inhibits companies, including those in the United States, from accessing these markets.

Many African governments are working hard to address this issue by building airports, rail lines, and power plants. But they cannot do it alone. The World Bank estimates that $95 billion is needed annually to build the infrastructure Africa needs to sustain its growth—a price too steep for the public sector to bear on its own.

The only way to meet this demand is to mobilize private capital in support of infrastructure development, which is exactly what the U.S. Trade and Development Agency (USTDA) does.[1] As the U.S. government's project preparation agency, we help African stakeholders alleviate a key constraint to infrastructure development: lack of bankable projects. There has been a sharp expansion of investors and investment funds interested in Africa in the last few years, but that investment has been stalled by a lack of qualified projects available for investment.

To address this issue, USTDA provides African project sponsors access to U.S. industry experts who conduct the comprehensive analysis required for their infrastructure projects to attract financing and reach commercial operation. This early-stage financial support creates opportunities that were not previously available: It opens the door for private sector capital to enter with less risk and opens up markets to U.S. firms. It also helps African developers build the infrastructure they need to grow their economies.

This mutually beneficial model works. At this year's U.S.-Africa Business Forum, our Kenyan partners described how assistance during a project's initial stages—which are also its riskiest—helps them attract financing. One energy developer said that while he went into the USTDA process thinking he had done his homework, undergoing our due diligence and working with U.S. industry experts has improved his project and prepared him to face financiers.

Demand for this kind of support has never been higher. To meet it, we at USTDA are leading the communications strategy for the Project Preparation Facilities Network, an association of 19 facilities preparing African projects for financing. By coordinating closely with our sister organizations, we can increase the number of bankable projects, unlocking private capital and building the infrastructure Africa needs in 2017 and beyond.

As both a daughter of Nigeria and a proud American citizen, I am excited about the promise this holds for African project sponsors and their U.S. partners.

[1] For more information on the United States Trade and Development Agency (USTDA), visit www.ustda.gov.

Credible and decisive domestic adjustment in 2017 is the main policy option left for oil-exporters

But unlike more diversified economies, oil-dependent economies are like oil tankers, and they are difficult to turn around quickly.

The typical medicine against a negative oil shock for oil exporters is a combination of fiscal contraction, currency depreciation, and monetary tightening (to limit inflationary pressures). In addition, state-owned enterprises (SOEs) and the financial sector are closely watched to avoid any bad surprises such as the materialization of quasi-fiscal liabilities and higher nonperforming loans from exposures to oil and gas and currency mismatches. To make the medicine easier to ingest, existing policy buffers can be used to smooth the adjustment. When policy buffers are too low, multilateral institutions such as the IMF, the African Development Bank, and the World Bank as well as bilateral donors, including China, are asked to pitch in (when the political economy environment allows it).

But unlike more diversified economies, oil-dependent economies are like oil tankers, and they are difficult to turn around quickly. Still, implementing the right set of policies quickly and in a credible way is crucial. Unfortunately, African oil exporters have typically not been able to manage this difficult situation as credibly and decisively as they need to.

