Turning resource wealth into sustainable and equitable development: International Experiences*

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- Overview the research literature; what does international experience tell us?
- Sketch the policy implications

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International Experiences

The summary of international experience:

- ***On average***:
- Growth: each 1% point increase in the share of natural resources in GDP reduces growth by 0.09% per annum
- Resource booms are short-lived: An increase in resource prices has a short-run positive and long-run negative effect on the income of a resource exporter.
- Resource rich economies have low investment rates and ***very*** low real savings rates:
- Savings adjusted for change in ‘natural wealth’;
    - Nigeria, -30% GDP
    - Central Asia, approximately 0% GDP

International Experiences

- ***But – plenty of exceptions:***
- Role of resources in history – UK, Germany, US.
- 4 resource rich developing economies had long term investment rates > 25% GDP and growth rates > 4% pa (Botswana, Indonesia, Malaysia, Thailand).

- ***Effects are conditional:***
- Countries with 'good institutions' do not have the resource curse.

- ***What are the mechanisms?*** Economic and political:
- Crowding out
- Volatility and sustainability
- Institution building

Crowding out

1: Crowding out: Natural resources can reduce the return to doing other activities:

- The ‘Dutch disease’:
  - Resource revenues crowd out other exports (via appreciated read exchange rate)
  - The lost export sectors may be ‘dynamic sectors’ – with increasing returns, learning, foreign direct investment, technology transfer
  - Exports from these ‘dynamic sectors’ matters for growth:

    In a ‘growth acceleration’ the share of exports to GDP is 11% higher, real exchange rate 22% lower than previously.
  - Evidence that around 10% of resource curse effect due to Dutch disease (?).

- Entrepreneurship:
  - Talent diverted into unproductive rent seeking

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Crowding out

- Education: Increase in natural capital share of wealth by 5 percentage points associated with secondary enrolment 10 percentage points lower.

