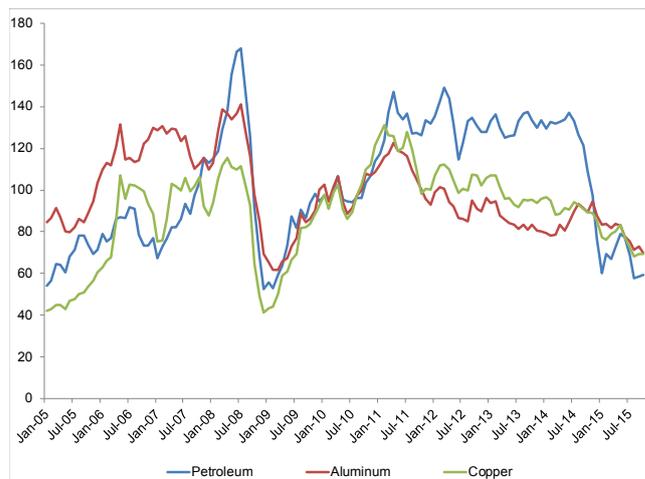


Reducing resource dependence: What can Asia-Pacific resource rich countries do?

Many Asia-Pacific economies are excessively reliant on certain commodities for growth, fiscal revenues and foreign exchange earnings. In more than a dozen countries, commodity exports account for more than 10 per cent of the GDP. The current decline in a host of commodity prices has exposed this vulnerability. In general, over the last 25 years, the total natural resources rent, which is defined as the difference between the commodity price and its average production cost, increased significantly in several economies with an average increase of 8.5% in terms of percentage change (see figure 1). With diverse income and population levels, growth and macroeconomic stability in these countries are highly vulnerable to changes in commodity prices.

Figure 2. Evolution of commodity prices index during the period from 2005 to 2015 (most recent available data) – 2010=100.

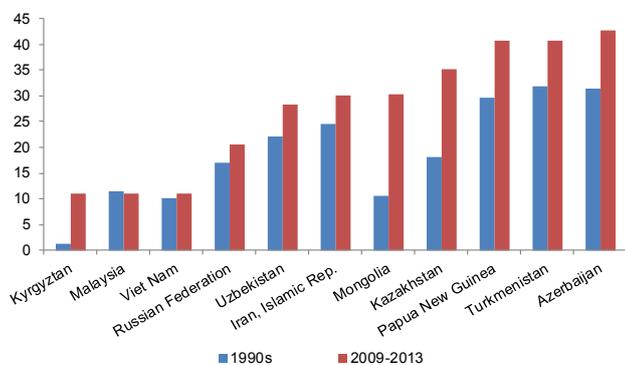


Source: Author's analysis based on data from CEIC database, accessed on December 10, 2015.

developments have already resulted in lower economic expansion in most commodity dependent economies in 2015 and remain a major challenge to their economic outlook. Lower commodity prices, and the consequent significant impact on fiscal revenues, could become a significant constraint for these commodity dependent economies as they initiate programs in pursuit of the 2030 Agenda for sustainable development.

In the short term, other than negatively affecting fiscal positions and economic growth, declining commodity prices have also resulted in lower export revenues and higher imported inflation in some economies. In fact, exports have declined by more than 30% in Azerbaijan, Kazakhstan and the Russian Federation. Furthermore, for Kazakhstan and the Russian Federation, the decline in exports, the negative impact on economic growth, as well as the subsequent loss in business sector's confidence in the economy are among the key factors that explain the depreciation of their local currencies by 19% and 63% respectively during 2015 and the surge in imported inflation. Higher inflation is most likely to affect consumption as the purchasing power of households is eroded. It is in this stressful context that governments

Figure 1. Total natural resource rent in major commodity dependent countries (% of the GDP)



Source: Author's analysis based on data from the World Development Indicators database, accessed on December 10, 2015.

After a decade of unprecedented boom, several commodity prices are on a declining trend since the fourth quarter of 2014, particularly energy products such as petroleum and gas, and mineral products such as copper and aluminum (see figure 2). For instance, on average, oil prices have declined by 44% between 2014 and 2015 because of a moderate global economic expansion, a higher anticipated supply of oil and the shift of the OPEC's objective from price target to market share target. These prices are expected to remain largely at current levels according to most projections. These

have been obliged to implement counter-cyclical policies by drawing more resources from their sovereign wealth funds to cushion their fiscal balances. For instance, as the sovereign wealth funds of Azerbaijan and the Russian Federation have been used concomitantly to finance public spending and to reduce the depreciation of the local currencies, their total assets decreased by about 6.4% and 9.4% respectively.