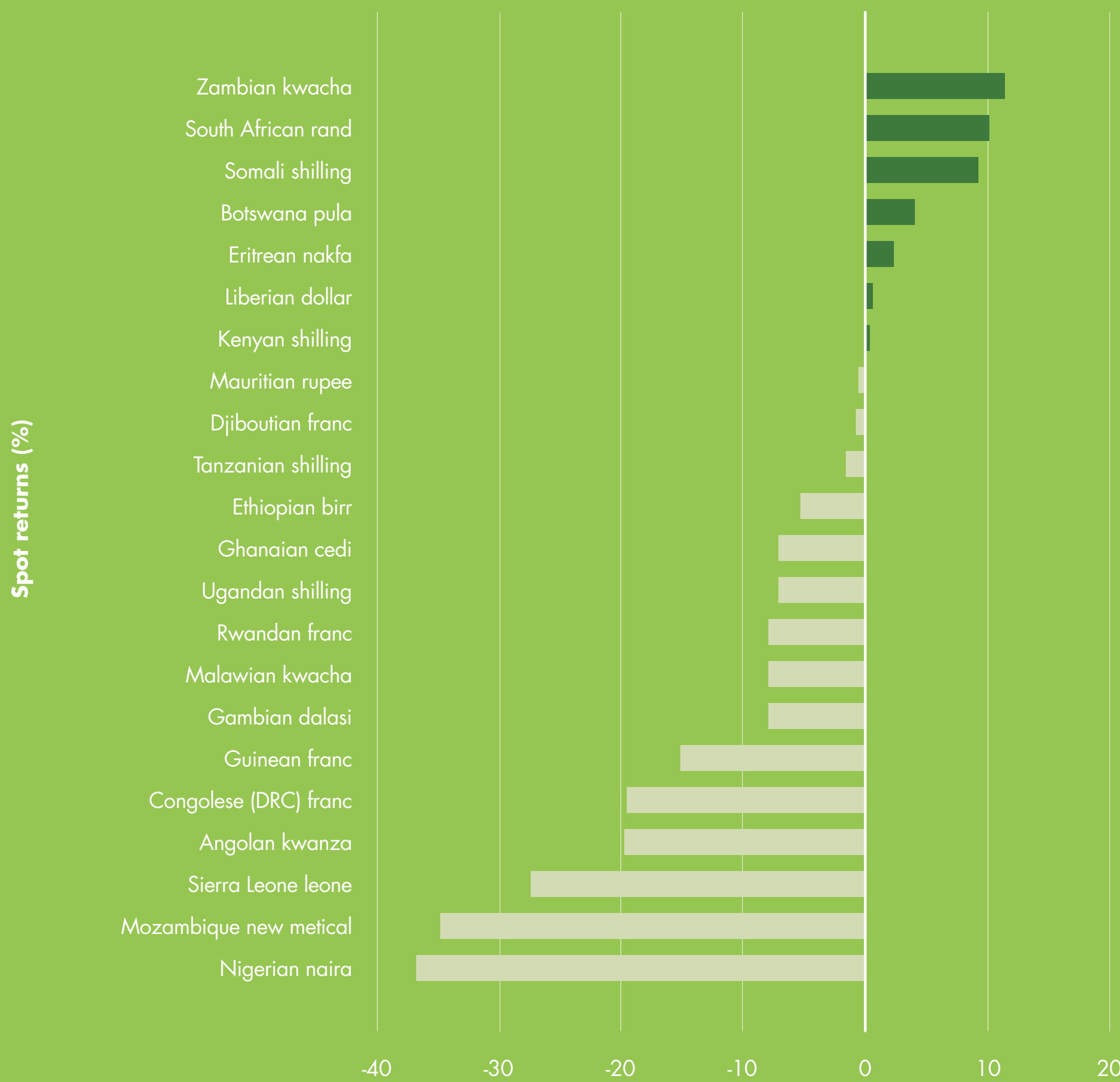
Slow exchange rate adjustment is evident not only in the dwindling international reserves of African oil-exporting countries but also in the scarcity of foreign exchange (getting U.S. dollars has becoming increasingly difficult in Nigeria, for instance), and in the large gap between parallel markets and official exchange rates such as in Angola and Nigeria. Budget outturns show that many countries were not able to rein in current expenditures or to execute capital expenditures (as in Nigeria, which sought to use it as countercyclical policy). In many countries, government debt has risen and a larger share of falling revenues are now allocated to service debt. IMF (2016) notes, for instance, that public debt has increased sharply among oil exporters by 20 percentage points of GDP since 2013 (although from a low level in Nigeria). Government arrears have also increased, and some governments have even resorted to central bank financing. Reasons for not achieving the right and timely policy mix have been numerous and include treating the oil shock as a temporary shock rather than a permanent one, long delays in coordination between ministries and in execution, and difficulty in managing the political economy of reform.

A silver lining, however, is that the current shock and its negative consequences on the economies and lives of the citizens of African oil-exporting countries can be an opportunity to "fix the machine." Indeed, the sharp fall in oil prices has highlighted the fragility of the current growth model. Structural transformation is not deeply rooted, and there has been little progress in diversifying economies

FIGURE 1.6.

IN 2016, MANY AFRICAN CURRENCIES DECLINED AGAINST THE DOLLAR

From January 1 to December 1, 2016, most African currencies declined against the U.S. dollar with the Nigerian naria and Mozambican new metical falling by more than 30 percent. The Zambian kwacha, on the other hand, strengthened the most against the dollar (as copper prices rose) in 2016 following its slump last year due to persistent power crises, a large budget deficit, and low copper prices.



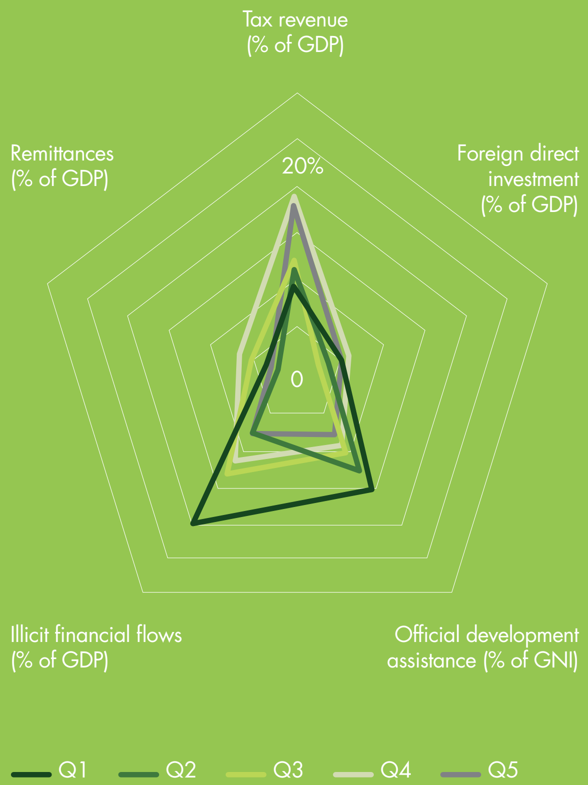
Source: Bloomberg L.P.