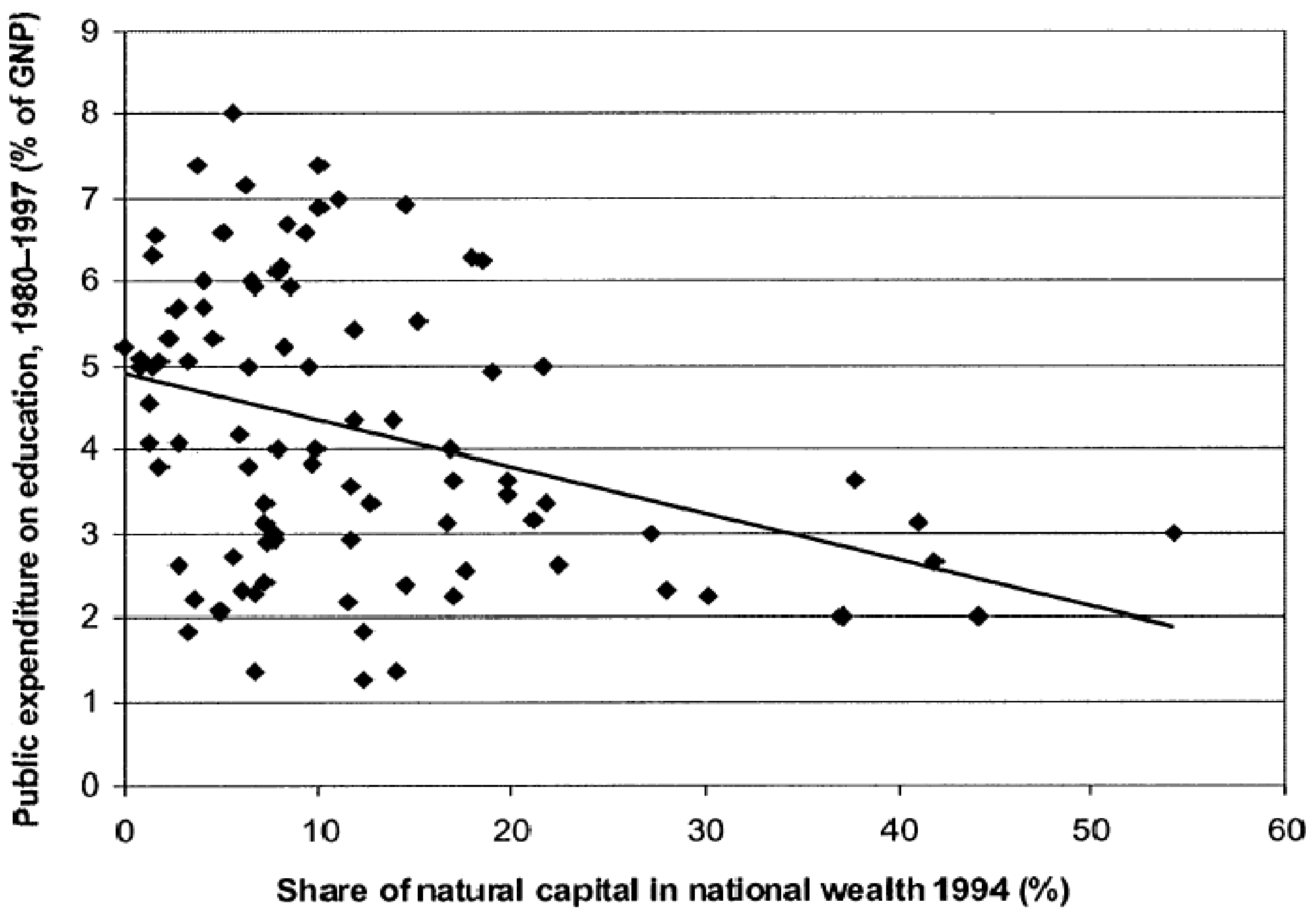

Fig. 2. Expenditure on education and natural capital.

Volatility and sustainability

2: Volatility and sustainability:

- Resource booms are short-lived: An increase in resource prices will have a short-run positive and long-run negative effect on the income of a resource exporter.
  - Direct effect of price boom such as 2006-07:
  - Additional short run growth effect, raises GDP 2.5%
  - Additional long run (25 year) effect, reduces GDP 26%.

- Resource rich countries borrow excessively – evidence of debt overhang from the 1970s.
- Resource rich countries embark on unsustainable social programmes (Netherlands, 1970s)
- Resource rich countries have high levels of public consumption and this slows down growth.

2: Volatility and sustainability (continued):

- Countries with exports concentrated in natural resources are more volatile according to most indicators.

- Plenty of evidence that volatility is bad for investment and growth, particularly in countries where the financial sector is weak.

- Statistical evidence that volatility is one of the most important channels through which the resource curse operates.

Institutions

3: Retarded institutional reform

'Weak institutions' amplify the negative effects we have seen so far.

What sorts of institutions mitigate the resource curse?

- Democracy is good for growth ***except*** in resource rich countries
- In resource rich countries, parliamentary democracy is better than presidential democracy
- In resource rich countries, democracy ***plus*** strong checks and balances (measured by the power of groups to constrain government) overcomes the resource curse.

Institutions

3: Retarded institutional reform (continued)

Weak institutions amplify negative effects ***AND*** resource abundance weakens institutions:

- Increased opportunities for corruption
- State is able to use funds to:
  - Postpone reform
  - Buy-off opposition: -- public sector jobs
- Checks and balances are weakened by resource abundance: A hypothetical country with resource rents worth 30% GDP and average income would see declines (over 30 years) of:
  - checks and balances score drops from the 22nd percentile to the 34th percentile.
  - Democracy score drops from 25th percentile to 50th percentile.
- Conflict:
  - No resources, probability of civil conflict 0.5% pa
  - Resources > 25% GDP, probability of conflict 23% pa.

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Choices

There are ***choices*** -- policy levers for all of these mechanisms:

1: Crowding out

- Trade liberalization to depreciate exchange rate:
  - Evidence that open trade policies particularly important in resource rich economies.
- Use of resource revenues to support economic activity elsewhere in the economy.

  Choices:

  - *Timing of expenditure:* Depletion rate / foreign investment (funds) / domestic investment
  - *Composition of expenditure*: Consumption / investment
  - *Quality of expenditure*:
    - Honest and efficient (Botswana)
    - Investment to increase the rate of return of other productive activities.

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Choices

2: Volatility

- Macro-stability:
- Expenditure smoothing
  - Domestic expenditure/ foreign assets
  - Facilitate domestic supply response – construction sector
  - Facilitate smoothing by private sector – financial sector development

3: Institutions

- The importance of commitment to good practise:
  - Transparency
  - International codes
  - Fiscal constitutions
  - Institution building
    - checks and balances
    - human and social capital, as well as physical

References:

References:

A useful survey of the economic research is:

Rick van der Ploeg, ‘Challenges and opportunities for resource rich economies’

This and other papers are at:

http://www.oxcarre.ox.ac.uk/index.php/research/

The political economy material draws on Paul Collier’s work, at:

http://users.ox.ac.uk/~econpco/research/politicaleconomy.htm