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

Tony Venables

Chief Economist, UK Dept for International Development
Director, Oxford Centre for the Analysis of Resource Rich Economies

- 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
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 real 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
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.
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.
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.
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 22\textsuperscript{nd} percentile to the 34\textsuperscript{th} percentile.
  - Democracy score drops from 25\textsuperscript{th} percentile to 50\textsuperscript{th} percentile.
- Conflict:
  - No resources, probability of civil conflict 0.5% pa
  - Resources > 25% GDP, probability of conflict 23% pa.
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.
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:

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