In the medium-term, as commodity prices are expected to remain at low levels, governments in these commodity dependent economies may have to consider alternative plans to consolidate their fiscal positions to avoid depletion of sovereign wealth funds and to increase resilience to vulnerability to international shocks. Monetary policy stance may also need to be tightened to check inflationary pressures and stem rapid depreciation of currencies. However, this fiscal consolidation should not take place at the cost of critical social expenditures such as health and education and productivity-enhancing infrastructure spending. Such expenditures are important contributors to government's efforts to diversify their economies and to achieve the newly adopted Sustainable Development Goals (SDGs). To this end, reducing the procyclicality of the fiscal and monetary policies, as well as diversifying the economies could be considered as medium and long term objectives.

One option to reduce the procyclicality of fiscal policy in commodity dependent countries is to use fiscal rules that incorporate dynamics of the business cycle. For instance, governments can focus on stabilizing a "cyclically adjusted fiscal balance" in order to counter risks associated with revenue shocks stemming from large movements in commodity prices. But implementing such revision of the fiscal rule would also require strengthening the forecasting capabilities of the government, as "over-optimistic" forecasts of commodity prices can result in inappropriate long-term policies. It also helps to enact fiscal responsibility laws.

The case of Chile can be used as a reference for the implementation of "cyclically adjusted" fiscal policy rules. Over-optimistic forecasts were avoided by involving panels of independent experts from mining companies, financial sector, research centers and academia. The Chilean government was allowed to have a higher fiscal deficit than the target if the output was below its long-term trend during a recession, or if the price of copper was below the medium term equilibrium (10 year).¹

Commodity-dependent economies could also better manage inflation risks by considering indices that are more production-oriented rather than consumption-oriented. An example of such an index is the producer price index. This approach could help accommodate volatile fluctuations in the terms of trade while furnishing a nominal anchor for inflation expectations.

Moreover, economic diversification can be promoted by private sector and civil society participation in government policy formulation to promote new, higher value added products and services. The participation of these stakeholders would also support the strengthening of productivity-enhancing infrastructures, and the development of entrepreneurship and innovation in the non-resource sector. Public private partnerships (PPPs) with appropriate risk-sharing and regulatory framework are options for the delivery of cost-effective infrastructure. For entrepreneurship and innovation, research and development activities as well as reforms aimed at training a creative labour force and financial support to entrepreneurs would be essential.²

Diversification can also be supported by attracting foreign direct investment (FDI), which creates spillovers into the local economy. For example, when Viet Nam liberalized FDI in the 1990s, this was initially concentrated in the oil sector, but other sectors, including real estate, food processing and heavy and light industry, gradually became important. Positive spillover effects from FDI can only exist if domestic firms have the technical capacity to perform a reverse engineering of "new" products or to supply multinational enterprises (MNEs). Beyond the technical capabilities, a support from financial support would be important as MNEs are more likely to have access to funds at lower costs.

¹ Frankel J. (2011). How Can Commodity Exporters Make Fiscal and Monetary Policy Less Procyclical? In Arezki R., Gylfason T. and Sy A. (eds) *Beyond the Curse: Policies to Harness the Power of Natural Resources*. Washington DC: International Monetary Fund; Frankel J. (2011). *A Solution to Fiscal Procyclicality: the Structural Budget Institutions Pioneered by Chile*. Working paper No. 16945, Cambridge: National Bureau of Economic Research.

² UNESCAP (2014). *The Economic and Social Survey of Asia and the Pacific 2014*. Bangkok: UNESCAP; UNESCAP (2015). *The Economic and Social Survey of Asia and the Pacific 2015*. Bangkok: UNESCAP.

The MPDD Policy Briefs aim at generating a forward-looking discussion among policymakers, researchers and other stakeholders to help forge political will and build a regional consensus on needed policy actions and pressing reforms. Policy Briefs are issued without formal editing. This issue is prepared by Steve Loris Gui-Diby. This policy brief benefitted from comments and suggestions by Hamza Ali Malik and Daniel Jeongdae Lee. For further information on this issue, please contact Aynul Hasan, Director, Macroeconomic Policy and Development Division, ESCAP (escap-mpdd@un.org).