FIGURE 1.7.

FINANCIAL FLOWS AND GOVERNANCE

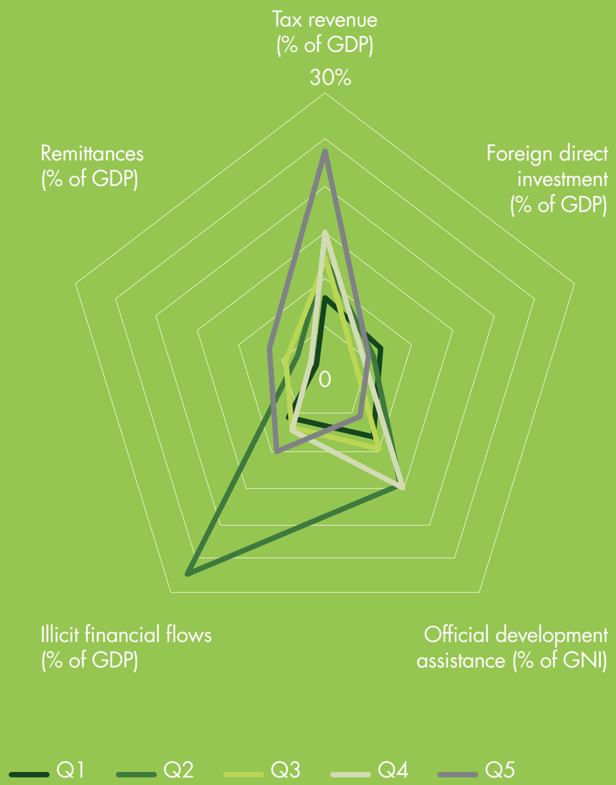
Recent AGI research has found that good governance has a more significant effect on domestic resource mobilization (tax revenues) than on external financial flows such as FDI, ODA, remittances, and illicit financial flows. The radar charts below indicate that countries with the lowest levels of corruption and highest levels of political stability have the highest tax-to-GDP ratio. Conversely, countries with low political stability scores have a relatively high ODA-to-GDP ratio. In addition, though the differences are subtle, the charts hint that more corrupt countries have higher FDI-to-GDP ratios.

POLITICAL STABILITY



Note: Q1 indicates least politically stable quintile; Q5, most politically stable.

CONTROL OF CORRUPTION



Note: Q1 indicates most corrupt quintile; Q5, least corrupt.

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2017 is the time to accelerate the implementation of the domestic revenue mobilization agenda.

and the overdependence on oil-export revenues. 2017 is the time to accelerate the implementation of the domestic revenue mobilization agenda, which was much heralded in the 2015 Addis Ababa Action Agenda, and improve the taxation of the non-oil economy, consider the merit of increasing the VAT (value-added tax) rate, and revisit poorly targeted tax exemptions and subsidies. 2017 is also the time to ensure that capital expenditures (which are still needed to finance the large infrastructure gap) have a value for money and outcomes that are really growth enhancing. 2017 is the time to revisit how current expenditures in the oil economy were part of an ineffective social contract where oil windfalls would result in a higher wage bill and increased government spending for goods and services.

2017 is the time to reconsider the role of the private sector and the financial sector as engines of broad-based growth beyond their typical dependence on government contracts and oil and gas revenues. In the oil economy, the government is too often the be-all-end-all and crowds out or even stunts the private sector. 2017 is the time to level the playing field and revisit the role of the state and its areas of interventions, including reducing the cost of doing business and providing adequate infrastructure to boost private sector-led growth and competitiveness. Such measures are also part of the needed new social contract.

2017 is the time to step up the improvement of institutions to complement the macro stabilization effort and set the foundation for sustainable and inclusive growth. Too often poor governance has arrested the effectiveness of public expenditures to improve outcomes and enhance growth. Good governance is also critical for the domestic revenue mobilization agenda. Recent work shows that good governance is more relevant for raising tax revenues than for attracting foreign direct investment. This is important because tax revenues are typically the largest source of financing for development.[3]

2017 is also the time to take a serious look at the social compact in oil-exporting countries. Social protection expenditures can be very low in oil-exporting countries and should be revisited. After all, how much did the poor really benefit from the boom cycle in oil prices? Now that adjustment times have come, how much of its cost should they bear? 2017 is the time to build the capacity to implement targeted interventions and proceed to implement targeted social protection measures to help smooth the effects of the necessary macroeconomic adjustment. For instance, increasing the VAT, which is a regressive tax should be accompanied by well-targeted compensation of the poorest segments of the population.

