Challenges in Using Resource Rents for Development

"Beyond the Resource Curse"

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Challenges Along the Value Chain

- Challenges exist for resource-rich countries at all stages of the value chain:
  - Resource regulation and taxation
  - Budget and financial management, accountability to citizen “owners”
  - Spending/saving options: over time and by type
  - Associated policies (trade etc)
- Here focus on later stages: use of resource rents

Some Questions

- Some resource exporting countries have benefited from their discoveries while many have not. How do particular country characteristics interact with features of particular resources to shape development outcomes?
- Is the problem more related to politics or economics? And how do they interact with resource rents?
- Can countries build on particular windows of opportunity – whether before, during or after discovery – to lock in better policies and institutions?
- Can external influences improve the outcome?

The economics is better understood than the political economy, and how to design interventions to strengthen accountability, especially from an initially weak position.

Resource Curse?
Conditional but Real

- Measures of both resource abundance and dependence are endogenous, complicating cross-country estimate of impact of resources. But broadly, literature suggests:
- Human capital, governance capital needed to complement resource wealth:
- Path Dependence:

Countries with better initial conditions do better

Countries with poorer initial conditions do worse

High natural resource dependence can be endogenous to macro-stability and governance: two-way causality

How to identify, create, support constituencies for strong governance, good management, whether before or after discovery?

Using Resource Wealth Better: the Governance Challenge

- Considerable empirical support for association –point-source resources - poor governance. And at least for oil exporters:
- Some evidence poor governance reduces growth: ICRG governance deficit in 1982 explains lower growth 1982 - 2006
- Poorer development outcomes than expected. Infant mortality 20 per thousand higher than expected given GNP/head, equivalent to a 60% GNP discount.

The Volatility Challenge

• Resource exporters face huge volatility, especially oil.
• Post 1970s-80s, fiscal rules are well known: permanent income, "modified" permanent income for resource-constrained countries, reference-price smoothing (Chile), etc.
• But stabilization often unsuccessful. Overexpansion (including excessive borrowing), fiscal lock-in, short booms, long slumps. Macro instability discourages investment and diversification. Can easily turn a windfall into a liability.
• Difficult problem because of length of planning horizon. Also:
  • Low accountability: corruption favors lucrative contracts and non-transparency….
  •Short political horizons (factional political competition without strong institutions?)…..
  •Believe boom investments will pull economy through slump (the Big Push)….

Share experience, encourage and strengthen constituencies to restrain spending

The Spending Challenge

Capacity constraints, overextension

- Public spending options
  - investment
  - recurrent
- Redistribute rent to citizens (in most countries, the owners)
  - low non-oil taxes (average, 20% of revenues; about 3.2% of GDP)
  - price subsidies on energy, essentials (up to several percent of GDP)
  - Wide range of possible transfer programs
    - **Community-based (Indonesia)**
    - **Employment-based (Gulf)**
    - **Direct conditional/categorical (pensions, child allowances, negative income tax)**
    - **Direct unconditional (universal stipends)**

Tradeoffs

- Can transfers be:
  - transparent and efficient (low deadweight losses)
  - equitable (rents are owned by citizens after all) yet not entitlements
  - fiscally sustainable
  - made in ways to encourage accountability?

- Tradeoffs:
  - price subsidies: inefficient, inequitable, environmentally damaging, tend towards unsustainable (fuel subsidies)
  - low non-oil taxation: weakens accountability? Low tax rates and good tax administration not common (Knack)
  - conditional transfers: could be inequitable, violate “ownership” principle?
  - unconditional transfers: reduce work incentives?

Some Good Examples

- We know little about the impact of transfer programs in general, but can study some good examples
- Community-based transfers: INPRES, 20% of domestic development spending on rural projects, absorbed 3% of labor force. Monitoring for effectiveness; materials-only programs;
- Household-level transfers (building on Alaska?)
  - CCTs (Mexico, Brazil, etc), towards education funds?
  - targeted pensions, child allowances (South Africa)
  - use of biometric ID (South Africa) for citizen dividends?
- Some countries considering shifting from indirect subsidies to direct transfers (Iran)

The Diversification Challenge

- High-performing resource-rich countries over 1975-2001 (Malaysia, Thailand, Chile, Indonesia, Sri Lanka); all have diversified production, exports
- Invest to bring down costs for non-oil tradeable sectors:
  - Indonesia: oil income -> gas ->fertilizer -> green revolution ->food supply-> manufactures
  - Malaysia: land development, replanning, energy, transport, telecoms ->palm oil, rubber, tin -> industry
  - Chile: PPPs for technology, standards -> salmon, wine
- Monitor for effectiveness, including investments in core infrastructure (eg roads, ports, power): benchmark performance; its not just money
- Basics essential, including macroeconomic stability to encourage non-oil investments in traded sectors

Positive Country Factors

- Some common features of better cases: examples: Chile, Norway, Malaysia, Indonesia (early Suharto); also Botswana
  - shared priority on social and economic stability
  - strong, credible, engaged technocracy
  - non-oil exporter constituencies for stability

- Resource Funds? Can be useful but not a panacea
  - can encourage transparency and clarity on saving
  - vertical and horizontal accountability mechanisms can increase constraints on executive
  - can build constituency (Alaska) but not a substitute for checks and balances (Chad)

Communication: essential to link policies to objectives that people can understand (saving for pensions, reducing national debt, sustaining non-resource sectors)

External Pressure?

- "Hard Pressure" faces severe limits: weakest when resource price high and most needed.
  - Lessons from Chad: under-determine; plan for unexpected power shifts?
- "Soft Pressure": unlikely to prove decisive but can slowly change behavior and open windows of opportunity
  - Benchmarking, norms and codes of conduct, EITI++ asset recovery programs. Nigeria?
- "Peer Pressure": Cannot only be seen as agenda of some rich countries, NGOs and development agencies.
  - Engage regional bodies, AU, new MIC players

Conclusion

- The resource curse may not be universal but for many countries (particularly those lacking governance capital and human capital) it is real.
- Much understood on the technical side, particularly on stabilization.
  - But the problem is political: how to strengthen institutions and constituencies to support prudent management of resources despite perverse incentives. Area for research.
  - Is there a threshold below which little progress is possible?
- More research is also needed on the implications of alternative mechanisms of distributing rents

Thank You