[3]See Sy and Sow (2016).

Policymakers in oil-exporting countries need a three-pronged approach that will credibly and decisively focus on macroeconomic adjustment, set the basis for medium-term broad-based growth, and revisit the social contract. These objectives are vital at this juncture, and addressing short-term issues must be done to avoid jeopardizing medium-term growth.

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EVENT TO WATCH

MAY 22-26, 2017

The African Development Bank Group's 2017 Annual Meetings

The African Development Bank Group (AfDB) and the government of India will host the AFDB's 2017 Annual Meetings in Ahmedabad, the capital of the Indian state of Gujarat. Following the India-Africa Summit that took place in New Delhi in 2016, the 2017 meetings are meant to highlight the close economic cooperation between India and the African continent and present new opportunities to further develop India-Africa business ties. India is one of the AfDB's 24 non-regional member countries, having joined it in 1982. Although it comprises a small share of contributions to the AfDB's African Development Fund (less than 1 percent), it still serves as a major investment partner to the continent, channeling nearly $7.4 billion as lines of credit mainly through the Export-Import Bank of India in order to implement 137 projects in 41 countries.

Revenue mobilization in commodity-rich countries: Challenges and opportunities

Since the fall in commodity prices in 2014, most commodity-rich countries have been facing a growing fiscal challenge. The large decrease in commodity prices has increasingly been perceived as more permanent than temporary. This issue is particularly pressing in African countries whose fiscal revenue structure depends "excessively" upon commodity revenues.

Excessive dependence on commodity revenues occurs when the share of revenues from commodities greatly exceeds their contribution to GDP. For example, between 2010-2013, some of Africa's biggest economies such as Nigeria and Angola have had fiscal revenue structures that depend "excessively" upon commodity revenues, while others, such as Guinea, Mauritania, and Zambia have been much more balanced. For example, in Nigeria, hydrocarbon revenues represent about 75 percent of total revenues while hydrocarbon only constitutes about 20 percent of GDP. This "excessive'' dependence on the revenue from commodities naturally leads to important fiscal vulnerabilities in the current period of, apparently, permanently low commodity prices.

In the near future, most of these countries will still be able to finance their way out of growing fiscal deficits by increasing their public debt. However, larger spreads as well as the prospect of interest rate hikes by the U.S. Federal Reserve severely limit the continuation of this strategy in the medium run.

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How should these fiscally vulnerable commodity-rich countries proceed in 2017? One option is to reduce the fiscal deficit by reducing government spending and increasing efficiency. While tough times provide the political will to increase efficiency and carry out medium- to large-scale spending reforms, there are limits to how far spending can be cut considering important social, developmental, and infrastructure gaps in the region.

Another option is to use the political space provided by these difficult times to enact much-needed tax reforms which, among other things, may involve increasing tax rates, especially in those "excessive'' commodity revenue dependent countries.

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As shown in Gunter, Riera-Crichton, Vegh, and Vuletin (forthcoming),[1] increasing taxes may be a smart option because tax changes have non-linear effects on economic activity. Under low or moderate initial tax rate levels, the negative impact of tax hikes on long-run economic activity is very small (or virtually zero), while the impact increases in a non-linear way as the initial level of tax rate rises. Naturally, more revenue collection is not the only answer to complex fiscal problems and increasing government efficiency and targeting will always go along in improving the overall effect of fiscal policy. Interestingly, countries with high dependency on commodity revenues such as Nigeria and Angola often have low tax rates (e.g., with standard VAT rates of 5 percent and 10 percent, respectively). In contrast, countries that are less dependent on commodity revenue, like Mauritania, Guinea, and Zambia, have relatively higher VAT rates of 16 percent, 20 percent, and 16 percent, respectively. This new policy research insight indicates that countries like Nigeria and Angola could quickly mobilize revenues from non-commodity-related activities by increasing their VAT rates with relatively small side effects on economic activity. In other words, the fiscal challenges currently faced by African countries with "excessive" dependency on commodity revenues may provide not only the chance to reduce a growing structural fiscal deficit and debt problem, but also an opportunity to help balance their revenue composition in a manner that is more in sync with their economic structure.

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[1] Gunter, S., Riera-Crichton, D., Vegh, C. and Vuletin, G. Non-linear Effects of Tax Changes on Output: A Worldwide Narrative Approach. Forthcoming.